WHAT KIND OF LIFE INSURANCE SHOULD I BUY?

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I know I'm supposed to have life insurance, but there are so many options. What do I need to know to decide?

Talking about life insurance? There are two key factors to address. The most important one is, "How much life insurance do you need?" There are various methods and calculations needed to figure out that number, but once you do, you can ask the second question: "What type of life insurance is right for me?"
What product is appropriate to deliver the proper amount of coverage, the amount of time coverage is needed, and is within the budget you can commit to protection?
There are two primary types of life insurance, so let's discuss them below:

Term Life insurance
Term provides the most amount of protection with the least pinch to your wallet. Like all other insurances (think home, auto, or renters etc), it provides essential protection against a possible loss. The loss here being a breadwinners income. Think of it as a bet that a healthy young person will outlive the length of the term. Odds are overwhelmingly in favor of the insurance company.
Typical term lengths are 10, 20 and 30 years, although there are others. The length of the term means that the insurance company is promising to provide coverage for the selected length of time at a consistent amount of premium. The longer the term, the more risk to the company which results in a higher premium.

Whole Life Insurance
Whole life provides a permanent death benefit. You can think of it more as building a legacy. There is no end to the coverage so long as the premium is satisfied. The risk in this case is not if the insured will pass (they most certainly will) but when they will pass. As said previously, companies almost always have time to make this worthwhile for them. Besides for the permanent protection it offers, whole life provides a cash value, disability protection and a long term care benefit as well. The cash value, also known as the living benefit, is a portion of the death benefit that can be accessed during the insured's lifetime.

It is simply a pool of money that can be used for whatever purpose you desire. This money grows tax free and can be accessed from the policy without creating a taxable event, giving it a unique position on the distribution end of a balanced retirement account.
Also worthy to note is that the cash value growth is consistent. There is no fluctuation. Cash can be accessed at any time with no penalty. The cash accumulation does not start immediately and it takes years until it equals premiums paid in rendering it a forced savings.

So why not a whole life?

Many objections to Whole Life stem from the cost. Understandably due to the nature of the risk, the cost is much higher. Whole life premiums can be more than ten times those of term insurance for an equal amount of coverage.
While the outlay is definitely higher, the premiums do not need to be paid out of pocket forever. Policies come with a non-guaranteed dividend. Initially this dividend is used to purchase additional life insurance, thereby increasing the cash value as well. After time there comes a point that the policy builds enough strength, through the dividend, for the premiums to be satisfied internally. Another possibility is that at some point all the money paid in can be taken out with interest and the death benefit would remain. Policies may also be designed to be paid up over a shorter period.

Buy term and invest the difference

Another common objection, one that is promoted by personal finance expert Dave Ramsey, is to buy term insurance which is cheaper and take the difference in premium and invest it in other investments such as mutual funds. This avoids the commitment to whole life (which takes time for the cash value to break even) and has a higher potential for upside (Ramsey claim of what he gets on his mutual funds seems higher than what most people experience).
Any licensed and trained insurance professional has serious questions on Ramsey’s representation of the product, but the point is still valid and needs to be addressed. The basic difference is that whole life is permanent insurance. While the most prevalent need for life insurance is income protection during someone’s working years, the value of permanent protection cannot be underscored. Another big difference is fluctuations. Any market based products will fluctuate. Even though it may be likely that at some point in time a mutual fund or the index will yield a higher return, timing may be crucial. Those relying on the market to retire in 2008 were faced with a choice of taking a significant reduction in retirement income or delaying retirement by up to three years. The same plans supplemented with a life insurance policy were able to borrow retirement income from their plan with no reduction in income.
Another point to consider is behavior. Life insurance provides consistent guaranteed growth with no fluctuations. Investors who will react emotionally to the sometimes roller-coaster like behavior of the markets, may make decisions that would not allow them to take full advantage of a down market.

Long term care

Any discussion on the benefits of a whole life insurance policy would be incomplete without mentioning the long term care benefit it provides. While exact definitions and reimbursement structure may vary by the company, every whole life insurance policy has a provision that allows for up to 90% of the death benefit to be used to pay for care if needed. There is no product out there that can give a return on investment if that benefit would need to be exercised.

The hybrid option

This is a great option that unfortunately does not receive the attention it deserves. Term and Whole Life are not mutually exclusive. The two can be combined together to reach a desired amount of death benefit and there are even hybrid products that give much of the benefit of a whole life policy at a much lower cost.

Conversion option

Many term policies include a conversion option. This simply guarantees insurability for the period that the option is offered. If a person takes out a term policy and is awarded a top health rating, they will be able to convert up to their full death benefit to whole life at the rating they got when the policy was issued even if there was a significant decline in their health or they are currently uninsurable. Many people use the conversion option to incrementally change their coverage to whole life. If using such a strategy it’s important to purchase from a company that has a competitive whole life product.