



The truth about term insurance

Posted on August 2, 2008

You may not be ready for this. Despite all you may have heard, term life insurance is not better than permanent life insurance! And what's even more confusing, permanent life insurance is not better than term life insurance!

Mathematically speaking, they're equivalent. Term insurance is cheap initially, but its premiums usually increase at regular intervals, generally every ten or twenty years. It's like renting your accommodation. Most term insurance policies only provide coverage to a certain age.

Unfortunately, as you get older, your term insurance can become so expensive that you may not be able to afford to continue it. That explains why only about 1% of term policies ever pay off.

In the early days of life insurance, term insurance was all there was. This was heaven for the life insurance companies. It meant most policyholders had to cancel their no longer affordable policies before they died. This left the companies with very few death claims to pay out for the many premiums they'd collected.

After about half a century of this inequitable arrangement, some Londoners got together about 245 years ago to form the Equitable Life Insurance Society. Their idea was a level premium policy. You'd pay a higher premium than for term insurance in the early years in order to pay a lower one in the later Policy years. This would allow you to carry it for the whole of your life, hence the name, whole life insurance. Today, because of a variety of innovative policy types, these types of policies are generally known as permanent life insurance.

If term life insurance is similar to renting your living space, permanent life insurance is like buying a home. You pay more in the early years to pay less later on. Meanwhile your equity is building up. This gives you something to use as collateral if you need a loan. Or to exchange for cash when you no longer need to own a home (or a permanent life insurance policy).

Unlike those pre-1762 life insurance buyers who could only buy term, we have a choice. We can use term for our temporary, or short term needs, and permanent life insurance for our long term requirements. Or we can use term insurance as a short term stop gap until we can afford permanent life insurance.

We may seem to have many more choices today than just these two. There are now such names as Universal Life, Permanent Term, and the like to confuse our decision making. They are all mere variations on the same basic themes - temporary or permanent life insurance, and variable or fixed premiums.

Want help with your life insurance planning?

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