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Life Insurance: What's Right For You?

By Althea Chang

The life insurance business is built on our most basic fear: death. And though death is inevitable for all of us, the financial strain that often accompanies it isn't. Life insurance is designed to relieve people of the financial stress and ensure that when you or a loved one dies, the survivors aren't overly burdened.

But it can be difficult to separate money concerns from the emotions tied to mortality. When it comes to life insurance, it important to chose a policy that truly makes sense for you, rather than one based on fear and anxiety.

For example, it may be tempting to go overboard in an effort to make sure your loved ones are financially secure, but some life insurance can frankly be a waste of money.

"Life insurance was never designed to be an investment vehicle," says Chad Nehring, a certified financial planner based in Appleton, Wis. It's meant to cover expenses like the cost of a funeral or to help a surviving spouse pay off mortgage and car payments, he says.

Some consumers may also choose to use life insurance benefits to cover child care and put their kids through college, but when it comes to funding a luxurious, jet-setting retirement, that's what a separate retirement fund is for, Nehring says.

If you're looking for a way to make sure your spouse or your heirs don't get into financial trouble as a result of your death, but you don't want to overpay for a plan that's not right for you, here's what you need to know about life insurance.

Employer-Sponsored Plans

Americans with full-time jobs can get employer-sponsored life insurance paid by their company, but the policy you're offered may be a one-size-fits-all plan that's not enough for you and your family.

Some companies offer a flat amount, say $50,000, for each employee, and for others, the amount of money your heirs might get depends on your salary. For instance, your plan's payout might be three times your annual salary, explains Guardian, a company that provides employer-sponsored as well as individual life insurance plans.

A downside to employer-sponsored plans is that your coverage may not be portable. This makes it a deal for those who plan to stay at their current jobs indefinitely, but if you end up leaving your company, you'll have to find new coverage.

Individual Plans: Who Doesn't Need One

For those who don't have an employer-sponsored plan, or don't think it's adequate based on their family's particular financial needs, an individual life insurance plan in which you pay premiums for a certain amount of coverage might be best.

For those considering individual plans, there are cases in which you might not need it. If you're single and don't have mortgage or car payments to worry about, or if you're so wealthy that even your great grandchildren don't need to worry about money, you probably don't need it, insurance experts say.

"Many a life insurance agent will attempt to tell everyone that they need life insurance before even digging into the specifics of their situation, but in a nutshell, if you don't immediately think of someone who would be worse off financially if you were to die … then chances are that you should not buy life insurance," advises Joel Ohman, a certified financial planner based in Tampa, Fla.

The Right Reasons to Get It

If you own a home, you're married or you have children, you should seriously consider getting life insurance, financial planners say.

Younger, newly married couples who are financially dependent on each other and can't live on their own individual income, for example, may want to get life insurance right away.

And as soon as you have a child, life insurance benefits can help you make sure your dependents can be taken care of in your absence.

When you own a home and you die, your mortgage could end up being a burden to your parents, children or other beneficiaries on your will, so you may want life insurance to cover your estate taxes and save your family the financial trouble of selling or keeping your home, Nehring explains.

Life Insurance Types Demystified

Term Life Insurance: This is the smartest type of life insurance for 90% of Americans, according to Ohman. Term life insurance requires you to designate a period of time, during which you'll pay a flat yearly rate. If you die during that period, those you leave behind will get what's called a "death benefit." When your term is up, you can sign up for a new term life plan, but your premiums are likely to change.

How much you'll pay for a term life policy can vary depending on a number of factors including your age, gender and health.

On average, a 30-year-old man can get a 20-year term life policy with a death benefit of $500,000 for about $340 to $360 per year, no matter how his health changes during those 20 years, according to Nehring's estimates.

A woman might expect to pay between $280 and $300 annually, he says. Rates for women tend to be lower because they have longer life expectancies and "because they actually listen to the doctor," while men tend to try and tough it out when they're sick, Nehring notes.

Permanent Life Insurance: This is an umbrella term that covers two types of life insurance: whole and universal life. Whole life insurance plans have fixed premiums, but universal life insurance plans have fee structures and payouts that are more flexible. While term life insurance plans last for a set number of years, permanent life insurance plans last until your death as long as you pay your premiums.

As a result, premiums for permanent life insurance plans are significantly higher. A 30-year-old female non-smoker might pay $1,750 per year every year until she dies, while a 30-year-old, non-smoking male might pay $2,125 every year until death to secure a death benefit of $500,000, according to Nehring.

Other Factors Determining Fees

Unfortunately for your budget, you shouldn't just wait until you get sick before you buy life insurance. The amount you spend on premiums can depend on your health.

When you sign up for life insurance, you'll likely have to have some medical exams (paid for by your life insurer) to determine how risky it is for a company to insure you and to determine what your premiums will be. These tests are less common with employer-sponsored life insurance plans.

Your premiums also depend on the size of your death benefit, and calculating that is a process in itself. According to a decades-old school of thought, the amount you should need is a multiple of your income, say 20 times your annual salary, says Nehring.

But now, financial advisers conduct what's called a capital needs analysis that takes into account your funeral expenses, estate taxes, mortgage and car payments, cost of childcare, your kids' college tuition and your family's other regular expenses that need to be covered, Nehring explains.

And while a term life plan may be cheaper upfront, once the term you choose has reached its limit, the annual premium you'll have to pay can increase exponentially, warns Brian Ashe, spokesman for the Life and Health Insurance Foundation for Education, a non-profit group working to educate consumers about their insurance options.

Rates really depend on the individual insurer and their premium structures, but if consumers get term life coverage and pay $1,000 for 10 years to get a $1 million death benefit for their spouse or heirs, in the 11th year, their premium could increase to anywhere from $7,500 to $11,000 a year, Ashe says. And for many people, paying that amount will be seen as a waste of money.

In those cases, people tend to drop their coverage and look for a better deal from a competing insurer. After 10 years of being insured, however, health, weight and other factors affecting premiums have likely changed, Ashe says.

Your Best Bet

Unless you're going to be single with no dependents and no debts or liabilities for the rest of your life, or if you're incredibly wealthy, chances are you'll need life insurance, and a permanent life insurance plan is usually best, Ashe says.

But if it's difficult for you to afford insurance in the first place, permanent life insurance can easily be cost prohibitive. Especially when you're young, just starting a family or just starting to make mortgage payments, you might want to choose term life coverage instead, and switch over to a more permanent policy later, Ashe says.

But going from one term life insurance plan to another term life insurance plan could be an incredible waste of money for some families, especially if you haven't found the fountain of youth. After all, when your term is up and your premiums rise, you may not be as sprightly as you were a decade or two earlier, when you could get great rates because of your good health.

Those who spend the least on life insurance are likely those who get group life insurance through their employer and stay employed until they die. However, some employer-sponsored plans reduce death benefits after you reach a certain age, Ashe says. For instance, once you reach 70, you may only get 50% of what you would have gotten before age 70.

A Warning Against Accidental Death Insurance

Some companies sell anyone at any age a cheaper plan called accidental death insurance that promises your spouse or heirs a similar benefit to life insurance in the event that you meet an accidental death. However, this could be a more obvious waste of money than any life insurance plan.

Accidents cause only 5% of all deaths between the ages of 45 and 64 and only 2% of all deaths in those aged 65 and older, according to Today's Seniors.