Life and Disability Insurance

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By Diana L. Criser

Most of us carry the types of insurance policies we absolutely must have, such as automobile insurance, which is required by law, and homeowner's insurance, which is usually required by our mortgage company. These two types of policies cover our material possessions, but what about the life or disability policies which would cover our family's expenses if we were no longer bringing home a paycheck due to an accident, illness, or even our own death?

For homemakers, disability insurance itself is not available, but other types of critical illness insurance policies may be well worth looking into. For example, if you were diagnosed with a disabling illness and unable to take care of your children for a long period of time, the added cost of day care would figure into your current family expenses. A life insurance policy for a homemaker may be justified for the same reason.

Life insurance and disability insurance are two policies which are extremely important, yet largely misunderstood. The amount and type of coverage you need depends on your own personal situation. Examine the needs of your family, and use the following information to assist you in making wise insurance choices.

Disability insurance covers your ability to earn an income. It provides cash to cover living and medical expenses while you are unable to work due to an accident or illness. Even if your employer offers a disability insurance policy, chances are you are under-insured in this area. Benefits paid from an employer's policy are taxable; self-insured policy payouts are usually tax free. Employer's policies only cover straight salary, not bonus or commission payments. Even in two-income families, the salary of the non-disabled wage earner cannot be counted on completely. Remember, you will be living on half the usual income, and it's also unreasonable to expect your spouse to take care of you, the children, *and* be a full-time employee!

Disability policy premiums are based on age, sex, occupation and income. An individual is allowed to take out a policy covering from 50% to 70% of their last monthly income. A "guaranteed future insurability" policy will allow the insured to increase the policy with each wage increase, with a customary raise in premium. For about a 20% increase in premiums, a residual rider may be added to provide partial disability payments if the insured is able to return to work part time. Many policies also offer a cost of living rider, which ensures the benefit will increase as the Consumer Price Index increases.

Life Insurance Options

Term life insurance is in effect for a preset length of time. The cost of term insurance is based on age, and increases as the insured person ages. It is most useful for young people in need of short-term coverage, and in situations when insurance needs will decrease over time. Term insurance policies are only worth the value of the policy and do not have a cash savings feature as permanent life insurance policies. A term life policy can be most beneficial when combined with a permanent policy to provide the benefits of both types.

Whole life insurance is a permanent policy that can be paid for in one lump sum (single premium), during a preset length of time (limited life), or throughout the insured's lifetime (straight life). Part of the premium is applied to the insurance portion of the policy, a small part is applied to administrative costs, and the balance is applied to the cash or investment portion of the policy.

An advantage to whole life insurance is the fixed premium amount, regardless of age. The premium, however, is substantially higher than term life insurance, due to the cash portion of the policy. The cash value belongs to the policyholder, and can be taken out in loans or the policy can be cashed in. Accrued interest is tax free until withdrawal. A disadvantage is that the cash portion of the policy is usually invested in bonds and mortgages, which can carry substantial interest rate risk. A whole life insurance policy should be held for five years or more due to the slow buildup of the cash value over the first several years.

Universal life insurance is a modified whole life insurance policy. The insurance portion and investment portion of the policy are kept separate. The cash value portion is invested in money market funds and is set up as an accumulation fund which grows at a variable rate. Most universal life policies have a minimum interest rate return on the cash portion. The premium is based upon the amount of coverage and the age of the insured.

A large benefit to universal life insurance is that the insured can vary the annual premium and annual death benefit. More money can be paid during years with good income, and payments can be reduced or stopped all together during times of financial hardship. When regular payments are not made, administrative costs for maintaining the insurance portion are taken out of the accumulation fund. Loans can also be taken against the cash value portion. Death benefit payouts can either be made at a level amount, or a specified amount plus the current cash value of the policy.

Variable life insurance is also another version of whole life insurance. The main difference is that the insured can specify how the cash value portion will be invested, usually based on the options available in their insurance company's portfolio. Premiums are very high due to investment flexibility, and commissions and service fees leave less money to be invested. Death benefits may fluctuate based on investment performance, but will never fall below a preset minimum.

Take some time to become familiar with the insurance policies you already have. Examine them closely to ensure they will meet your needs and those of your family, should the need arise. Insurance, with the exception of life insurance, is something we hope will will never need to make a claim on. But when the unexpected happens, you'll be glad you planned ahead!