



What Is Whole Life Insurance?

Most people are familiar with whole life insurance. For many years, whole life policies were the predominant type of life insurance sold in America.

When you purchase a whole life policy, you traditionally pay a fixed premium for as long as you live or for as long as you keep the policy in force. In exchange for this fixed premium, the insurance company promises to pay a set benefit upon your death.

In addition to providing a death benefit, a whole life policy can build cash value, which accumulates tax deferred. Part of the premium pays for the protection element of your policy, while the remainder is invested in the company's general portfolio. The insurance company pays a guaranteed rate of return on the portion of your premium that is in its investment portfolio, building up the value of your policy.

Note: Guarantees are contingent on the financial strength and claims-paying ability of the issuing company.

This buildup in cash value is part of the reason the premiums on a whole life policy generally remain fixed instead of escalating to match the increased risk of death as you age. As the cash value grows, the risk for the insurance company declines.

Although the cash value in your policy is “your” money, you can't simply withdraw it as needed, as you would cash from a savings account; but you do have limited access to your funds. You can either surrender the policy for its cash value or take the needed funds as a loan against the policy.

Under current federal tax rules, loans taken will generally be free of current income tax as long as the policy remains in effect until the insured's death, does not lapse or mature, and is not a modified endowment contract. This assumes the loan will eventually be satisfied from the income-tax-free death. Loans and withdrawals reduce the policy's cash value and death benefit and increase the chance that the policy may lapse. If the policy lapses, matures, is surrendered, or becomes a modified endowment, the loan balance at such time would generally be viewed as distributed and taxable under the general rules for distributions of policy cash values. Additional out-of-pocket payments may be needed if actual dividends or investment returns decrease, if you withdraw policy values, if you take out a loan, or if current charges increase.

You should be aware that, in addition to charging a modest interest rate for loans against a policy, the insurance company may pay a lower rate of return for the portion of your cash value that you borrow. However, loans against the value of an insurance policy are generally not taxable and can provide the cash to help with unexpected expenses.

The cash value of a life insurance policy accumulates tax deferred, but if you surrender the policy, you'll incur an income tax liability for funds that exceed the premiums you have paid.

The fact that whole life policies have fixed premiums and fixed death benefits can be either positive or negative, depending on the situation. To some people, it means one less thing to worry about. They know in advance what they'll have to pay in premiums and exactly what their death benefits will be.

To others, whole life policies don't provide enough flexibility. If their situations change, it is unlikely that they will be able to increase or decrease either the premiums or the death benefits on their whole life policies without surrendering them and purchasing new policies.

The cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance purchased. As with most financial decisions, there are expenses associated with the purchase of life insurance. Policies commonly have mortality and expense charges. In addition, if a policy is surrendered prematurely, there may be surrender charges and income tax implications. If you are considering purchasing life insurance, consult a professional to explore your options.

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