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A Consumer's Guide to Life Insurance

Life insurance is one of the most important ways to strengthen a financial plan, but it's something many people overlook or avoid. Learning how it works can help you protect your family and build greater confidence in your financial future. This guide offers an in-depth exploration of life insurance, detailing its benefits and providing practical advice on selecting the right policy to meet your needs. Whether you're new to life insurance or looking to update your coverage, this guide will help you make informed decisions to protect yourself and your loved ones.

What is Life Insurance?

Life insurance is a contractual agreement between an individual and an insurance company designed to offer an added layer of financial security to your loved ones in the event of your death. Under this contract, the policyholder agrees to pay regular premiums to the insurance company. In return, the insurance company commits to paying a designated lump sum, known as the death benefit, to the policy's beneficiaries upon the policyholder's death. This financial support can help cover funeral expenses, pay off debts, replace lost income, and assist with the financial well-being of your family during a difficult time.

Who Needs Life Insurance?

Life insurance is not a one-size-fits-all solution. It's not just for married individuals with children; it offers valuable financial support to many people, regardless of their life stage. For younger individuals, life insurance can help ensure their families are not burdened with any debts they may have accumulated. In later years, it can cover funeral expenses, sparing loved ones from financial strain during a difficult time. For business owners, life insurance can provide a financial cushion to secure the future of the business in the policyholder's absence. Additionally, purchasing life insurance for children can lock in lower premiums and guarantee coverage for their future. No matter your age or stage of life, life insurance can be a crucial tool in protecting the financial well-being of those you care about.



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The Benefits of Life Insurance

Provide for Lost Income

One of the main reasons people purchase life insurance is to help their loved ones with financial responsibilities in the event of an unexpected death. This is especially important for married individuals with children, mainly if they are the primary breadwinner. Without your income, your family might struggle to afford essential expenses such as the mortgage or tuition. The death benefit from your life insurance policy can help to cover these expenses, offering more financial stability to your loved ones in your absence. Life insurance on the primary caregiver spouse can also provide financial stability during an unexpected death, ensuring care for small children.

Help Cover Bills, Debts, and Any Estate Taxes Due

Life insurance can help cover bills and other types of debt in case of untimely death. If you pass away with credit card debt or a car loan, that debt doesn't automatically disappear; it generally must be paid by the estate unless it is a shared debt with one of your survivors. Life insurance proceeds may also help offset any estate taxes that may be due without selling assets at a discount to cover the tax bill.

Finally, your life insurance policy can also help pay for your funeral service and burial, alleviating the burden your loved ones might face trying to pay for it.



Reduce Stress

Losing a loved one is always an emotional and stressful experience, made even more challenging by financial concerns about replacing income and covering bills. While a life insurance policy can't solve every problem, it can provide a crucial financial buffer for your family during this difficult time. The death benefit from your policy can help cover essential expenses like the mortgage, giving your spouse the time and space to move forward at their own pace without immediate financial pressure.

Benefits of Life Insurance Beyond the Death Benefit

Certain types of life insurance have various uses that extend far beyond the traditional income replacement model. Here are some examples.

Tax-Favored Retirement Income

Certain types of life insurance policies can offer supplemental income to complement Social Security or other retirement sources, often on a tax-advantaged basis. When used appropriately, withdrawals and policy loans may help manage tax exposure on Social Security benefits and reduce the risk of higher Medicare Parts B and D premiums. They can also be useful in years with elevated tax liability or to avoid selling investments during a market downturn, providing a flexible source of funds when needed.

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Long-Term Care

Some life insurance policies offer the option to include additional benefits, known as riders, which can provide crucial financial support in various situations.[1] For instance, riders can offer needed cash if you suffer a critical illness or require custodial care. Without insurance, these types of care can be prohibitively expensive, whether provided at home or in a residential facility. Riders can cover costs associated with treatments, long-term care, or assistance with daily living activities, ensuring you have the necessary resources without depleting your savings. This added layer of protection enhances the overall value of your life insurance policy, providing comprehensive support beyond the standard death benefit. Keep in mind, however, that taking loans or withdrawals, or exercising a long-term care rider, which accelerates part of the death benefit, will generally reduce the amount ultimately payable to your beneficiaries.

Legacy Planning

Under the SECURE Act, most non-spouse heirs who inherit an IRA or retirement account after 2019 must withdraw the entire balance within 10 years. This often means taking money out during your highest earning years, which can lead to bigger and sometimes surprising tax bills. If the inherited funds are not needed for expenses, you could use them to fund a life insurance policy for your future income needs or to provide stability for a loved one in the event of your death.[2]

You might consider using these funds to purchase life insurance if you don't need your lifetime required minimum distributions (RMDs), which must begin at age 73 if you were born between 1951 and 1959.[3] The death benefit from a life insurance policy is tax-free to your heirs, often making life insurance a more effective legacy tool compared to leaving taxable retirement accounts to your beneficiaries. This strategy can help ensure that your loved ones receive the maximum benefit from your estate with minimal tax implications.



Employee Benefits

Employers may offer employees group life insurance as part of an employee benefits package. If the employees benefit from a reasonable cost for the coverage provided, life insurance might help to generate outstanding performance and worker retention.

Business Transition

Many closely held companies have multiple owners; when one dies, keeping the firm in familiar hands may be the desired goal. Life insurance can provide the funds needed for a buyout from the decedent's heirs.

Estate Equalization

If you own a successful small business or a valuable property that you intend to leave to a single heir or a charity, excluding other potential heirs may create an imbalance and potential discord among your survivors. To mitigate this, you can name the excluded individuals as beneficiaries of your life insurance policy. This approach can provide them with financial parity, ensuring a more equitable distribution of your wealth and helping to avoid hard feelings or conflicts within your family.

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Many Americans Lack Life Insurance

Despite all the possible advantages, only 51% of American adults report owning life insurance, according to the 2025 Insurance Barometer Study. Of those that do, 25 million insured Americans are underinsured. The study that three quarters of Americans overestimate the cost of life insurance, and this misconception accounts for 46% of the reason people either choose not to purchase coverage or remain underinsured.[4]



How to Choose the Right Life Insurance Policy

Choosing the right life insurance policy can be overwhelming, but selecting one that suits your specific needs and financial goals is essential. Working with a knowledgeable life insurance professional can help you determine the appropriate amount and type of coverage you need, making the process more manageable.

The premiums you pay will generally depend on the type of policy you purchase. Other factors influencing these payments include your health, gender, occupation, and habits such as tobacco use. Beyond providing a death benefit to your beneficiaries, life insurance policies may offer payouts under other circumstances if specific conditions in the contract are met.

Therefore, finding a policy and insurance company that aligns with your needs is crucial. Since your circumstances may change over time, regularly reviewing your policy with a financial professional ensures you maintain adequate coverage.

Additionally, a financial professional can help you assess the financial stability of the insurance carrier you choose, ensuring that your policy remains a reliable source of support for your loved ones. They can use one of many independent security rating organizations that measure the financial strength of insurance companies; such organizations include **www.ambest.com**, **www.moodys.com**, or **www.standardandpoor.com**[5].

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Types of Life Insurance

Life insurance policies come in different variants that suit various needs. The most common types are term and permanent.

Term Life Insurance: This type of insurance works as it sounds—in exchange for required premiums, coverage remains in effect for a set period. Once the agreed-upon term ends, the coverage ends. If new coverage is acquired, premiums will likely be higher because you will be older and perhaps less healthy, with a shorter statistical life expectancy.

Some policies may offer a guaranteed renewable feature that allows you to renew the policy without satisfying another health underwriting process. (Some term life coverage may allow the policy to be converted to a permanent life policy.) Term life insurance does not have a cash value, so it generally is less expensive to purchase than policies with cash value built in.[6]

Permanent Life Insurance: Permanent life insurance comes in various forms and provides coverage for your entire life if the premiums are paid as agreed. These policies, also known as cash-value life insurance, offer a unique feature: a cash-value component that grows over time.

As the name suggests, cash-value life insurance policies accumulate cash value through excess premium payments and earnings. This cash value can be accessed in several ways, including withdrawals, policy loans, or partial/full surrender. However, it's crucial to understand the tax implications and impact on the policy's death benefit before making any withdrawals from your cash value account.



Popular add-ons for these policies include:

- **Accelerated Death Benefit:** Provides a portion of the death benefit to the policyholder in case of critical or terminal illness.
- **Waiver of Premium:** The policy waives premium payments in the event of loss of work, injury, or serious illness.

These additional features enhance the flexibility and value of your life insurance policy to help tailor coverage to your needs.[7]

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Term vs. Permanent: Which is Better for You?

Term life insurance often has much lower premiums than permanent life insurance, making it an attractive option for families managing the rising cost of living while raising children. The cost savings can be significant, allowing families to allocate more resources toward their immediate needs.

Another benefit of term life insurance is the availability of long-term coverage with reasonable premiums for 10 or 20 years. By the time these policies expire, your family's income may have increased, making higher premiums more affordable or reducing the overall need for life insurance.

However, term life policies do have limitations. They do not build cash value, so there is no opportunity for tax-free growth or withdrawals, and many advantages of permanent life insurance are unavailable with term life.

On the other hand, permanent life insurance comes with higher premiums, which can be a significant drawback. Additionally, some permanent policies can be complex, so working with a knowledgeable life insurance professional is essential. When well-advised, cash value life insurance can offer benefits beyond just death benefits, providing a tool for diversifying assets and managing financial uncertainty, inflation, and market fluctuations.

The higher premiums may be worthwhile if you can obtain a desirable permanent policy, often with a professional's guidance. Permanent life insurance can build cash value, mitigating other retirement risks.



Potential additional benefits include:

- **Lifelong Liquidity:** Tax-free withdrawals and policy loans are available without the pre-age-59-1/2 penalty imposed by many retirement accounts.
- **Overfunding Options:** Unlike employer-sponsored plans and IRAs, permanent life insurance doesn't impose contribution limits, offering potential tax-advantaged growth for more of a family's assets.
- **Minimizing Stealth Taxes:** Generally, untaxed cash from permanent life insurance doesn't count in the Provisional Income calculation when determining any federal income tax on Social Security benefits. For high-income seniors, such cash flow also won't trigger IRMAA surcharges on Medicare premiums.
- **Living Benefits:** Certain riders allow an insured individual to receive benefits in the event of critical illness or disability.
- **Tax-Free Death Benefits:** Policy beneficiaries won't owe income tax on the payouts. This is a significant advantage for non-spouse beneficiaries who must generally distribute pre-tax retirement accounts (and pay ordinary income tax) within ten years of the account owner's death.

By considering these factors and working with a professional, you can choose the right life insurance policy that meets your needs and financial goals. Note that the last two advantages may apply to term and permanent life insurance.

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Conclusion

Life insurance is a crucial aspect of financial planning that can help to provide you and your loved ones financial security and peace of mind. Choosing the right life insurance policy and considering your specific needs and financial goals is essential. By safeguarding your family, protecting your assets, building wealth, protecting against critical illnesses, and saving taxes, life insurance policies provide a risk management tool to generate returns while providing life coverage.

Consumer Action Plan:

- Select a knowledgeable financial professional who can help you assess your current needs and anticipate ways that life insurance may help mitigate other risks besides the death of a loved one.
- Partner with your financial professional, CPA, and legal advisors to understand the advantages and disadvantages of your options.
- Ask your financial professional to discuss the life insurance company's ratings using information from one of the well-known rating organizations.
- Plan to reassess your life insurance needs at least annually to determine whether anything has changed, requiring revision of your existing life insurance coverage.
- Always inform your financial professional of changes in your financial, family, or health circumstances as soon as they occur.
- Inform family members and other loved ones about your life insurance arrangements and the location of needed documents so that they can act efficiently when necessary.

To learn more about life insurance, contact your financial professional or visit the National Association of Insurance Commissioners at **https://content.naic.org/consumer/life-insurance.htm**.



[1] www.nerdwallet.com/article/insurance/life-insurance-riders

[2] www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-beneficiary

[3] www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-required-minimum-distributions-rmds

[4] https://www.limra.com/en/research/research-abstracts-public/2025/2025-insurance-barometer-study/ensuring-a-protected-tomorrow-with-life-insurance-partial-infographic/?utm_source=website&utm_medium=infographic&utm_campaign=barometer-2025

[5] www.iii.org/article/how-to-assess-the-financial-strength-of-an-insurance-company

[6] www.investopedia.com/terms/t/termlife.asp

[7] https://www.investopedia.com/terms/l/lifeinsurance.asp

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