How to choose the right type of life insurance

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Deciding what to buy – term, permanent or universal life insurance – doesn't have to be an either/or choice. You may need more than one type.

If you've spent any time researching life insurance, you know that there is a long-standing debate about the benefits of term versus permanent insurance. It's often presented as an either-or decision, as if one is right and the other wrong, depending on your situation. Don't be fooled.

A short primer to start. Term and permanent aren't the only kinds of life insurance. Universal life is another. Unlike health insurance, which generally speaking pays out when you get sick, life insurance pays a tax-free cash benefit to your beneficiary or beneficiaries when you die. A lot of Canadians have group life insurance provided to them as an employee benefit. Many don't, and many others choose to top up their group plans with individually purchased life insurance.

Here's how they work:

Term life insurance is a relatively inexpensive form of life insurance that provides protection over a pre-defined period of time (it gets more expensive as you get older). Typically, consumers purchase this temporary insurance to protect their dependents during times when they have significant financial obligations (like a mortgage, for example). Let's say you owe $400,000 on your mortgage. Holding half-a-million dollars' worth of term life insurance for a period of time would prevent your family from experiencing real financial hardship if you died.

Permanent life insurance provides guaranteed lifetime protection. Younger Canadians will find it more expensive than term. But your premiums remain constant, so at a certain point in your life it will be cheaper to pay for your permanent life insurance than it would be to buy additional term insurance. (Some permanent life insurance products are adjustable, which is to say that their premiums change over time.) A participating life insurance policy — which is a kind of permanent life insurance — can provide policyholder dividends. You can use the dividends to buy more coverage, take a cash payment or decrease your annual premium, or you can save the money with your insurer and earn interest. Over the long term, you're probably better off owning permanent than you are continually renewing term insurance.

Universal life insurance is more complex. In most cases, it provides consumers with lifetime (or at least long-term) protection while at the same time making possible tax-deferred savings. Some universal life insurance products feature premium payments that remain constant over time, some require payments that rise over time and others combine both. Payments made over and above the cost of the insurance can be invested and your savings will be held on a tax-deferred basis.

I'm only scratching the surface here on how these products work. Please research the options available, and talk with a financial advisor.

In my opinion, the term vs. permanent debate is a false choice. For me, permanent life insurance plays a fundamental role in my family's financial plan. I'm lucky enough to have group life insurance and I've topped that up with additional permanent life insurance I bought myself. I also added term life shortly after my wife and I bought our first home together. We're covered for about twice the value of what we owe on our mortgage.

In other words, for me the question was never term or permanent. It was: How much term and how much permanent?

Why so much life insurance? Partly because as a 20-year-old I saw firsthand what happens to a family when a parent dies (we lost my mom to a heart attack at 44). Mostly though, this is simply a matter of how I think about and manage risk.