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What Is Universal Life Insurance?

Universal life insurance was developed in the late 1970s to overcome some of the disadvantages associated with term and whole life insurance. As with other types of life insurance, you pay regular premiums to your insurance company, in exchange for which the insurance company will pay a specific benefit to your beneficiaries upon your death.

As with whole life insurance, a portion of each payment goes to the insurance company to pay for the pure cost of insurance. The remainder is invested in the company's general investment portfolio, with the potential to build cash value.

Most universal life policies pay a minimum guaranteed rate of return. Any returns above the guaranteed minimum vary with the performance of the insurance company's portfolio. The policyholder has no control over how these funds are invested; funds are managed by the insurance company's professional portfolio managers.

However, universal life policies are very flexible. As the policy owner, you can vary the frequency and amount of premium payments and also increase or decrease the amount of the insurance to suit changes in your situation.

For example, if your financial situation improves significantly, you can increase your premiums and build up the cash value more rapidly. On the other hand, if you find yourself under a financial strain, you can reduce your premiums, or you may even be able to deduct premium payments from the cash value of the policy. Of course, changing the premium or withdrawing part of the cash value in your policy will affect the rate at which your cash value accumulates. It may also reduce the size of the death benefit.

Any cash you withdraw from your universal life policy is considered "basis-first." You won't incur a tax liability until your withdrawals exceed the premiums you've paid into the policy. Any amount that exceeds the premiums will be taxed as ordinary income.

It is possible to structure many universal life policies so that the invested cash value will eventually cover the premiums. You would then have full life insurance coverage without having to pay any additional premiums, as long as the cash-value account balance remains sufficient to pay for the pure cost of insurance and any other expenses and charges.

Access to cash values through borrowing or partial surrenders can reduce the policy's cash value and death benefit, increase the chance that the policy will lapse, and may result in a tax liability if the policy terminates before the death of the insured. Additional out-of-pocket payments may be needed if actual dividends or investment returns decrease, if you withdraw

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policy values, if you take out a loan, or if current charges increase. Guarantees are contingent on the claims-paying ability of the issuing company.

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.

For investors who want the flexibility to change their premiums or death benefits, a universal life insurance policy may be ideal. If you are considering purchasing life insurance, consult a professional to explore your options.

The information in this article is not intended to be tax or legal advice, and it may not be relied on for the purpose of avoiding any federal tax penalties. You are encouraged to seek tax or legal advice from an independent professional advisor.