What type of life insurance policy should I buy?

Most people have two main protection needs that can be covered by life asssurance

- paying off large debts like your mortgage
- family protection, where you leave behind money for your family to live on after you've died.

Different types of insurance policy are good for different protection needs.

Term assurance

The most basic type of life insurance is called term asssurance. With term assurance you choose the amount you want to be insured for and the period for which you want cover. If you die within the term, the policy pays out to your beneficiaries. If you don't die during the term, the policy doesn't pay out and the premiums you've paid are not returned to you.

There are two main types of term assurance to consider – level-term and decreasing-term insurance.

Level-term policies

A level-term policy pays out a lump sum if you die within the specified term. The amount you're covered for remains level throughout the term – hence the name. The monthly or annual premiums you pay usually stay the same, too.

Level-term policies can be a good option for family protection, where you want to leave a lump sum that your family can invest to live on after you've gone. It can also be a good option if you need a specified amount of cover for a certain length of time, e.g. to cover an interest-only mortgage that's not covered by an endowment policy.

Decreasing-term policies

With a decreasing-term policy, the amount you're covered for decreases over the term of the policy. These policies are often used to cover a debt that reduces over time, such as a repayment mortgages.

Premiums are usually significantly cheaper than for level-term cover as the amount insured reduces as time goes on. Decreasing-term insurance policies can also be used for inheritance tax planning purposes.

Family income benefit

Family income benefit life insurance is a type of decreasing term policy. Instead of a lump sum, though, it pays out a regular income to your beneficiaries until the policy's expiry date if you die.

The upside of family income benefit is that it's easier to work out how much you need. For example, if you take home £2,000 a month, you can arrange for the same amount to be paid out to your family if you die.

However, there is a downside too. If you die two years into a 20-year family income benefit policy, your family could get £2,000 a month for 18 years. But if you die a year before the policy ends, your family gets £2,000 a month for just one year.

Whole-of-life policies

As the name suggests, whole-of-life policies are ongoing policies that pay out when you die, whenever that is. Because it's guaranteed that you'll die at some point (and therefore that the policy will have to pay out), these policies are more expensive than term assurance policies, which only pay out if you die within a certain timeframe.

Premiums start from as little as £5 per month.

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