Return of Premium Term Life: Is it for Real?

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Physicians who feel they are wasting their money in paying premiums for a typical 30-year-level term life insurance policy may find help in a return-of-premium term life insurance policy. Premiums are higher, but all the money is refunded at the end of the term if the policyholder has not died. Estimates are that 93 percent of policyholders outlive the term of their life insurance.

Key words: Term life insurance; return-of-premium term life insurance; ROPT.

Is your life insurance agent looking out for your best interest? If you think so now, you might not after reading this article.

The vast majority of physicians under the age of 60 have at one time or another purchased term life insurance. Usually, physicians purchase 10- to 30-year-level term insurance because it is the most inexpensive way to fund a death benefit without increasing costs for a specific period of time.

Insurance companies love to sell term life. The numbers vary depending on the statistics you find out there, but somewhere around 93 percent of all clients who buy term insurance do not die during the coverage period. Therefore, the premium at the end of the period is a total waste (although the policyholder does have peace of mind while insured).

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A very few select companies have come out with a product called return-of-premium term life insurance (ROPT). ROPT is simple to understand. You pay a premium that is marginally higher than the normal for level term life, and if you do not die, the premium is returned to you in full. The rub is that you do not get investment growth on the premium paid.

Let's look at an example: Assume Dr. Smith is 38 and has two kids and a wife. Dr. Smith's total assets are less then $1 million, and he wants to make sure that if he were to die in the next 20 to 30 years, his family would be taken care of (his children would be able to go to college, wear nice cloths, and drive good cars, and his wife would not have to go to work to provide for the children and herself). Dr. Smith would normally have purchased 20- to 30-year-level term until he found out about ROPT.

As shown in Table 1, the amount of premium Dr. Smith would pay per year is $1,540 more with ROPT than normal term life insurance. Most physicians would resort to their default position when it comes to spending money: Always opt for the less expensive product when it comes to insurance and invest the difference in the stock market.

If Dr. Smith invested the difference in premiums in the stock market each year for the 30-year period, assuming an 8 percent annual investment return, he would have approximately $86,503 after taxes (capital gains and dividend taxes). The difference between the amount in Dr. Smith's brokerage account ($86,503) and ROPT ($118,200) is $31,697.

Remember that while Dr. Smith is investing the difference in premiums ($1,540) each year, he still would have to pay his traditional level term life premiums of $2,400 each year for 30 years to equal the premium paid each year with the ROPT policy ($3,940).

Via his ROPT, Dr. Smith will receive a guaranteed return of premium of $118,200, income tax free. The return of premium is tax free because the premium was paid for as an after-tax expense (and the return is simply a return on capital with no growth).

Table 1. Comparison of Normal Term Life and ROPT

	Term Life Cost	ROPT Cost
30-year-level Term Life	$2,400	$3,940
Total Cost for 30 Years	$72,000	$118,200
Premium Difference	($46,200) over 30 years	($1,540) per year

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Dr. Smith would have to earn well in excess of 8 percent pre-tax in the stock market with the difference in premium to have more money than he would receive with his ROPT. And Dr. Smith has no guarantee that his money in the stock market will not earn less then 8 percent—or even negative returns (as we have seen in 2000-2003).

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The higher premium is the reason an insurance company can offer clients "free" insurance. The insurance company's "term" cost of insurance is the same, but the company is now able to invest the new higher premium for a 20- to 30-year period. The company is able to keep the investment growth and simply hand back to the client the initial premium at the end of the term. Also remember that some of the people buying ROPT will drop the insurance before the term is up. Depending on when that happens, the client will forfeit some or all of the return of premium. This also adds to the profitability of ROPT.

Because the ROPT is purchased by individual physicians out of their personal checking accounts (i.e., the physician is not deducting the premium), there is no need to worry about imputed income on the costs of insurance that an employee would be concerned about if the insurance were purchased in a deductible manner through the medical practice.

CAUTION

The beginning of this article asked whether or not you thought your insurance agent was looking out for your own best interests. Those readers who were not offered ROPT life insurance may say no. Even if your local insurance agent brought ROPT life to your attention, the agent most likely did not offer you the most inexpensive ROPT life in the marketplace.

Understand that there are two different types of life insurance agents. One is what I call a "captive" agent. This means the agent can sell only one insurance company's policies. The other type of insurance agent is independent and can sell any insurance company's policies (as long as they are licensed with the company).

Captive agents, unless you get lucky, are almost never going to find you the least expensive life or annuity contracts. You would think that "independent" insurance agents would be able to find you the least expensive insurance because they can shop "all" the companies. In theory, that's right. In reality, insurance agents for the most part place their business with a select few companies, because their commission overrides go up as they place more business with a particular company.

Therefore, even if your insurance agent shows you ROPT life, the chances are that the company is not the least expensive in the marketplace. The theme of the day when shopping for insurance is try to find an agent who is not captive, who does shop around, and who uses the best and least expensive company for clients.

A very few select companies have come out with ROPT. Those that have are always changing their prices; therefore, I will not list the companies that offer the product. Just remember, it is important to use an agent who knows all the viable companies and can shop thoroughly with those companies.

With ROPT, you are getting free death benefit coverage because you will receive every dollar paid in premium back via the return of premium rider. This will allow Dr. Smith (and you) to avoid feeling like paying your term life premiums is a waste of money. ■