Term Life Insurance

Term Life Insurance is thought of as a simple product. It obviously has to be if people are purchasing it by droves on the internet and from television commercials, right? While most clients and non-insurance advisors think of term as simple, it is not as simple as it seems due to some important factors that many times should not be overlooked.

A simple explanation of term is that the client pays a set insurance premium for a certain period of time (the term); if the client passes away during that term, the beneficiaries receive the death benefit. If the client does not die during the term there is no refund of premium unless the policy is the new kind of term life called ROP (Return of Premium) Term. They simply paid the cost of insurance during that period and received no financial benefit (except for the peace of mind).

As we address the three major types of term insurance; Guaranteed Level, Annually Renewable, and ROP, in detail we will also show a comparative illustration so you can see what current pricing is and why one might make more sense for the client than the other. We will use one carrier for these examples.

Please keep in mind that, as with any good or service we purchase, cheaper isn't always better. Don't be so quick to rush to the lowest cost term product without knowing how the company is rated, how they deal with underwriting (especially if a client is not completely healthy), and how long it takes a company to issue a policy (some take months to issue even the simplest term policies). For the non-insurance advisors, an experienced life agent with the support of a good General Agency (GA) should be able to point you and your clients in the proper direction.

Types of term life

Level Term

Level term is the most common. You can purchase 5-, 10-, 15-, 20- and 30-year term policies from almost any company. Level term means that the premium will be level for a particular death benefit. After the term is up, typically you still have the contractual right to purchase insurance from the company; but there is no guarantee what the rates will be. You typically do not have to go back into underwriting at the end of the term, which is nice for those who happen to get sick (cancer) before the end of the term.

Most clients who are not counseled on the benefits for a cash value life policy will opt for level term to fit their short term life insurance needs at the lowest cost.

Annually Renewable Term (ART)

Annually Renewable Term is not commonly used anymore despite its extremely low cost to the client (ART is the **least expensive** type of new life insurance policy a client can purchase in any given year). ART used to be a popular policy because it has the lowest cost during the first few years of the policy.

The problem with ART is that the policy renews (re-prices) itself every year. While a client does not have to go through underwriting to keep the policy for the period purchased, from an economic standpoint, it is like the client is buying a new policy every year. The older the client gets, the more the policy costs. At some point an ART policy will cross over and cost more each year than a guaranteed level premium policy. The crossover point will vary depending on the age of the client.

For example, let’s say a client is 30 years old and the cost of 20 year regular GLT costs $600 for $1,000,000 in death benefit. That means if the client pays $600 dollars a year for 20 years, the client will have $1,000,000 in coverage in force for the full 20 years. If a client purchases 20 year ART, the first year premium would be much lower, let’s say $250. That premium would increase each year, and eventually would begin to cost more than that the GLT. This is the crossover point. After the crossover point ART will always cost more than GLT.

As a general statement, GLT is always a better option for clients who believe they will keep the life policy for the contract term. ART is usually purchased by clients who have very little money and need insurance. They also usually hope that, in the near future, they will have more money so they can buy a GLT policy so they can afford to keep it for the entire term.

Also, at the end of the guaranteed term the client does not receive any return or refund of any premiums; and unless the client does accepts the tremendous increase in premium as the policy becomes an ART, they will no longer have life insurance coverage.

Convertible Term

Most companies will allow you to convert your term policy to a whole, universal, or variable policy without going through the underwriting process. There are a number of reasons to purchase convertible term, the main one being that, as you get older, you will typically want a guaranteed and possibly a paid-up life policy. Term insurance is far too expensive after the age of 70, and most people for estate planning purposes will switch their term policies around the age of 50 to a cash building guaranteed policy. With convertible term, you do not have to go back into underwriting in order to switch insurance policies. Again, this is important to people who have a family history of cancer or diabetes who might not be able to purchase a new guaranteed policy when they get older.

Miscellaneous comments on term life

You can purchase all sorts of different term riders like increasing and decreasing term. You would buy increasing term because you think that, as you get older, your estate will grow; and you want a policy you know will increase its death benefit. Others like decreasing term because they believe, as their estate grows, their need for insurance decreases due to the fact that, if they die, their heirs have ample assets in the estate to live a comfortable life. Finally, there are those that would rather buy ROPT due to the fact that every dollar they pay in premium will come back to them via the Return of Premium Rider.

Recommendations

If financially viable we recommend that you purchase “permanent” insurance to that you can insure that a death benefit will pay to your heirs when you die (no matter when that is). Permanent insurance should work out as nice investment for you as well due to the tax free growth and tax free income.

Having said that, if you feel you must buy term insurance we recommend 10-30 year level term for those clients who need life insurance to take care of a family in a manner they have become accustomed to when the breadwinner is still working and less than 50-60 years old. We suggest term insurance of 2 million dollars (or more) so that, if a younger client dies, the spouse does not have to go back to work in order to support him/herself and so there is enough money to send the children to college. Term is good for younger clients because it is inexpensive.

If you are going to be paying term life premiums for 10-30 years we recommend you consider purchasing ROPT if the numbers make sense. With ROPT you can receive free term life insurance in the event you do not die and, therefore, it will not seem nearly as painful to you when paying your term life premiums.