Factors to Consider When Buying Term Insurance

Term insurance pays the policy death benefit if the insured dies during the stated term period, but pays nothing if the insured survives the term period. Term insurance is also relatively inexpensive (compared to permanent insurance). Therefore, term insurance is generally appropriate for individuals with modest incomes (or cash flow) with high insurance needs, and for individuals who have a temporary insurance need (e.g., paying off a mortgage or other loans, funding for a child's education or providing funds for survivors to continue their lifestyles). Healthy insureds sometimes use term insurance to protect their insurability (via a term policy's conversion privilege) especially when they foresee a high insurance need in the future or when their genealogy indicates health problems in the future.

Listed below are the key factors to consider when shopping for term insurance.

1. Match the duration of the guaranteed term period to the duration of the insurance need. Term premiums either (i) increase with age (e.g. "yearly renewable term (YRT)"), (ii) increase every three, five, or ten years (e.g. "three-year-renewable term"), or (iii) stay level for a set number of years (e.g. "10-year-level term," "15-year-level term," etc.). Term premiums are usually guaranteed for a period of years and then increase dramatically after the guarantee period, possibly making the premiums unaffordable at that point.

   Generally, YRT is less expensive than level term in the early policy years and then becomes more expensive in the later policy years. Therefore, if coverage is only needed for a few years, YRT is more appropriate than level premium term. If coverage is needed for 20 years, buy 20-year-level term. If coverage is needed for eight years, 10-year-level term would probably be most appropriate (since there aren't any carriers who offer 8-year-level term). If coverage is needed for 20 to 25 years, err on the high side and buy 25-year-level term.

2. Compare term quotes, but only after the completion of medical underwriting. A proposed insured's medical underwriting results can have a dramatic effect on pricing. Since insurance carriers can differ on how they view medical impairments from a mortality perspective and categorize underwriting risks, the same insured may be considered a "preferred" risk with one carrier and a "substandard" risk at another! Thus, the cost for the same amount of insurance can vary among carriers by thousands of dollars. The best approach is for the insurance broker to send the proposed insured's medical underwriting requirements (i.e., attending physician statements, lab results and exam paperwork) to multiple carriers, obtain each carrier's underwriting offer, determine the pricing based on each offer, then then compare the quotes.

3. Evaluate the conversion feature. Term policies often include a conversion feature that allows the policyowner to exchange the term policy for a cash value policy (from the same carrier) without having to prove insurability for an amount up to that of the term policy. The premiums for the new cash value policy are based on the insured's attained age and underwriting status of the original term policy. (For example, if the term policy was issued based on "preferred" rates, the new cash value policy will be issued based on "preferred" rates, even if the insured is uninsurable at the time of the exchange). Typically, conversion rights must be exercised within a certain number of years or by certain age. Obviously, the longer the conversion period, the more valuable the conversion privilege. Individuals who anticipate an insurance need in the future acquire inexpensive convertible term insurance while they are healthy to protect their insurability.

4. Consider the insurance carrier's financial strength. Insolvent carriers have historically paid death claims but they typically only pay a fraction of the cash value when a policy is surrendered. Therefore, the insurance carrier's financial strength could become an important factor if there is a possibility that the term policy will be converted.

5. Consider the term insurance carrier's cash value policy product offerings. The term policy's conversion feature may be meaningless if the policyholder can only convert to a cash value policy that is expensive compared to other cash value products on the market.

6. Evaluate banded rates. Many insurance companies use "banded" rates whereby the cost per $1,000 of coverage is lower for coverage greater than $1 million than it is for coverage less than $1 million. Therefore, in some cases, if you round up your coverage, you could actually pay less for more coverage.

7. Take into account potential needed future reductions in the death benefit. Some term products do not permit death benefit reductions, while others allow reductions as often as needed to a minimum allowable death benefit.