Term Life Insurance

Overview: Term life insurance may be a good bet for specific situations. The following discusses some basics about life insurance and when such coverage may be appropriate.

Basics
Term life insurance, also known as temporary life insurance coverage, provides a guaranteed death benefit for a specific period of time, such as one year or 30 years. If you outlive the specified term of the policy, the insurance coverage simply expires.

While the coverage of some term life insurance policies can decrease or increase over time, level-term life insurance is the most common and is what will be discussed here. With level-term life insurance, the death benefit and the premium remain the same for the entire term period.

Pricing
Unlike permanent insurance, term life insurance policies generally do not provide a cash value. For that reason, premiums are primarily paid to cover the death benefit and are based on the likelihood of dying during the term period.

Premiums are typically lower than premiums for similar permanent life insurance policies. However, term insurance premiums can increase considerably as policyholders get older, making the cost difference between term and permanent insurance less significant.

Additional Features
Although coverage expires after the specified term, insurance companies can offer two features (typically with higher premiums) to extend life insurance coverage. These options are:

- Renewability — A renewable term-life policy provides an option to renew coverage at the end of the term period without retesting for insurability. The premiums for the renewed coverage would only reflect your current age at the time of renewal.
- Convertibility — This option, known as a conversion right, allows you to convert your term life insurance to permanent life insurance. A conversion right can be included in a policy or issued as an additional benefit rider. Conversions can either occur as:
  - Attained age conversion — The existing term insurance can be exchanged for permanent life insurance at your age at the time of conversion.
  - Original date conversion — You can convert to a permanent policy as if you were the age when the original term policy was purchased. However, this type of conversion requires a payment to the insurer to ensure that the insurance company is in the same financial position it would have been if the permanent policy had been issued at the original age.

Who Should Purchase Term Insurance?

The following individuals could be good candidates for term life insurance:

- Individuals who have a need for insurance but have limited funds
- Individuals who need coverage for a specific period of time and can drop coverage after the need expires
- Young, healthy individuals whose premiums will be significantly less than premiums for permanent products and don't have a permanent need for insurance

What Terms and Coverage Should Be Considered?

If you need coverage for a specific need (such as planning for a child's education through college), you should consider purchasing a term policy to cover that time period. Others may consider purchasing enough term insurance to cover their life during high-earning work years. The amount of coverage needed can be determined by completing a capital needs assessment.

Another consideration is that if there is a chance additional coverage may be needed (and you can afford it), it is easier and cheaper to purchase the higher coverage upfront. In addition, you can always reduce the death benefit at any time, but underwriting is required to increase it.

Differences Between Long-Term and Short-Term Policies

Buying coverage for a longer time period (about 20 years or more) is more expensive than buying shorter-term policies. The advantage is that the coverage is guaranteed for that entire period, regardless of any changes to health. If you need long-term coverage and can afford higher premiums, purchasing a long-term policy would eliminate the risk of a significant change in premiums due to a change in health or in term premiums in general.

Shorter-term policies are more affordable, but you risk needing additional, more expensive coverage after the initial term. However, if your health remains the same and the rates for term premiums are level or decreasing, then purchasing multiple short-term policies to cover a longer period of time can be more affordable than purchasing a single policy for the entire period of needed coverage. Additionally, those who need coverage and can only afford a shorter-term policy can purchase what is possible and then reassess the ability to need and pay for additional coverage later.

Let's look at an example. A healthy, 35-year-old female needs $1 million of coverage for 20 years. Assuming her health status does not change after 10 years and term premiums are the same as today, two consecutive 10-year term policies are more affordable than a single 20-year policy. This is especially true when considering the present value of the premiums paid, discounted at the 20-year Treasury yield of 4.3 percent.*

Difference in Term Policy Coverage*

	Two 10-Year Policies	One 20-Year Policy	Savings
Years 1–10	$228 per year	$398 per year	
Years 11–20	$508 per year	$398 per year	
Total Premiums	$7,360	$7,960	8%
Total Present Value of Premiums	$4,679	$5,495	15%

* As of April 2010

Although purchasing two 10-year term policies is cheaper than one 20-year policy, there are risks associated with that strategy. (Again, this assumes that premiums stay the same over 10 years and that your health remains basically the same.) If these risks are too high, the single 20-year policy (and higher premium) may be better for you.

Summary

First, it is important to determine how much coverage is needed and how long you need the coverage. Then, you should consider the costs and risks for each type of product. Finally, depending on what you can afford — in terms of both premiums and risk tolerance — transfer all that risk to a strong insurance company.

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