Term Insurance

As the name implies, term insurance provides protection for a specific period of time and generally pays a benefit only if you die during the "term." Term periods typically range from one year to 30 years, with 20 years being the most common term.

Advantages

One of the biggest advantages of term insurance is its lower initial cost in comparison to permanent insurance. Why is it cheaper when initially purchased? Because with term insurance, you're generally just paying for the death benefit, the lump sum payment your beneficiaries will receive if you die during the term of the policy. With most permanent policies, your premiums help fund the death benefit and can accumulate cash value.

Term insurance is often a good choice for people in their family-formation years, especially if they're on a tight budget, because it allows them to buy high levels of coverage when the need for protection is often greatest. Term insurance is also a good option for covering needs that will disappear in time. For instance, if paying for college is a major financial concern but you're pretty sure that you won't need life insurance coverage after the kids graduate, then it might make sense to buy a term policy that'll get you through the college years.

When the Term Ends

But what happens if you buy a term policy only to realize at the end of the term that you still have a need for life insurance? Well, it's sort of a good news, bad news story. The good news is that many policies will give you the option to renew your policy when you reach the end of the term. The bad news is that you'll probably face much higher costs since age is one of key factors used to determine life insurance premiums. To renew the policy, you also may have to present evidence of insurability (that's insurance jargon meaning, "take another medical exam and answer a new round of questions about your lifestyle, health status and family health history"). If you're still a fine specimen with healthy living habits, you might requalify at a reasonable rate. But if your health has deteriorated, you may find that it's too expensive to renew your policy or you may not even requalify.

So if you're considering a term policy, make sure you carefully consider how long you'll need the coverage. If you're pretty sure that your needs are temporary, then term insurance is probably the right choice for you. But if you think there's a possibility that you might need the coverage for a long time, then remember that if you want to renew your term policy after it expires or buy a new term policy at that time, your age, health status or other factors may make coverage very expensive.

To better understand term insurance, consider this analogy. When you purchase term insurance, it's sort of like renting a house. When you rent, you get the full and immediate use of the house and all that goes with it, but only for as long as you continue paying rent. As soon as your lease expires, you must leave. Even if you rented the house for 30 years, you have no "equity" or value that belongs to you.

Return-of-Premium Option

One exception to this rule is what's called a return-of-premium term policy. With these policies, if you keep the policy in force for the entire term, say 20 years, the insurance company will refund the premium payments you made over that 20-year period. Of course, there is a price to be paid for this added benefit. The premiums for return-of-premium policies are considerably higher than premiums for standard term policies. The price difference can be 20%, 30% or more. Another factor to consider is that term insurance rates have dropped considerably over the past decade, mostly because people are living longer. If you own a standard term policy, there's really no harm done in dropping that policy in favor of a newer and cheaper term policy. But if you own a return-of-premium policy, dropping the policy before the full term has expired means that you will have paid a high price for your term insurance coverage and the premiums you paid won't be fully refunded. At best, you'll get a partial refund of the money you put into your policy to that point.

Key Policy Provisions

When considering a term purchase, one thing to keep in mind is that not all term policies are the same. Some may include certain provisions as standard features, while others may require you to pay extra to add these features as "riders" to your policy. So if you're comparing term policies, remember that price is not the only factor to consider. Ask your agent about provisions such as:

- Accelerated death benefits – allows a terminally ill person to collect a significant portion of his or her policy's death benefit while that person is still alive
- Disability waiver of premium – waives premiums when a policy owner suffers a long-term disability, typically one lasting six months or longer
- Accidental death benefits – doubles or triples the benefit in the case of death by accidental means

Convertibility

Another provision that is very important is something called convertibility. Some insurance contracts only allow "conversion" in the first few years of the policy, while others allow it at any point during the term. This valuable feature allows you to convert your term policy to a permanent policy (e.g., whole life insurance) without submitting evidence of insurability. Being able to convert to a permanent policy is a great option to have in the event that circumstances in your life change such as failing health or maybe just the realization that coverage is needed for a longer period of time than you originally anticipated. That's why when purchasing a term policy, it's never a bad idea to find out what kind of permanent policies are offered by the company you are considering. Some companies may only have strong term insurance offerings, while others may have very competitive products in both categories.