# HOW AND WHEN TO PURCHASE LOW-COST TERM LIFE INSURANCE

By Peter Katt

Buying low-cost level term insurance directly from companies that advertise directly to consumers is an easy and economical way to purchase term life insurance.

It doesn't seem long ago when I would only occasionally encounter an advertisement for low-cost term life insurance. But more recently these encounters seem to occur during almost any hour of a radio or television show. Unlike permanent (cash value) life insurance that is usually creatively sold or planned for, term insurance has become a commodity that consumers usually purchase on their own, without planning assistance. This column will examine term insurance and identify when its purchase is most appropriate. I will not clutter this piece with possibly more creative planning alternatives or cover inherent potential complications associated with tax and other matters because this column is for consumers of life insurance who wish to move from the desire for coverage to obtaining it.

## LOW COST

Very low term insurance costs are achieved by separating potential insureds into three categories: super-perferred, preferred, and standard. Generally, a super-preferred rating is earned by not using tobacco and having good to excellent height/weight ratios, blood values, health history, personal habits, and family health history. A lesser preferred rating is earned when one or two of the areas needed for super-preferred are a little bit weaker. Standard is given to insureds who have greater weaknesses in any of the important underwriting areas. Given the excellent health of super-preferreds and the limited coverage period, these policies are similar to accidental death insurance.

You should be aware that some aggressive marketers of low-cost term insurance will advertise or quote term costs based on their super-preferred rating category regardless of the actual health of a particular potential insured. This potential dichotomy between the quoted super-preferred cost and the actual cost after the underwriting process has been completed has caused some consumers to feel like they have been victims of a conscious *bait-and-switch* tactic because a preferred rating is typically one-third higher in cost than super-preferred, while standard is twice the cost.

## PERIOD AND CONDITIONS

Five-, 10-, 15- and 20-year level term policies are the most common. The *level* term designation means the cost remains constant for the period of time designated. Many level term policies' premiums are guaranteed for the specified period of time. Many can be renewed after the specified period of time with proof of continued good health or the cost to continue coverage can be very high. The renewal cost won't be known in advance because companies change them at their discretion. Many policies can be converted, without further proof of good health, to permanent policies the company so designates.

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Also available are annual renewal term [ART] policies, whose costs go up incrementally each year. ART is appropriate when the coverage is only needed for less than five years. For example, a creditor may require insurance protection on a credit line to a small business for a short period of time. ART would also be the better choice if the insured intends to convert to permanent coverage within five years when his cash flow improves.

### APPROPRIATE USES

Term life insurance is the appropriate insurance method for these situations:

- **Family Protection:** The primary purpose for life insurance is to provide protection to those financially dependent on you. Let's consider Matt Green, a recently certified internist taking his first post-training job. Matt's wife doesn't work outside the home, and they have two young children. His annual salary is $100,000. Without much calculation, he determines he wants to protect his family with $2.0 million worth of life insurance. He isn't interested in considering any *fancy* life insurance or tax planning, so he contacts one of the companies advertising low-cost term insurance, complies with their underwriting requirements, qualifies for a super-preferred rating. He purchases a 10-year level term policy for $2.0 million at an annual cost of $630, which is less than the unit cost for group policies through such professional organizations as the American Medical Association. Matt's attitude is: With little expenditure in time or money, he can now forget about his life insurance needs for 10 years.
- **Fund Buy-Sell Agreements:** Business owners frequently have agreements that obligate either each other or the business entity to purchase a deceased partner's interest in the business (See the April and August 1997 *AAII Journal* Insurance Products columns that discussed buy-sell agreements and life insurance). Such obligations should be funded with life insurance. For business owners who have limited cash flow or plan on selling or liquidating the business within a particular time period, term insurance is a good option.
- **Estate Liquidity:** Generally, estate liquidity life insurance is held until the death of the insured(s), so term insurance isn't predictably cost effective. That is, when the life insurance will definitely be held until death and the insured lives to life expectancy or beyond, term insurance will most likely become too expensive. However, in cases where estate owners have highly illiquid assets that are likely to be sold or liquidated within a given period of time and personal cash flow is a problem, using term insurance as a temporary liquidity fund is a good idea. Once the illiquid assets have been sold or liquidated, the estate owner then might consider converting the term insurance to a permanent form of life insurance, perhaps as a wealth transfer asset.

### POLICY REPLACEMENTS

The cost, primarily for the level term policies, has been on a downward trend (sometimes approaching a spiral) for the past decade. Because of this, many buyers of level term policies have replaced their policies before the level term period expires. Comparing prices is easy. However, there are two intangibles to consider before going ahead with the policy replacement. First, for the replacement policy, there is a new two-year period during which if death occurs the insurance company will investigate to determine whether there were any misrepresentations on the insurance application. If they can prove there were, they will try to deny the claim. Also, if death is by suicide, no benefits are paid during the first two years. Second, consider the quality of the company and cost of converting to a permanent policy. Generally, the quality of the company isn't as much of a concern with guaranteed-cost term insurance, but it is with permanent insurance. And, converting to a full-load permanent policy is less attractive than being able to convert to a low-load permanent policy.

### PREMIUM GUARANTEES

I am not aware of any term policies' guaranteed premiums being changed or death benefits not being paid, at least during this century. But level term insurance is so competitive, with lower and lower prices coming out, that it wouldn't surprise me if some companies end up being seized by regulators due to solvency concerns. If that were to happen, we would be in uncharted waters regarding the effects it would have on policyowners. My advice is that, besides cost, you should consider the quality of the company, and especially the amount of low-cost term insurance the company sells as a percentage of its other life insurance business.

### BUYING TERM INSURANCE

Earlier this year, Ameritas Life Insurance Corporation, through its low-load direct-to-consumer-unit Veritas (800/552-3553), began marketing and selling 10- and 20-year level term insurance with some of the lowest premium costs available.

As an alternative to Ameritas, you can call Insurance Information (800/472-5800) and for a $50 fee they will give you the names of insurance companies (including Ameritas) with the lowest rates based on your specific situation.✦