Life insurance: Should you go for 10 years or 20?

Term-policy strategies for the financially challenged

By Deanne Gage

If you need life insurance, but can't afford huge premiums, your best bet is term insurance. As the name implies, term insurance offers coverage for a specific period of time. It works like this: You fill out a detailed application for the policy and undergo a medical. If your application is accepted, you promise to pay premiums, usually by month or year. In return, if you die within the specified period, the policy will pay out the decided amount to your beneficiary.

Ten-year and 20-year are the most popular term-policy increments. How do you decide which term is best for your family?

Mark Halpern, CFP and founder of illnessPROTECTION.com in Toronto, considers a number of factors. Let's use fictional client Bruce, a 40-year-old non-smoking male, as an example. He's married with no plans for children but has a mortgage.

After Bruce meets with his advisor, he decides on $1 million of insurance. A 10-year, $1-million term policy would run Bruce $540 a year if he's deemed to have extraordinary health and an excellent family history, or $750 a year if he's standard. The vast majority of people fall into the standard category.

On the other hand, a 20-year term policy for Bruce would increase to either $932 or $1,223 a year, respectively. If Bruce falls into the above-average health category, Halpern would advise him to get the 20-year policy. At $932, it'll cost $182 more than the standard 10-year policy, but more importantly Bruce will have coverage for 20 years at that price.

Halpern recommends 10-year policies for people on a limited budget or who won't require insurance after the coverage expires. For those of limited means who will need to renew, Halpern suggests four strategies.

1. Make sure your 10-year policy is renewable. That ensures that once the 10 years are up, your policy can renew for another 10-year period automatically without medical evidence, albeit at a more expensive rate. In the case of Bruce, his annual premiums would jump to just over $4,000 a year after the first 10 years, Halpern notes.

2. Has the client's financial situation improved within five or fewer years of buying a 10-year term policy? Note that most insurance companies will allow policyholders to convert to a 20-year policy without any medical

evidence or penalties, but only if it's within the first five years of the 10-year policy, says Halpern. "The 20-year policy starts from when they decide to make the change and they pay whatever the rate is at that time," he explains.

3. As you get closer to your policy-renewal date (less than 10 years away), you can attempt to qualify for a new 10-year policy at a rate cheaper than $4,000, to use Bruce as an example. You'll need to have a medical and you will also be 10 years older. If you pass the underwriting, you could be looking at a similar premium to what you were paying before. While you may be tempted to try this strategy, you are taking a large risk for you and your family that you'll still be healthy enough to qualify for a similar insurance policy. "There's no guarantee that you'll be insurable at any point in the future," Halpern notes.

Let's say Bruce has high blood pressure or is diagnosed with a critical illness at age 48. That means he won't qualify for a new insurance policy. Unfortunately, he will be stuck paying the $4,000-a-year premiums after his 10-year renewal. If Bruce had chosen a 20-year policy, he'd be shelling out only $1,223 a year -- a bit more than the first 10-year policy but way less than $4,000, and a consistent price for 20 years.

4. Make sure your term insurance is convertible. This means that in the future, Bruce could convert some or all of his term insurance to permanent insurance (either universal life or whole life) without medical evidence. If Bruce determines a need for insurance after the term insurance ends (i.e. for tax and estate planning, inheritance considerations, charitable planned giving, etc.) the permanent insurance will provide the liquidity necessary for him and his family, Halpern says. He notes that permanent insurance is much more expensive and the cost increases considerably with age.

Halpern prefers 20-year policies for younger families and those who have substantial debts and expenses such as a mortgage and education costs. Twenty years gives them a chance to get their "financial house in order," he explains. "By then, the mortgage will hopefully be paid off and the kids will be grown up and more established."

What happens if you want more insurance after 20 years? Be prepared to pay a huge amount of money. "Term insurance is very inexpensive when you are young and healthy but once you hit age 50 the rates go up dramatically and can be cost prohibitive," Halpern says. Bruce, for instance, could expect to pay $15,000 a year.

That's why Halpern recommends sitting down with a qualified professional insurance advisor to discuss your unique insurance needs and how it will fit into your overall planning. He has met many people who believe they already have term insurance only to discover that it was accidental death insurance (ADD) or mortgage insurance from a bank -- not quite the same thing.

When a loved one dies, they are confused about why they are having difficulty collecting the claim on such a product. "With accidental-death insurance, the only way to get payment is if somebody dies due to a violent, external act," he says.