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Term Life Insurance That May Pay Back Your Premiums

Would you like to buy term life insurance that pays back the premiums you paid over the life of the policy?

Many people would love that deal. Perhaps they can't afford permanent life insurance with its investment component, or they hate "wasting" their premium dollars on term insurance for which they'll likely never collect any death benefits because most don't keep it late in life because it becomes so expensive.

In recent years, insurance companies have promoted a concept called return-of-premium term life insurance, which pays back in a lump sum all the premium dollars insureds pay into their policy as long as they keep the policy for its full term. It sounds like a good deal, but some financial planners and insurance experts express caution.

Say you need a $500,000 term policy for the next 30 years. A regular term policy with an insurer rated A+ would cost a nonsmoking male, qualifying for preferred plus, around $410 annually, according to quotes provided by the online insurance broker AccuQuote. If you lived to the end of the term, you would have shelled out $12,300 in premiums, and the policy's death benefits would not have been paid out.

A comparable return-of-premium term policy would cost $605 a year, according to AccuQuote. If you keep the policy in force the full 30 years, you'd get back all $18,150—tax free—the you paid in premiums. Or looked at in another way, for the $5,850 you paid in extra premiums, you'd get back the $12,300 in premiums you wouldn't have gotten back at all if you'd bought the regular term.

For some needing insurance, this can be a good deal. But there are some catches. The first, of course, is whether you can realistically afford the higher premiums. For our example, the annual premiums for the return-of-premium policy are 47 percent higher than the premiums for the standard term policy.

That difference jumps dramatically the shorter the term. A $500,000 standard term policy for 15 years would cost $210 a year—but $1,035 for an ROP policy, according to AccuQuote. That's five times the cost! (ROP premiums are higher, the shorter the term, because the company has fewer years to earn the money necessary to pay back the premiums plus cover costs and profit.)

The differences are larger the older you are when you take out the policy. A 40-year-old who wants 15 years of $500,000 coverage would pay $285 for a standard term policy, but six times that—$1,715—for ROP coverage.

Yet most financial planners strongly recommend that the first priority for life insurance is to have sufficient coverage. If you can't realistically afford ROP coverage for the amount you need, but you can for regular term, you probably should go with the regular term. You also don't want the higher ROP premiums derailing contributions to retirement plans or excluding other insurance needs such as disability coverage.

Even assuming you can afford ROP, there is the question of whether you'll actually keep the policy for the full term. A few companies will refund a portion of your premiums if you drop the policy before the term is up, but it's not a large portion. And if you surrender the policy in its early years, you might receive no refund at all and even pay surrender charges.

Historically, holders of term insurance keep their policies for an average of only eight or nine years before they either drop coverage or switch policies. Yet over 20 or 30 years, you might go through some difficult financial times and be forced to drop the steeper-priced ROP policy.

Some critics of these policies argue that people would be better off buying a cheaper standard term policy and investing the difference that would have gone to ROP premiums, particularly if they can invest in a tax-deferred retirement account.

Proponents counter that many people are not disciplined enough to consistently and wisely invest the difference. They claim you'd have to earn six to eight percent annually to accumulate an amount equal to the amount of the return of premium. Furthermore, that invested amount will eventually be taxed, unlike the ROP refund.

Regardless, before plunging into a return-of-premium policy, talk with your financial planner to see what is really the best option for you.

This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by Safe Harbor Financial Planning, a local member of the FPA.