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Convertible Term Insurance: The Third Option

"The third option is that other possibility…"

– Lynn Barrette, Counselor and inspirational blogger

Life Insurance: It's Not An Either/Or Decision

"Whole Life or Term Insurance?" It's a never-ending debate amongst financial advisors and self-proclaimed experts. Today, we'd like to suggest a third option.

But first… let's summarize the two most popular and obvious choices:

Term life insurance allows the insured to afford more coverage for less premium, thus putting greater protection in place, in the form of a death benefit. However, term life insurance policies rarely provide a benefit, because they only provide coverage for a certain period of time and typically expire (like product warranties) before they're likely to ever be used.

Like most other insurances, term life is an "if" insurance, not a "when" insurance. A benefit is paid only IF your house burns down, your car is vandalized, or someone passes away long before expected.

Whole life insurance, on the other hand, is a “when” insurance. It is a policy that allows the policy owner to build equity in the form of savings which is always liquid and available “when” needed through-out your whole life. It also provides a death benefit “WHEN” the insured passes. Purchased through a mutual insurance company, such policies have a long history of paying dividends, provide tax deferred growth, and an option to access (borrow or withdraw dividends) the equity in the policy tax free.[1, 2, 3]

Opinions run strong on this matter, and individuals are made to feel they have to choose one option or the other.

We’re led to believe it’s an either/or dilemma. However, often “both” term and whole life makes sense. But what if we can actually have both in one policy?

Think about questions like:

- Steak or lobster?
- Cats or dogs?
- Ginger or Mary Ann?

These questions are designed to make us pick just one. But what if we want both? Surf and turf can be pretty delicious, after all.

Buy Vs. Rent Your Life Insurance?

Sometimes insurance policies are compared to a home that you can either buy or rent. Term insurance is like renting life insurance; you only get to keep it for a certain term, and when that term expires, you no longer have it. With whole life, as soon as you make your first premium payment, you’ve begun the process of “buying” the whole asset. This is similar to the way you purchase a home by making your first mortgage payment.

But there's a third option when it comes to homes and life insurance policies…

Some people find a home they can "rent to own." In this arrangement, you, the lessee, would *rent* the home while securing an option to *buy* it at a later date. In a lease-to-own agreement, you don't HAVE to buy it, but you CAN if you choose to. You know you want to buy a home soon, and you're getting ready.

Did you know that you can "rent to own" a life insurance policy, too?

These types of policies are known as **convertible term life insurance.** A convertible term policy guarantees the insured an option to convert a term policy to a whole life policy at a later date.

A convertible term policy is typically a level term life insurance policy (with a level death benefit for a specific term or length of time, such as $500,000 for 15 years), and all or part of it can be converted within a specified time frame. You can apply for a convertible term policy today, put it into place in 4-8 weeks, and decide *later* if and when you'd like to convert it to a whole life policy… *without* having to re-qualify medically.

This could provide a perfect solution for you if you:

- don't want to leave your future insurability to chance;
- know you want whole life but are currently on a "term" budget;
- already have a whole life policy and want to lock in your ability to purchase more;
- want to protect your growing income and assets;
- have (or expect to have) children to whom you wish to leave an inheritance;
- wish to have a future option for storing cash in a tax-advantaged environment; or
- want to increase your death benefit permanently while keeping premiums low right now.

Is convertible term insurance a fit for you? Consider the following…

Five Things to Know about Convertible Term Insurance:

1. **It locks in your insurability.**

This benefit is of utmost importance, whether you realize it or not! You can only obtain life insurance when you are perceived to be relatively healthy, just as you can only obtain home insurance when your house is not on fire!

You also may be able to lock in a better qualifying class than you could obtain later. It is not unusual to experience higher blood pressure, blood sugar, or cholesterol levels, etc. as you age. By obtaining a convertible term insurance policy, you guarantee future insurability and keep your options open.

Future insurability may be especially important to you if you are healthy now, but there is a family history of diabetes, heart disease, or cancer. However, it can't be emphasized enough… *you have no way of knowing what the future brings,* and your insurability can change in a moment. You will wake up one day and be uninsurable…you just don't know when.

2. **You have to convert within a certain time frame.**

Typically, convertible term policies can be converted only during a portion of the term, such as the first half of the policy term. For instance, if you own a 10-year convertible term policy, you might have five years to do the conversion. You'll want to fully understand the time frames of the policy and manage the policy appropriately. Although you can usually add a rider[4] that allows you to convert through-out the whole term period…such as the full 10 years.

3. **You can convert just a portion of the policy to whole life insurance.**

If you obtain a convertible term policy with a death benefit of $1 million, and wanted to only convert half of it down the road, or convert a portion of it each year, that is typically an option.

Keep in mind though, the company may have a minimum amount for a convertible term insurance policy, which could affect your options. If you purchased a $200k convertible term policy, and $200k was the company's minimum amount for convertible term, you could convert a portion to whole life, such as $100k, but you would not be able to keep the remaining amount as a convertible term policy.

4. **You want to insure your "Economic Human Life Value," not conduct a "needs analysis" to determine the optimal amount.**

Life insurance companies won't give you insurance in any amount you want. Someone making minimum wage with minimal assets will not be able to obtain $10 million in life insurance. Just like an insurance company won't insure a $40,000 car for $1,000,000 or a $750,000 home for $10,000,000; it has to make sense!

There are two common ways to determine how much life insurance you should get. The first way “Needs Analysis” is typically not as accurate. The more accurate way is “Economic Human Life Value,” which is based on the maximum you can purchase.

The “needs analysis” method calculates what you may “THINK” your family “needs” upon your demise. It may consider such things as the amount needed to pay off a mortgage, pay college tuition, or maintain a certain standard of living for a surviving spouse.

We prefer measuring the “Economic Human Life Value,” (EHLV) which represents a person’s economic value, measured through their earning ability or by their assets. This is the method that insurance companies use to determine the maximum amount of insurance a person can qualify for.

Depending on one’s age the typical EHLV is 20 times a person’s Gross Income. It ranges from 10 to 30 times Gross Income. When the insured is retired, another way to determine EHLV is a measure of gross assets, including debt such as mortgages.

We prefer EHLV because it replaces the amount of income the insured would have earned if he or she were to live to expected retirement, or the worth of their assets. Since life insurance is the most effective way of passing assets to the next generation and/or funding foundations and charities, plus an efficient financial vehicle for minimizing taxes, wouldn’t you want the maximum amount?

5. **Convertible term is a fantastic option if you WANT life insurance, but don’t want higher premium payments right now.**

Convertible term policies are competitively priced. Premiums are only slightly higher than regular “non-convertible” term policies for healthy individuals while securing a potential permanent death benefit.

There is even a cost savings when you convert. An amount equal to one year of convertible term premium payments is typically credited towards your new whole life premiums.

Too often, people delay obtaining life insurance until it is too late. There are many reasons for this procrastination, but if you are delaying because the type of policy you want isn't quite within **your budget, convertible term may be your solution.**

Solving the False Dichotomy

Like "steak or lobster?" the question of "whole life or term insurance?" is almost exclusively presented as a false dichotomy. A false dichotomy sets up two apparently opposite choices, and tells us we have to pick one because there's no way for the two to coexist.

The implication is that you can (or should) buy one or the other, but not both, and there are no other options. The question polarizes the beneficial effects of a life insurance policy into a false dichotomy of "*now or later*?"

Do you save money now (lower premiums for term) or later (by securing level premiums with whole life)?

Should you get the maximum death benefit you can afford now (term) or secure a permanent death benefit that will provide a guaranteed[5] benefit later (whole life)?

Of course, you *can* purchase *both* term and whole life insurance. This can be an excellent option, and one that we often recommend. However, convertible term is the third option that does not make you choose.

It's Easier Than You Might Think!

You need to be relatively healthy to qualify, but the exam is remarkably hassle free (a doctor will come to your home or office to weigh, measure and do a blood draw).

Don't delay as you never know when you will no longer qualify for inexpensive term life insurance at preferred rates.

[1]Dividends are not guaranteed. They are declared annually by Guardian's Board of Directors.
[2]Guardian, its subsidiaries, agents, and employees do not provide tax, legal, or accounting advice. Consult your tax, legal, or accounting professional regarding your individual situation.
[3]Policy benefits are reduced by any outstanding loan or loan interest and/or withdrawals. Dividends, if any, are affected by policy loans and loan interest. Withdrawals above the cost basis may result in taxable ordinary income. If the policy lapses, or is surrendered, any outstanding loans considered gain in the policy may be subject to ordinary income taxes. If the policy is a Modified Endowment Contract (MEC), loans are treated like withdrawals, but as gain first, subject to ordinary income taxes. If the policy owner is under 59 ½, any taxable withdrawal may also be subject to a 10% federal tax penalty.
[4]Riders may incur an additional cost or premium. Riders benefits may not be available in all states.
[5]All whole life insurance policy guarantees are subject to the payment of all required premiums and the claims paying ability of the issuing insurance company. Policy loans and withdrawals affect the guarantees by reducing the policy's death benefit and cash values.

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