Term life insurance offers 'return' feature

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Q. My insurance agent wants me to buy a term insurance policy that has a "return of premium" feature. That makes it a lot more expensive. Is it worth it?

A. First, let me explain what this feature is. Then you can decide if getting all your money back in 30 years — assuming you live that long and keep the policy in force — is worth it.

Remember, term insurance is a policy that you purchase for a specific period of time, typically 10, 20 or 30 years. It costs less because it builds no internal cash value. All the premiums you pay go to pay for the actual life insurance. Almost all term policies are sold with a "level" premium — a promise that the premium can never rise during the specified term. That gives you a regular, predictable annual payment.

Most people who buy term insurance have a specific time frame in mind for which they need the insurance coverage — i.e., until the mortgage is paid off, or until the children graduate from college.

And, of course, people buy term insurance because it is far less expensive than "whole life" policies, or the variation known as "universal life" policies — which have various ways of using a portion of your premium to build up cash inside the policy.

The insurance industry knows that a large percentage of term policies are dropped — lapsed — before the end of the term, as needs change. In fact, in pricing term-insurance policies, the insurance actuaries actually count on many people dropping coverage, leaving the insurer with all those paid premiums and no coverage obligation.

That's where Return of Premium comes in. It's typically offered on 30-year term policies. It says that if you keep paying on your policy for the full term, and if you don't die during that term, the insurance company will refund all the premiums you paid in.

In effect, the insurance company is getting the "use" of your money for 30 years and then returning it to you. Of course, no one knows what the buying power of all those premiums will be in 30 years. But it will still be a nice chunk of change.

How can insurers afford to do this? They charge a higher premium for this feature. Today, for $500,000 in coverage, a healthy 40-year-old man would pay only $620 a year for 30-year level term. But the premium for the same policy with the return of premium feature, would be $1,285 annually.

Still with the premium returned, at the end of 30 years, you'd get your $38,550 back. With the traditional term, your premiums would be down the drain — assuming you don't die first.

Byron Udell of Accuquote, a popular insurance website, says that, at least in this example, the total cost of the policy is about $3.50 per day — and it works sort of like saving pennies in a piggy bank (where you don't get any interest). If you die within 30 years, the insurance company gets the money in the piggy bank — and your heirs get $500,000. But if you live, at the end of 30 years, assuming the policy is in force, you get your money back!

If you're making your decision on the mathematics of it all, Udell says if you invested the difference between the two premiums, you'd need to earn about 4 percent, after tax, to beat this deal. And that's not easy these days.

There is a catch, of course. If you stop paying on the policy during the 30 years, you get only a small fraction of your money back, depending on how long you paid in.

So if you need life insurance coverage, and will keep making premium payments for 30 years, you can shop for policies that offer return of premium at Accuquote.com or call them at 888-314-4455 . If you can afford the higher premiums, why not plan on the most likely scenario: that you'll live to get your money back in 30 years.