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American PRIVATE WEALTH®

Return of Premium Term Insurance: Reward for Living

Return of premium term insurance appeals to the idea that you won't die during the period coverage is in effect. Live to the end of the term, and all of your premiums are returned to you.

You've come to the conclusion that you need life insurance for your young family who depends on you for financial support. So with the help of your insurance professional, you consider various types of life insurance, from permanent cash value insurance to temporary or term insurance. You like the potential of cash value accumulation provided by permanent insurance, but you don't like the higher premiums. You decide term insurance better suits your finances, but you ask "What if I don't die during the term of coverage? Do I get any of my money back?" You may, if you consider buying a special kind of term insurance called return of premium term insurance, or ROP.

ROP in a nutshell

In general, straight term insurance provides life insurance coverage for a specific number of years, called the term. The face amount of the policy, or death benefit, is paid to your beneficiaries if you die during the term. If you live longer than the term, or if you cancel your policy during the term, nothing is paid. Alternatively, ROP returns all of your premiums at the end of the term of insurance coverage, as long as you haven't died or cancelled the insurance. Some issuers even pay back a prorated portion of your premium if you cancel the ROP term insurance before the end of the term. Also, the premium returned generally is not considered ordinary income, so you won't have to pay income taxes on the money you receive from the insurance company (please consult your tax advisor).

Unlike permanent cash value life insurance, ROP premiums generally do not earn interest or appreciate in value. Also, the premium returned usually does not include the return of added premium charges for substandard coverage (extra premium charged for poor health) or costs for certain policy riders (extra premium you pay for benefits added to the basic term policy, such as a disability rider).

ROP compared to straight term

ROP term insurance appeals to the idea that you won't die during the time coverage is in effect. Live to the end of the term, and all of your premiums are returned to you. However, there are some differences between ROP term and straight term. The cost of ROP can be significantly greater than straight term insurance, depending on the issuer, age of the insured, the amount of coverage (death benefit) and the length of the term. But ROP almost always costs less than permanent life insurance with the same death benefit. While straight term insurance can be purchased for terms as short as 1 year, most ROP insurance is sold for terms of 10 years or longer.

Can you get a better return on your money?

Some financial professionals recommend that the best way to provide for your life insurance needs is to "buy term and invest the difference." This suggestion is based on the premise that you know how long you will need life insurance protection (until your mortgage is paid off, for example), and that you'll be able to get a better return on your savings from other investments. The same rationale may apply to ROP term insurance. Since your premiums do not earn interest while with the issuer, they likely will not keep up with inflation. So, you may want to consider paying the lower premiums for straight term insurance and investing the difference to potentially accumulate more savings.

However, term life insurance is not sold as an investment, but is intended to insure against financial hardships that may occur due to your death. Viewed in this light, whether to buy ROP term (and pay a higher premium) may depend on whether you can afford the extra premium cost, and whether you want to provide for the chance that you outlive the term of insurance coverage.

Calculating the rate of return of ROP allows you to compare it to the rates of return of other investments.

The return of premium, as well as any other guarantees related to life insurance, are based on the claims-paying ability of the issuer.

For illustration purposes, assume a 30-year-old male in good health can purchase a $1,000,000 20-year term policy at an annual cost of $420 for straight term and $1,210 for ROP term. If we assume that the difference in cost ($790) is available for investment, and the payout ($24,200) is the amount received at the end of the ROP term ($1,210 x 20 years), the approximate rate of return of this ROP policy is about 3.9%. Incorporating these hypothetical facts, the following table illustrates the rate of return of ROP, the annual rate of return needed for a taxable investment to match the rate of return of the ROP (Strategy 1), and the 20-year return of savings at different interest rates (Strategy 2 and Strategy 3).

	ROP	Strategy 1*	Strategy 2*	Strategy 3*
Amount invested	$790	$790	$790	$790
Annual return	3.9%	5.42%	5%**	6%**
Return in 20 years	$24,200	$24,200	$23,068	$24,950

*Assumes 28% federal and state income tax rate.
**These rates of return are hypothetical and are not intended to depict a particular investment.

Is ROP term the right choice?

Before you buy life insurance, you should know how much insurance you need. Your need for insurance is based on numerous factors, some of which include your current age and income, your marital status, the number of incomes in your household, the number of dependents, your long-term financial goals, the amount of your outstanding debt, your existing life insurance, and your other assets. You should also consider your overall financial, estate, and tax-planning goals as part of your insurance needs evaluation.

Term insurance is appropriate for situations when there is a high need for insurance but not much cash flow to pay for it. For example, a young family with limited cash resources may have a great need for survivor income to provide for living expenses and education needs. Term insurance is especially helpful here, allowing the family to buy insurance protection with minimal cash outlay. Also, term insurance is well suited to cover needs for a limited period of time, such as coverage during your working years, your children's college years, or for the duration of a loan or mortgage.

Whether to consider ROP term insurance usually revolves around a few issues. Does the added cost of ROP fit into your budget? It's great to know you can get your money back if you outlive the term of your life insurance coverage, but there is a cost for that benefit. Also, if you die during the term of insurance coverage, your beneficiaries will receive the same death benefit from the ROP policy as they will from the less expensive straight term.

When choosing between these two alternatives, you may want to think about the amount of coverage you need, the amount of money you can afford to spend, and the length of time you need the coverage to continue. Your insurance professional can help you by providing information on straight term and ROP term life insurance available, including their respective premium costs.