

Smart Money: Marketing slogans are catchy, but...

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Brad Brain: "People will underestimate how much insurance coverage they need. Some people tend to think that cancer and heart attacks only happen to other people. Often people will buy just a token amount of coverage, rather than full protection, because they really don't think they will need the policy." | Getty Images



I am a big life insurance guy, but I am not a fan of the phrase "buy term and invest the difference." Here's why.

Generally speaking, permanent life insurance is designed to last for your lifetime. Often your premiums do not increase. These policies can also have cash value.

Term life insurance is designed to last for a temporary period. Generally speaking, the premiums go up over time, like the steps in a staircase. Initially the premium for a term insurance policy will be less expensive than a permanent life insurance policy of the same size, but over time term insurance can become more expensive than permanent insurance.

Here is what is meant by “buy term and invest the difference.” Let’s say a permanent life insurance policy costs \$200 a month, and the premiums never increase. A term insurance policy only costs \$40 a month now, but the premiums go up every 10 years. The theory is that if you buy the term policy now, and invest the \$160 monthly cost differential, you will be better off than if you purchased the permanent insurance.

That sounds great, but in the real world there are some important disconnections.

People will underestimate how much insurance coverage they need. Some people tend to think that cancer and heart attacks only happen to other people. Often people will buy just a token amount of coverage, rather than full protection, because they really don’t think they will need the policy.

I have even had multiple experiences with scenarios such as someone who has an active disability claim for a heart condition wanting to reduce their life insurance coverage. That’s the ultimate in denial; when the life-threatening condition has already manifested and you still want to reduce your life insurance.

People will underestimate how long they will need coverage for. They will buy term coverage thinking that they will only need the insurance for 10 or 20 years. But at the end of the 10 or 20 years they discover that they still need protection, and their term insurance is renewing at higher, perhaps significantly higher, premiums. In my experience I will say about 65% of the time the people that thought they would be done at the end of their term still need coverage.

People can be overconfident on the results that they expect from their investments. There are two parts to this. The first is whether people actually carry through on their intentions to invest the money over time, rather than finding some other use for it. The second is having realistic expectations on their investment returns. How much do you think investing \$160 a month for 10 years will grow to anyway?

Here is the least appreciated aspect of this. Your needs will change over time. Initially people buy term insurance because they have mortgages and young families, and they need to have an income replacement plan at an affordable cost. But mortgages get paid off, and kids grow up. That doesn’t mean that financially successful people don’t have obligations through.

The price of success is taxes. Successful people don’t buy permanent insurance to pay off their mortgage, they buy it to pay their final tax bill. If you are like me, you want all those things that you worked so hard for to go to your beneficiaries, not to pay your taxes. Permanent life insurance is often

the most efficient, most cost-effective tool available for estate planning. And, when you eventually do buy permanent life insurance, the younger you are, the more affordable it is.

Nothing in this column will tell you which option is right for you. To do that, see a professional insurance agent. If you need term, buy term. If you need permanent, buy permanent.

But don't cheap out on your coverage, and don't underestimate the amount and the duration that you will need coverage for. Sometimes people think life insurance premiums are expensive, but they are wrong. What is expensive is to leave your family with inadequate coverage.

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