What Is Term Life Insurance?

Term life insurance, also known as pure life insurance, is a type of life insurance that guarantees payment of a stated death benefit if the covered person dies during a specified term. Once the term expires, the policyholder can either renew it for another term, convert the policy to permanent coverage, or allow the term life insurance policy to terminate.[1]

KEY TAKEAWAYS

- Term life insurance guarantees payment of a stated death benefit to the insured's beneficiaries if the insured person dies during a specified term.
- These policies have no value other than the guaranteed death benefit and feature no savings component as found in a whole life insurance product.
- Term life premiums are based on a person’s age, health, and life expectancy.
- Check our recommendations for the best term life insurance policies when you are ready to buy.

How Term Life Insurance Works

When you buy a term life insurance policy, the insurance company determines the premiums based on the value of the policy (the payout amount) as well as your age, gender, and health. In some cases, a medical exam may be required. The insurance company may also inquire about your driving record, current medications, smoking status, occupation, hobbies, and family history.

If you die during the term of the policy, the insurer will pay the face value of the policy to your beneficiaries. This cash benefit—which is, in most cases, not taxable—may be used by beneficiaries to settle your healthcare and funeral costs, consumer debt, or mortgage debt among other things. However, if the policy expires before your death, there is no payout. You may be able to renew a term policy at its expiration, but the premiums will be recalculated for your age at the time of renewal. Term life policies have no value other than the guaranteed death benefit. There is no savings component as found in a whole life insurance product.

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Term Life Insurance Explained

Because it offers a benefit for a restricted time and provides only a death benefit, term life is usually the least costly life insurance available. A healthy 35-year-old non-smoker can typically obtain a 20-year level-premium policy with a $250,000 face value for $20 to $30 per month. Purchasing a whole life equivalent would have significantly higher premiums, possibly $200 to $300 per month. Because most term life insurance policies expire before paying a death benefit, the overall risk to the insurer is lower than that of a permanent life policy. The reduced risk allows insurers to pass cost savings to the customers in the form of lowering premiums.

When you consider the amount of coverage you can get for your premium dollars, term life insurance tends to be the least expensive option for life insurance.

Interest rates, the financials of the insurance company, and state regulations can also affect premiums. In general, companies often offer better rates at "breakpoint" coverage levels of $100,000, $250,000, $500,000, and $1,000,000.

Example of Term Life Insurance
Thirty-year-old George wants to protect his family in the unlikely event of his early death. He buys a $500,000 10-year term life insurance policy with a premium of $50 per month. If George dies within the 10-year term, the policy will pay George's beneficiary $500,000. If he dies after he turns 40, when the policy has expired, his beneficiary will receive no benefit. If he renews the policy, the premiums will be higher than with his initial policy because they will be based on his age of 40 instead of 30.

If George is diagnosed with a terminal illness during the first policy term, he likely will not be eligible to renew once that policy expires. Some policies do offer guaranteed re-insurability (without proof of insurability), but such features, when available, tend to make the policy cost more.

Types of Term Life Insurance
There are several different types of term life insurance; the best option will depend on your individual circumstances.[2]

1. Level term, or level-premium, policies
These provide coverage for a specified period ranging from 10 to 30 years. Both the death benefit and premium are fixed. Because actuaries must account for the increasing costs of insurance over the life of the policy's effectiveness, the premium is comparatively higher than yearly renewable term life insurance.

2. Yearly renewable term (YRT) Policies
Yearly renewable term (YRT) policies have no specified term, but can be renewed each year without providing evidence of insurability. The premiums change from year to year; as the insured person ages, the premiums increase. Although there is no specified term, premiums can become prohibitively expensive as individuals age, making the policy an unattractive choice for many.

3. Decreasing term policies
These policies have a death benefit that declines each year, according to a predetermined schedule. The policyholder pays a fixed, level premium for the duration of the policy. Decreasing term policies are often used in concert with a mortgage to match the coverage with the declining principal of the home loan.

Once you've picked the policy that's right for you, remember to research the firms you're considering thoroughly to ensure you'll get the best term life insurance available.

Benefits of Term Life Insurance
Term life insurance is attractive to young people with children. Parents may obtain large amounts of coverage for reasonably low costs. Upon the death of a parent, the significant benefit can replace lost income.

These policies are also well-suited for people who temporarily need specific amounts of life insurance. For example, the policyholder may calculate that by the time the policy expires, their survivors will no longer need extra financial protection or will have accumulated enough liquid assets to self-insure.

Term Life Insurance vs. Permanent Insurance
The main differences between a term life insurance policy and a permanent insurance policy, such as universal life insurance, are the duration of the policy, the accumulation of a cash value, and the cost.[3] The right choice for you will depend on your needs; here are some things to consider.

Cost of premiums
Term life policies are ideal for people who want substantial coverage at low costs. Whole life customers pay more in premiums for less coverage but have the security of knowing they are protected for life.

While many buyers favor the affordability of term life, paying premiums for an extended period and having no benefit after the term's expiration is an unattractive feature. Upon renewal, term life insurance premiums increase with age and may become cost-prohibitive over time. In fact, renewal term life premiums may be more expensive than permanent life insurance premiums would have been at the issue of the original term life policy.

Availability of coverage
Unless a term policy has guaranteed renewable policy, the company could refuse to renew coverage at the end of a policy's term if the policyholder developed a serious illness. Permanent insurance provides coverage for life, as long as premiums are paid.

Investment value