The Value of Locking in Insurability

Buying affordable term insurance today can lock in the ability to access permanent insurance tomorrow—even if your health status changes.

The COVID-19 pandemic exposed just how much uncertainty we face every day. In addition to claiming the lives of more than four million people worldwide, including over 600,000 in the United States[1], the pandemic disrupted the global economy, forcing us to suddenly worry not only about our health but also our job security, household finances, access to medical care, access to food and household supplies, and even when and where we could travel to visit with family and friends. It was a harsh and often cruel reminder to expect the unexpected.

One consequence of all this disruption is that Americans are increasingly looking to life insurance to safeguard their families against many of the financial risks they face. Thirty-one percent of consumers now say they are more likely to buy life insurance as a direct result of the pandemic.[2] They are thinking more about their legacy, what will happen to their loved ones in the event they pass away unexpectedly, and the important role life insurance can play in securing their family's financial security. The need for this security is widespread: four in 10 Americans say they would face financial hardship in as little as six months if their household wage earner died unexpectedly.[3] Ultimately, life insurance injects an element of certainty into uncertain lives. It delivers peace of mind knowing that the financial needs of loved ones will be taken care of in the event of our untimely death.

Four in 10 Americans say they would face financial hardship in as little as six months if their household wage earner died unexpectedly.

1 Worldometer; https://www.worldometers.info/coronavirus

2 LIMRA/Life Happens, "2021 Insurance Barometer Study," 2021.

3 Ibid.

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Of the two main types of life insurance—term and permanent—term insurance can be particularly attractive to many buyers because of its affordability. Generally less expensive than a permanent policy, a term policy expires after a fixed period of years but can provide a valuable death benefit when protection needs are expected to be high for a period of time, such as when your family is growing or other financial responsibilities are outpacing income. This can be immensely helpful for those who are trying to stretch their dollars at the very time an unexpected death could leave their families struggling financially to replace their income for years, if not decades. With the help of term insurance, families can afford to make sure they will be able to maintain their lifestyle and reach their dreams and goals even if the family breadwinner dies unexpectedly.

Term insurance also can be a key building block in a well-structured financial plan. While there's never a bad time to start planning, many people struggle with where to start. Term life insurance can be an important first step because the security it provides begins immediately. It can lock in the buyer's insurability—the ability to qualify for insurance—at the same time it locks in affordable death benefit protection for a set period of time.

Buying term insurance is also easier today than it was in the past for those "digital native" consumers who prefer to manage their finances online. Many companies, such as Prudential, have expanded their suite of online tools and resources to offer an accelerated application process, faster underwriting, and more efficient application processing.

Let's take a closer look at why locking in future insurability with a term life insurance policy can be so valuable.

Protection Through Health Changes

Age and health status are the most significant drivers of cost for a life insurance policy, and the biggest determinants of insurability. As people age, they are more likely to develop health problems that could make life insurance more expensive or even disqualify them from buying it. Accordingly, financial planners often recommend that people buy insurance when they are young and most likely to be in good health, allowing them both to secure coverage and take advantage of lower premium payments. Term life insurance is generally less expensive than permanent largely because it stays in effect only for a specified length of time, or term, and has no cash value. Among Americans who already own an individual life policy, 39% wish they had purchased it at a younger age.[4]

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Importantly, many term life policies have a conversion feature, which means the policyholder can convert their term policy to a permanent policy before the term expires without going through another medical exam—even if their health declines while the policy is in force. This ability to lock in coverage, or insurability, is extremely valuable given the many health changes someone might experience over the many years—perhaps as much as three decades—that a term policy can last. Although it is still unknown how insurers will underwrite those who survived COVID-19, locking in insurability at a young age could prove valuable for them given the uncertainty around the virus's long-term impact and the medical care that may be available to them.

Converting to a permanent policy may be beneficial for some with long-term life insurance protection needs because the coverage stays in effect for the insured person's entire life, as long as the premiums are paid. Permanent insurance also has the ability to build cash value, which can be accessed over time, and can be a valuable tool for estate planning.[5]

4 LIMRA/Life Happens, "2021 Insurance Barometer Study," 2021.

5 Outstanding loans and withdrawals will reduce policy cash values and the death benefit and may have tax consequences.

Protection Through Job Changes

Some people believe they don't need to buy an individual life insurance policy because they have group coverage through their employer. Unfortunately, this type of coverage typically provides a death benefit equal to only one or two times salary, which for many people would not be enough to support their loved ones after an unexpected death. A general rule of thumb suggests carrying enough life insurance to provide a death benefit equal to 10 to 12 times annual income.[6]

Although group life is a valuable benefit—it's often offered with some coverage paid by an employer—it can have some limitations, too. For starters, it generally disappears if the employee loses their job or goes to work somewhere else. A 2019 Bureau of Labor Statistics survey of America's baby boomers found that they hold an average of 12 jobs over the course of their lifetime.[7] Also, while group coverage often includes an option to allow conversion to an individual policy, it generally converts to a more expensive, standard rate policy that may not be affordable for many people.

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Given these caveats, buying term insurance to supplement group life coverage available at work makes sense for many people, allowing them to have higher levels of coverage with less vulnerability to job market disruptions, including any that accompany recessions.

Protection Against Debt and Final Expenses

Over the last few decades, Americans have become more comfortable carrying higher levels of debt. U.S. consumer debt, including mortgage and non-mortgage debt, now stands at approximately $14.35 trillion.[8] It equaled 76% of the nation's gross domestic product at the start of 2020,[9] up from 23.8% in 1952.[10] Mortgage debt hit an all-time high in late 2019 and by the first quarter of 2020 stood at $9.71 trillion, approximately double what it was in 2003.[11] Student loan debt, which now stands at $1.5 trillion,[12] is twice what it was a decade ago and five times more than it was in 2003.[13] Increasing comfort with different types of borrowing has carried over to credit cards, with outstanding U.S. credit card debt hitting an all-time high of $930 billion as of the end of 2019.[14]

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6 Prudential, "Do You Have Enough Life Insurance?" https://www.prudential.com/financial-education/enough-life-insurance (accessed June 16, 2021).

7 U.S. Bureau of Labor Statistics, "Number of Jobs, Labor Market Experience, and Earnings Growth: Results from a National Longitudinal Survey," August 22, 2019.

8 Federal Reserve Bank of New York, "Quarterly Report on Household Debt and Credit: 2020 Q3," November 2020.

9 Federal Reserve Bank of St. Louis, "Household Debt to GDP for United States," https://fred.stlouisfed.org/series/HDTGPDUSQ163N

10 Trading Economics, "Unites States Household Debt to GDP: 1952-2020 Data," https://tradingeconomics.com/united-states/households-debt-to-gdp

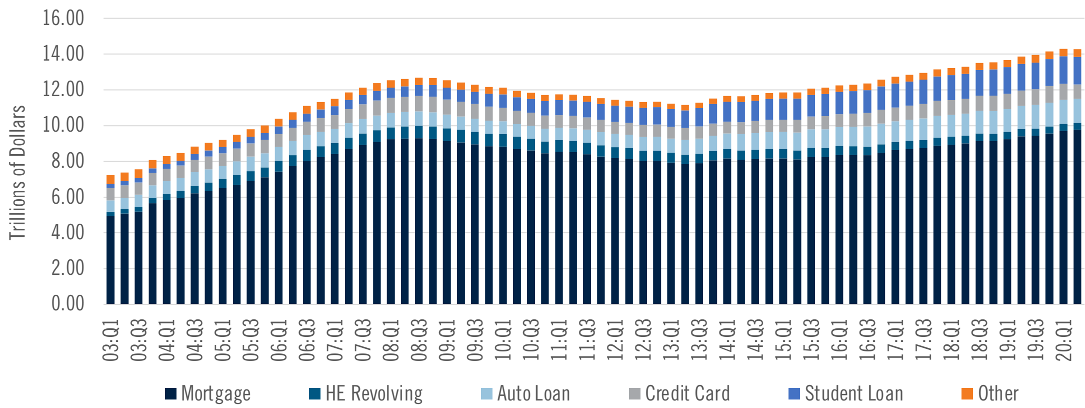
11 New York Fed Consumer Credit Panel/Equifax. Mortgage debt is tabulated on a quarterly basis.

12 American Association of University Women, "Deeper in Debt: Women and Student Loans in a Time of COVID," 2020.

13 Federal Reserve Bank of New York, "New York Fed Consumer Credit Panel/Equifax," 2020.

14 New York Fed Consumer Credit Panel/Equifax.

Total Debt Balance and Its Composition*



Source: New York Fed Consumer Credit Panel/Equifax
*Balance is tabulated on a quarterly basis.

Life insurance can be used after an insured's death to pay off outstanding debts, including mortgages, student loans, car loans, credit cards, and personal loans. Outstanding balances on federal student loans are likely to be discharged upon a borrower's death, but the disposition of private student loans varies by lender. If the lender does not discharge the loan, the balance is passed to the borrower's estate. If there is a co-signer on the private loan, the co-signer will be responsible for repaying the student loan. Here again, carrying adequate levels of life insurance can provide the peace of mind that comes with knowing that loved ones will be able to pay off the mortgage and other debts, remain in their home, maintain their lifestyle, and continue a child's education plan.

Term insurance can be useful in other applications as well, including covering final expenses. Forty-three percent of millennials say they are very concerned about leaving their dependents in a difficult financial situation or burdening others with burial/funeral expenses if they should die.[15] Term life insurance also can make sense for anybody who needs financial protection for a specific period of time—to cover a mortgage, for example, or pay for a child's education.

Conclusion

The COVID-19 pandemic was a wake-up call for many families, revealing just how much uncertainty there is in nearly every aspect of our daily lives. For many Americans, the importance of life insurance has never been more clear.

Term insurance in particular can provide an affordable way to lock in future insurability. It also can serve as a valuable first step in creating a holistic financial plan that includes protection for loved ones in the event of an untimely death.

[15] LIMRA/Life Happens, "2021 Insurance Barometer Study," 2021.

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