

# The Strategic Value of Term Conversion

Term life insurance conversion offers a significant opportunity to enhance value to clients while strengthening advisory relationships. By transitioning a term life insurance policy into a permanent one, clients gain access to lifelong coverage and additional planning benefits without the need for new medical underwriting.

## Technical Overview of Term Conversion

### *Definition and Mechanics of Conversion*

Term conversion allows policyholders to convert a term life insurance policy into a permanent policy, such as Indexed Universal Life (IUL), Variable Universal Life (VUL), Whole Life, Universal Life, or Guaranteed Universal Life (GUL), without undergoing a new medical exam. This allows clients to retain their original underwriting classification, which is particularly valuable if their health has changed since the term policy was issued.

### *Policy Structures and Rider Options*

Permanent policies offer diverse options to meet a range of client needs:

- **Indexed Universal Life (IUL):** A flexible policy with cash value

accumulation tied to index performance. Offers a guaranteed minimum return and conservative premium structure.

- **Variable Universal Life (VUL):** A policy offering market-linked cash value growth with index account options for investment flexibility. Ideal for clients seeking higher potential returns with greater risk tolerance.
- **Whole Life:** Provides guaranteed cash value growth and level premiums, making it a highly predictable option for clients seeking stability.
- **Universal Life:** A flexible permanent life insurance option that allows policyholders to adjust premium payments and death benefits over time. UL policies

accumulate cash value based on a fixed interest rate set by the insurer, making them suitable for clients who want long-term coverage with some level of flexibility in funding and benefits.

- **Guaranteed Universal Life (GUL):** Focuses on providing a lifetime death benefit with minimal cash value accumulation, appealing to clients prioritizing legacy planning over investment growth.
- **Long-Term Care Riders:** Available on many permanent policies, these riders provide access to a portion of the death benefit to cover long-term care expenses, offering an additional layer of planning flexibility.

### *Long-Term Care Rider Underwriting Considerations*

Whether new underwriting is required to add a Long-Term Care (LTC) rider when converting a term policy to a permanent policy depends on the insurer's guidelines and the specific rider structure.

When converting a term policy to a permanent policy, the base life insurance coverage typically retains the original underwriting classification with no new medical exams required. However, adding an LTC rider is often treated as an additional benefit that may require separate underwriting.

Some insurers allow LTC riders to be added without new underwriting if the rider is included as part of an eligible conversion option. Others require full medical underwriting to assess insurability for the

LTC benefit, as long-term care risk factors (such as cognitive and mobility issues) differ from standard life insurance underwriting. Certain policies may offer a simplified underwriting process for LTC riders at conversion, which could involve a medical questionnaire rather than a full medical exam.

If adding an LTC rider requires new underwriting, some clients may choose a separate hybrid LTC policy (such as an asset-based life and LTC policy) to complement their life insurance needs without affecting their term conversion eligibility.

### *Key Actuarial Considerations*

**Premium Structure:** Permanent policies require higher premiums, reflecting their additional features and longevity. Funding schedules should be tailored to each client's unique financial picture.

**Cash Value Accumulation:** The ability to accumulate tax-deferred cash value over time adds significant financial planning potential. Policies such as IUL and Whole Life offer guaranteed minimum growth, while VUL provides higher growth potential with greater market exposure.

**Duration and Funding:** Shorter premium funding periods can help reduce market risk exposure, while longer schedules allow for manageable cash flow alignment. Selecting the right funding strategy is crucial for ensuring long-term policy sustainability.

## Case Study: Driving Client Value

### *Background*

The client, an affluent individual, held a \$5 million term life insurance policy. Due to a recent health change, they no longer qualified as a preferred risk with new underwriting. After an in-depth review of available term conversion options, it became clear that transitioning to permanent coverage would address both immediate and long-term financial concerns.

The objective was twofold:

- Provide lifetime coverage to meet estate planning goals and provide liquidity for potential estate tax obligations.
- Help increase the value of the life insurance policy as a tax-deferred investment vehicle.

### *The Challenge*

While the client valued the flexibility of term policies, the need for more robust long-term strategies became evident. Additionally, the cost-effectiveness of the available permanent products varied significantly depending on the insurer and policy type. The client needed guidance on:

- Selecting between Indexed Universal Life (IUL) and Variable Universal Life (VUL) policies.
- Balancing premium commitments with desired policy features and potential cash value accumulation.

### *The Solution*

After evaluating policy options from multiple carriers, two primary options were recommended:

#### Death Benefit Focus:

- **Policy Type:** VUL with a level death benefit designed to last for the client's lifetime.
- **Premium Structure:** \$56,276 annually for 10 years, assuming a 7% gross return (or up to 21 years at 5%).
- **Opportunities:** This structure provides estate tax liquidity while helping to preserve family assets. Funding the policy for a level death benefit helps ensure the policy's longevity and predictability.

#### Investment Focus:

- **Policy Type:** VUL structured as a tax-deferred investment vehicle.
- **Premium Structure:** Maximum funding over seven years while maintaining the policy's tax treatment.
- **Comparison:** When matched against a hypothetical taxable mutual fund option, the VUL policy provided significantly greater after-tax distributions. Additionally, the policy offered flexible access to cash value for retirement or other needs, making it a dual-purpose financial tool.

### *Key Takeaways*

This case demonstrates how term conversion can be tailored to meet specific

financial goals, whether for estate planning or investment purposes. By leveraging proprietary policy options and specialized guidance, the client was provided options to align their life insurance coverage with both immediate needs and long-term objectives.

## Client Suitability Analysis

Determining whether term conversion aligns with a client's needs requires a nuanced understanding of their financial objectives, personal circumstances, and long-term planning goals. By carefully analyzing suitability, we can identify clients who are a potential fit for permanent coverage while recognizing scenarios where alternative solutions may be more appropriate.

### *Ideal Candidates*

**Clients with Term Policies Nearing Expiration:** These clients are at a decision point where the continuation of coverage becomes a priority. Converting to a permanent policy provides uninterrupted coverage while leveraging the features of permanent policies.

**Spouses with Convertible Term Policies from the Same Insurer:** For married couples with individual term policies from the same company, converting to a survivorship policy is a strategic option. Some insurers even allow for adding the totals of the term policies - for example, a couple with two individual \$1 million term policies may convert to a \$2 million permanent survivorship policy.

**High-Net-Worth Individuals:** Clients with significant assets often require permanent life insurance to address estate tax liabilities, provide liquidity for asset preservation, or support legacy planning. Trust-owned policies are particularly well suited for these clients.

**Clients with Health Concerns:** Those whose health has declined since their term policy was issued can preserve their original underwriting classification through conversion, avoiding the need for new medical exams.

**Individuals Seeking Financial Planning Flexibility:** Clients looking for tax-deferred growth, cash value accumulation, or policies that can provide supplemental retirement income may find permanent policies attractive.

### *Potential Limitations*

**Premium Outlay:** Clients who are averse to higher premiums associated with permanent policies may be better served by maintaining term coverage or exploring alternative options.

**No Long-Term Insurance Needs:** If a client's financial situation or estate planning objectives do not require lifelong coverage, conversion might not align with their goals.

**Missed Conversion Deadlines:** Policies with expired conversion privileges are ineligible, underscoring the importance of timely action.

### *Additional Considerations*

**Alignment with Financial Objectives:** It is necessary to evaluate how the policy aligns with the client's broader financial

strategy, including retirement income needs, estate liquidity goals, and charitable giving intentions.

**Policy Ownership Structure:** Determining whether the policy should be personally owned or trust-owned is critical for addressing tax implications and meeting estate planning requirements.

**Risk Tolerance and Investment Goals:** Clients with a higher appetite for risk may prefer VUL policies for their growth potential, while those with a more conservative mindset might be better suited for GUL or Whole Life policies.

**Customizing Premium Schedules:** Offering flexible funding options, such as shorter premium payment periods for higher upfront investment or longer schedules for reduced annual cash flow impact, helps ensure the policy fits the client's budget and goals.

## Economic and Tax Considerations

### *Cost-Benefit Analysis*

Converting earlier allows for premiums based on the client's current age and original health classification, helping to reduce long-term costs. While permanent policies require higher premiums, they also provide cash value growth and tax

treatment that offset the initial expense. Whole Life and GUL policies offer premium predictability, while IUL and VUL policies provide growth potential for clients with higher risk tolerance.

### *Tax Implications*

**Tax-Deferred Growth:** Cash value accumulation grows tax-deferred within the policy.

**Estate Planning:** Trust-owned policies can provide liquidity for estate taxes, helping to preserve family assets and potentially reducing the need for asset liquidation.

**Tax-Advantaged Distributions:** VUL policies allow for tax-free withdrawals or loans, enhancing retirement income strategies. Additionally, certain riders can address long-term care needs, offering further coverage solutions.

## Conclusion

Term conversion is a strategic tool that addresses both immediate and long-term client needs. By providing specialized guidance on the mechanics, suitability factors, and economic implications unique to each client, Tenzing Insurance Strategies helps guide clients toward informed decisions that enhance their financial picture and planning outcomes.

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