Why you shouldn’t buy mortgage insurance

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There are many excellent articles about the pros and cons of mortgage insurance vs. term life insurance. But every spring a new crop of first-time buyers begins their search for a perfect new home, so it seems like a subject worth revisiting.

The purpose of mortgage insurance (also known as mortgage life insurance or creditor insurance) is to pay off the mortgage when you die so your spouse and dependents are mortgage-free and have one less major expense to worry about. If both you and your spouse are working and want to protect each other, both of you need to be insured.

The first major advantage of term life insurance is that it is much less expensive than mortgage insurance.

Using a calculator on the Cowan Financial Solutions web site, I got standard non-smoker term life insurance quotes for both a man and a woman aged 36 for $400,000 of life insurance for a term of 25 years. The lowest annual quotes were $604 for the man (Assumption Life) and $440 for the woman (Unity Life), or $1,044 in total for both. Of course, if you plan to pay your mortgage off more quickly, you can request quotes for a shorter term.

I compared this quote to mortgage insurance rates from the Canada Life Assurance Company in a brochure published by Scotiabank. Mortgage insurance premiums are calculated based on your age and the value of your mortgage. There is no discount for non-smokers or women. With a monthly premium of 20 cents per $1,000 for each borrower 36-40 years old, the annual bill for both spouses would be $1,920.

But the cost differential is only the tip of the iceberg. After viewing a YouTube video in which Cowan Financial Solutions advisor Rita Harris explains some of the other reasons why term life insurance is a better deal than mortgage protection offered by the banks, I gave her a call to get some additional details.

Here's what she said:

Protection: When you die, your mortgage insurance is payable directly to the bank. Term life insurance protects more than just your mortgage. Your spouse (or other beneficiary) can use the money as is most appropriate in the circumstances.

Premium Guarantee: The term life insurance premiums and benefits are guaranteed for the life of the policy. Your coverage amount is constant but can be reduced at your request. Premium levels for mortgage insurance can be unilaterally changed by carrier. As your mortgage reduces your coverage goes down but your premiums do not.

Portability: If you take your mortgage to another company, you may lose your existing mortgage insurance and have to re-qualify for new mortgage insurance coverage. In contrast, individual term life insurance is fully portable even if you move your mortgage.

Repayment: You lose all your mortgage insurance coverage when your mortgage is re-paid, assumed or in default. As long as your term life insurance premiums are paid, you can convert your insurance to a permanent plan.

Underwriting: If you buy term life insurance, the insurance company will assess the risk and establish the premiums based on your health at the time the policy is purchased. In the absence of any fraudulent activity, you know your claim will be paid out when needed in accordance with the terms of your contract. Mortgage insurance is subject to post-claim underwriting, which means technically you could be declared uninsurable when you submit a claim.

Moneyville blogger Ellen Roseman's story about the Feldmans is only one example of a case where a bank initially denied coverage after the fact for medical reasons. CBC marketplace also did a brilliant report about two families who bought mortgage insurance coverage and thought they were protected, only to have their claims denied when a homeowner became sick or died.

So caveat emptor!

Mortgage insurance is sold by bank employees who may not be trained to explain the legal intricacies of those insurance products. You could pay premiums and think you are covered, only to realize later you are not.

For a different perspective for buyers who do not have a 20 per cent down payment, see How mortgage insurance can help buy a house by Moneyville blogger Krystal yee.