Do You Really Need Mortgage Insurance?

By Robyn K. Thompson | June 9, 2014 | Last Updated: June 9, 2014 8:47 am

You've bought a new house, and you're sitting with the bank's loans officer ready to sign for that mortgage. Then she casually asks, "Would you like mortgage insurance with that?"—almost like your waiter asking whether you'd like fries or salad with your burger.

But this is one side you should decline, no ifs, ands, or buts. Here's why.

First, what is mortgage insurance? It seems pretty straightforward. It's insurance that pays off your mortgage if something prevents you from doing so. After all, you want your family to be protected against foreclosure should you die or become disabled or suffer from a critical illness.

The horror stories can multiply before your eyes. But your friendly loans officer assures you that the premium only adds up to a few extra bucks a month tacked on to your monthly mortgage payment, so it's hardly noticeable. If you decline, the loans officer might even ask you to sign a waiver, declaring that you've turned down this golden opportunity.

So, why not?

You Might Already Be Covered

First and foremost, you probably don't need it. If you already have life insurance, whether term, universal, or whole life, and it's at least for the amount of your mortgage, you're already covered.

Add a properly designed extended health, long-term disability, and critical care insurance package that many people already get through their employee benefits program, and you're pretty much covered in case illness prevents you from covering mortgage payments.

If you need more, you can increase the size of your term life insurance at very low cost, especially if you're young and in good health.

Poor Value for Money

Next in the reasons for "why not mortgage insurance" is the product itself. It just doesn't give value for money. Mortgage insurance pays only to the amount of the outstanding balance of the mortgage, whatever that balance is.

The maximum insured amount is typically $500,000, which may not be enough anyway. But even if the principal amount of your mortgage is paid down, the premiums on your mortgage insurance won't change. So you're actually paying more and more for less and less as time goes on.

Nothing Extra for Your Family

And the mortgagee gets the funds in the event of your death. If you were hoping for an additional sum to provide living expenses and so on, forget it. The mortgagee is the one and only beneficiary. To provide for your family, you'll need to buy ordinary term life insurance where beneficiaries receive the entire proceeds, no strings attached.

So again, why bother with mortgage insurance to begin with? Just buy additional—and cheaper—term life to cover the mortgage.

There are also other restrictions on mortgage life insurance that make it poor value for the money. Coverage is tied to the lender and the property—it isn't portable. If you sell your home or transfer your mortgage business to another bank, your policy is cancelled and coverage stops. Premiums are not refundable.

The Claim Denial Gambit

There is one last, really big reason for not forking out the big bucks for mortgage insurance: claim denial. Typically, you'll be asked to buy mortgage insurance when you're actually signing the mortgage document.

You're under a lot of pressure, and you've already agreed to borrow a huge sum of money. Okay, you've caved. Another few bucks, another quick application form. You fill out the application, and check off a few boxes on an innocuous-looking medical questionnaire, and you're done.

Actually, you're done like toast.

That's because mortgage insurance is sold without qualifying you. It's a form of underwriting called post-claim underwriting. Your application is filed with the underwriting insurance company (not the bank, unless it's the bank's insurance company, of course) but not reviewed to see if you qualify for coverage until a claim is actually made.

What could possibly go wrong? Plenty, it turns out.

If you did not read the questions on your application thoroughly and answered a yes-no question incorrectly, a future claim could be denied. The trouble is that the medical questions on mortgage-insurance applications are so wide-ranging that it's very easy to inadvertently provide an incorrect answer.

They may include something like this: "Have you ever consulted a medical practitioner, physician, specialist, or attended a hospital or other medical facility, or taken any medications or received treatment for a cardiovascular, respiratory, digestive, or nervous systems complaint?"

Tummy Trouble

The key word is "ever." Well, who hasn't ever gone to the doctor with a tummy ache (digestive), a bad cold or the flu (respiratory), or a migraine (neurological) at least once?

But if you answered "no" on your application, as most people are tempted to do (thinking that the question relates only to recent serious illnesses and heavy-duty prescription drugs), then the insurance company can (and often will) claim that you "lied" on your application and did not disclose pre-existing conditions.

Because you did go. It's right there in your doctor's medical file. Claim denied! Start looking for new accommodations. (But you might get your premiums back.)

And finally, unless you're applying for a high-ratio mortgage or considering an arm's-length mortgage for your RRSP, mortgage insurance is not a requirement for getting a mortgage.

The Better, Cheaper Alternative

Mortgage insurance comes with high costs, tight restrictions, and the dodgy post-claim underwriting. For those reasons, it's poor value for your premium dollar.

Instead, if you wish to protect your family against default on your mortgage, consider a much cheaper term life policy, which is reviewed at application to ensure you qualify, and that you can renew every five years, adjusting the insured amount to match the declining principal balance owing on your mortgage.

Your best bet is to consult a knowledgeable financial planner or licensed insurance agent, who will make sure you get the proper sides of insurance to go with your main course.

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