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Banks sell mortgage insurance, but independent experts say you shouldn’t buy it

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A woman helps a girl ride a bike in front of a house in Brampton, On. on May 20, 2017.
Mark Sommerfeld/Bloomberg via Getty Images

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Personal finance experts are a pretty soft-spoken bunch. It isn't often that they say they would "never ever" advise buying a certain financial product.

But that is exactly what they generally say when asked about mortgage protection insurance, according to Anne Marie Thomas of InsuranceHotline.com, an insurance comparisons site.

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Mortgage protection insurance isn't the mortgage insurance most Canadians are familiar with, the one you need to buy, generally from the Canada Mortgage and Housing Corp. (CMHC), when your down payment is less than 20 per cent of the value of your home.

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Unlike the better-known mortgage insurance, which protects lenders if homeowners default, mortgage protection insurance is, essentially, a type of life insurance. It covers your mortgage debt if you die or become disabled.

Banks generally try to sell homeowners this type of insurance when they sign up for a new mortgage. Insurance premiums are then seamlessly added to their monthly mortgage payments.

So, what's not to like about that?

A lot, according to Thomas:

1. The payout from mortgage protection insurance shrinks with your mortgage

These kinds of policies only cover your outstanding debt, meaning the payout gets smaller and smaller as you pay off your mortgage. Insurance premiums, on the other hand, stay the same through the insurance term.

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2. You may find out when you file a claim that you aren't eligible for coverage

Mortgage insurance policies are "typically underwritten after the fact," noted Thomas. This means that the insurance company will only take a close look at your case once you file a claim. And it may very well find that something in your particular situation violates the insurance contract, which would leave your family without coverage just when they need it most.

If you purchased mortgage protection insurance, comb through your policy carefully to make sure there's nothing that could potentially exclude you for coverage, advised Thomas.

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3. Your might get saddled with higher premiums when you renew your policy

With mortgage protection insurance, you'll need to renew your policy at the end of your mortgage term, said Thomas.

Your new premium will be based on your — now smaller — outstanding mortgage balance, but that doesn't mean you'll be paying less. Because you're a bit older, your premium won't necessarily go down — in fact, it may go up, Thomas told Global News.

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4. Your bank, not your family, pockets the payout

Assuming the claim goes through, mortgage insurance guarantees your family won't have to worry about mortgage payments if you die or become disabled.

In case of death, your beneficiaries can counts on a lump-sum payout that will take care of the outstanding balance, according to Jason Heath of Objective Financial Partners, a fee-only financial planning firm. In case of disability, the policy will generally cover your monthly mortgage payments until the debt is extinguished, he added.

But does it make sense to use the money to pay off the mortgage?

Not necessarily, said Heath. Perhaps your survivors could have easily eliminated mortgage by selling the house. Or they might have preferred to use the money for other purposes, while keeping up with your mortgage payments.

Mortgage protection insurance means any payout will flow out to your mortgage lender, not to you or your family, noted Thomas. And that's much like CHMC insurance.

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Consider plain life insurance instead

Skipping on mortgage protection insurance doesn't mean you have to go without coverage. Instead, you could buy life insurance, both Thomas and Heath said.

With life insurance, your payout remains the same through the term of the policy and the money comes with no strings attached.

For example, if you had a $300,000 mortgage and took out a policy for the same amount, your beneficiaries would still receive $300,000 even if you had paid down your mortgage in full by the time the claim is filed.

And life insurance is generally much cheaper, too, said Thomas.

“It typically could end up costing you half as much,” she said.

WATCH: Here’s how your selfie could one day affect your life insurance

Why does anyone get mortgage protection insurance, then?

Many homebuyers, especially those buying their first home, haven’t done enough research to know what they’re getting into, said Thomas.

“Generally, the way it’s offered to [homebuyers] is when they’re sitting there, signing a whole bunch of [mortgage] paperwork and they’re bored and they’re starting at the wall,” said Heath.

When the bank proposes adding mortgage protection insurance, “for most people, it’s a five-second decision.”

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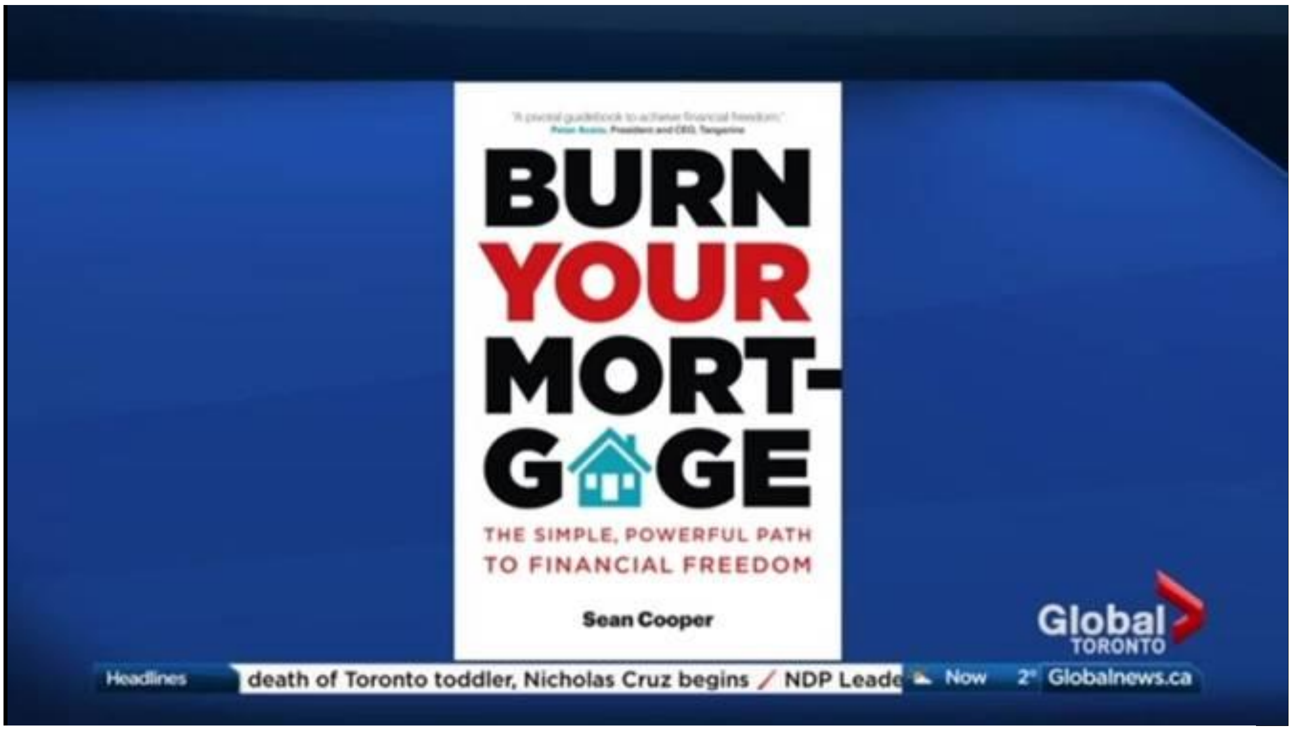

Banking and mortgage industry professionals are often under enormous pressure to sell mortgage insurance, and benefit handsomely through commissions when they do, said Heath.

“Your friendly neighbourhood banker is financially motivated to get you to buy mortgage insurance, whether it’s in your best interest or not,” he added.

That may be why, a few years back, Heath himself discovered in his first-ever mortgage statement that he was, in fact, paying for mortgage protection insurance even if he had clearly declined coverage.

Heath eventually got his lender to cancel the policy and refund the premiums.

But many homebuyers aren’t well-informed enough to know they shouldn’t have signed up for the service in the first place.

“Mortgage [protection] insurance is very expensive, but it’s a captive market,” said Heath.