Star-Telegram.com

Consumers overestimate cost of life insurance

POSTED THURSDAY, AUG. 25, 2011

By Teresa McUsic

If you don't think prices on anything ever fall, you haven't shopped for life insurance for a while.

Rates for term life policies have been dropping for 20 years, largely as a result of Americans living longer, according to Steven Weisbart, spokesman for the Insurance Information Institute.

"The most reduction was between 1990 and 2000, when rates were cut in half," he said. "Since 2000, rates have continued down around 30 percent, although we have reached a plateau in the past year or two."

Few Americans know that rates have dropped that much, however. A survey released last week shows that most consumers think life insurance costs nearly three times the actual price.

Respondents were asked to estimate the annual cost of a 20-year, $250,000 policy for a healthy 30-year-old. The actual annual premium cost is around $150, but those surveyed estimated the cost at $400. Younger adults overestimated the cost by nearly seven times.

The survey was conducted by the Life and Health Insurance Foundation for Education, a nonprofit educational group, and LIMRA, a marketing consulting company based in Windsor, Conn.

"Most people don't understand insurance," said Marvin Feldman, president and CEO of the foundation. "They think if you get a quarter of a million dollars in insurance that that is a huge number, so they assume that it will cost a lot. But premiums are at an all-time low."

The reason for cheaper premiums is tied to life expectancy. Life insurance rates are based on actuarial tables. So as more people live longer, fewer policies pay out and premiums decline, Feldman said.

Consumers also routinely misunderstand what life insurance is supposed to replace, said Burk Rosenthal, president of Rosenthal Retirement Planning in Fort Worth and a licensed insurance agent.

"Many people think life insurance is to pay off debt," he said. "But more than that it's to replace what is lost financially by a death -- your income."

About half of all Americans have some form of life insurance, according to the latest data from LIMRA. Most get life insurance through their workplace, which may not provide enough coverage, Rosenthal said. Only one-third own individual policies, the lowest level in 50 years, according to LIMRA.

"Group rates are great, and there is usually minimal or no underwriting," Rosenthal said. "But your company usually only gives one or two times your income in coverage. Even if you get four years of income replaced, what is your spouse going to do after that?"

Feldman said many companies have pared down life insurance offerings to save money and now replace one year of income.

Rosenthal recommends starting with 10 times your income in coverage. Other factors to consider are your level of debt and the age of your children.

Weisbart agrees with the suggestion of 10 times your income.

"That's loosely the equivalent of 10 years of replaced income," he said.

A common rule is to drop life insurance after the children are out of the house. That makes sense depending how close you are to retirement and benefits such as Social Security and Medicare, Rosenthal said.

"If you have sufficient assets, you may not need it after the kids are gone," he said. "Most of my clients are closer to retirement and need long-term care insurance more than life."

But Weisbart said the age span between a spousal death and Social Security eligibility could be significant if you had children at a young age.

"Social Security survivor benefits are only for people with kids 18 years or younger," he said. "If the kids are gone when someone is 50, the survivor benefit goes away and they may have 12-20 years before they collect Social Security. What are they going to do?"

Other benefits like pensions and health insurance may be tied to the spouse that dies as well, Weisbart said.

According to the survey, nearly a third of all consumers believe they need more life insurance, including 20 percent of current policyholders and about half of those who have no coverage. In addition to perceiving the product as too costly, consumers said they haven't purchased more because they have other financial priorities, such as paying their mortgage or saving for retirement.

Teresa McUsic's column appears Saturdays.

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