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10 Things Life Insurers Won't Tell You

The coverage you can skip, and what's buried in the fine print.

By [JILIAN MINCER](#)



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1. We won't try to find your family.

Even if you paid every premium in full and on time, it may not be enough to ensure a payout will reach your beneficiaries when you're gone. A task force of the National Association of Insurance Commissioners and at least three state insurance departments are currently investigating about a dozen large life insurance companies for failing to pay out more than \$1 billion in death benefits on thousands of small policies. Many of these of these policies were small and bought by working class families in the 1940s and 1950s, says a spokeswoman for the California Department of Insurance, which has been holding hearings on the issue. "They had a right to trust that this benefit would be there when they needed it," she says.

At issue, the state investigators say, is how the insurance companies keep track of who has died if a claim isn't made. Regulators say the companies could use the Social Security Administration's Death Master File, the same file they use to stop annuity payments. But they don't, regulators say, so if the beneficiaries don't file a claim, the money just sits in limbo. Todd Katz, an executive vice president of insurance products for MetLife told California state officials that many of the unclaimed policies were issued decades ago in small-face amounts "before Social Security Numbers became prevalent."

As a result of the investigations, some insurers have settled with some states and agreed to use the Social Security data to find heirs. Meanwhile, policyholders can help make sure insurance companies match their benefits with their beneficiaries by informing heirs about the policies they hold, including the policy number, the issuing agency, and the value. Policyholders can also make sure beneficiaries' most current contact information is on file with the insurance company.

2. All you need is term.

The kinds of coverage offered by life insurers can be dizzying. Term, policies designed to last for 10, 20 or 30 years, is the cheapest and the most basic, but salespeople often tout the benefits of more involved policies. Permanent policies, which include "whole-life" and "universal" coverage, for example, are insurance policies with an investment account built in, and salesman pitch the tax benefits (savings grow tax free) and the option to borrow against the policy if need arises.

But these policies are far more expensive than term, and most people don't need the extra features, says Robert Hunter, director of insurance for the non-profit Consumer Federation of America. The most common reason to buy life insurance is to provide for the people who depend on your income, in the event of your death, and financial advisers say it's most critical for people with young children. By the time the kids are salary-earning adults, they won't need the payout, and hopefully, your assets would be enough to support a surviving spouse. "You need a lot of life insurance for 25 to 40 years," says Hunter, but not much after that which is what term policies are designed for.

And the savings are significant. A healthy 45-year-old non-smoking man could get a 20-year, \$500,000 term life policy for about \$615 a year. In contrast, he'd have to pay \$2,900 to \$3,400 per year for a permanent universal life policy with a guaranteed \$500,000 death benefit, according to data provided by life-insurance comparison site [Accuquote.com](#). Invested over those same two decades, the difference in premiums could yield more than \$130,000 in savings.

3. We're watching a lot more than your waist line.

A medical check-up is typical for life insurance customers and smokers and obviously unhealthy folks can expect to pay extra. But so can pilots, mortgage-defaulters and lousy drivers. Insurance companies are increasingly checking hobbies, credit scores and driving records even, in some cases, web-surfing habits to decide who's a risk and who's not. Racking up traffic tickets is a sign of an unsafe driver, says Bob Barney, president of Compulife Software, which owns [term4sale.com](#), and that's enough to double your premiums. People with less-than-stellar credit are a dodgy financial bet for the companies, because they're more likely to let the policy lapse before the insurance company can recoup the costs of issuing the policy, says Steven Weisbart, chief economist at the Insurance Information Institute, an industry trade group. Frequent fliers may pay more, especially if overseas travel takes policyholders to parts of the world an insurance company deems dangerous, says Andy Hutchison, vice president of product development at Mutual of Omaha. Right now, that includes the Middle East or any war zone. In some cases, even being too fit can hurt: rock climbers may be strong and lithe, but the danger inherent in their sport of choice will quadruple their premiums over what a non-rock climber might pay, Byron Udell, chief executive officer of Accuquote.

There's little consumers can do to avoid these higher premiums. (Lying on a life insurance form could void the policy, in case you were wondering.) But if your behavior changes your credit score improves, you stop travelling, you pack up the carabiners for good you can ask the insurance company to reevaluate the policy. Many will lower your rates.

4. We rarely have to pay up.

In order for a life insurance policy to pay a benefit, the policies must be what's called paid up every premium must be paid in full. But most policies lapse long before insurance companies have to pay full benefits because consumers stop paying the premiums. One in every 14 of customers with term life-insurance policies stop paying the premiums each year, according to life insurance industry group Limra. For those with permanent policies, which may have a cash value long before the death of the insured, some 25% of policyholders stop making premium payments within the first three years of owning the policies; within 10 years, 40% have let the policies lapse.

For consumers with term policies, the consequences are straightforward: Stop paying and lose the coverage. With permanent policies, the policyholder gets to keep any built-up cash value though the policies aren't typically worth anything for the first year or two, says James Hunt, an consulting actuary for the Consumer Federation of America, because the insurance company takes the early premiums to offset the costs of issuing the policies.

Jack Dolan, a spokesman for the American Council of Life Insurers, says there are many reasons why people drop the policies, including that they may no longer need the coverage. Families may decide they can't afford to continue paying or they may find a better deal elsewhere, according to Limra. If consumers do decide they've bought too much insurance or can't afford their current coverage, they should contact their carrier, says Barney: Most companies will let policyholders scale back the level of coverage and pay lower premiums.

5. We're in bed with your boss.

Typically, a life insurance policy is taken out by the insured himself or someone very close to him. But not always: Companies have also been known to take out policies on their employees, from high-level executives to the rank-and-file. While commonly accepted for upper-echelon employees, critics say it's far more problematic when the insured is a lower-level worker, who typically won't know about the policies and whose families don't benefit from the payout.

In 2006, to curb the practice, Congress restricted any tax benefits only to policies written on the highest-paid 35% of employees in a company, and then only with their written consent. Still, some think it's an effective way to raise money or offset costs. Louisiana representative Joel Robideaux introduced legislation this session that would allow the state to insure the lives of state worker and receive some of the benefits at death to help fund pension liabilities. The workers would have the option not to participate. "Employees would have had to agree to it because they were going to share in the benefit," says Robideaux, who says he tabled the legislation after it received a cold initial reception.

6. This is one heck of a tax shelter.

Unlike other kinds of income or inheritances, the benefits of a life insurance policy are tax-free, and in some policies, any investments or cash-value also grow tax-free. So while most people buy life insurance policy primarily to replace the income they currently contribute to a household, one in three consumers use it to gain a tax benefit, according to a 2010 survey by Limra.

In fact, those tax savings are significant. The Tax Foundation estimates that the tax exemption on certain life insurance contracts totaled a whopping \$1.68 billion in 2011. The tax benefit is one reason financial advisers often recommend them to wealthy clients: Policies worth \$2 million or more typically with annual premiums over \$20,000 accounted for nearly 40% of permanent policies sold in 2007, according to the Wall Street Journal; a decade ago, they represented 10% of

policies. The insurance industry rarely touts its service to the wealthy, in part out of concern that Congress could limit the tax-free status of life insurance benefits. Dolan acknowledges the possibility, but says he thinks it's unlikely: The majority of policies are still owned by people earning less than \$99,000.

7. Paid-up doesn't mean we'll pay out.

So-called permanent policies are structured in a number of different ways. They all use premiums to build up a cash value that contributes to the death benefit, but how that money grows can differ. Some policies offer a "no-lapse guarantee" which secures the death benefit and fixes the cost of your premiums over the life of the policy; others, without the guarantees, are often cheaper and project a growth rate based on historical calculations that, they say, should keep premiums steady and build up a handsome death benefit over time.

But when those projections don't pan out, policyholders can be left with very little to show for their years of premiums, says Ken Besada, a financial planner at Cook & Associates. For those who bought their policies in the 1980s, when interest rates were high, the balances have not grown fast enough to cover the cost of the policy, let alone build a death benefit. As a result, balances may have actually decreased, as the insurance company deducted money to cover the annual costs associated with the policies. If the balance hits zero, the policy lapses and any death benefit evaporates. The problem, says Besada, is that many longtime policyholders never understand this variable nature of the insurance. "Most people don't find out about this until they receive a letter telling them that their cash value is zero, and in order to continue the policy they must increase their payments," he says.

Insurance companies note that the terms of each policy are spelled out in the initial contracts, and they send out a yearly statement that includes the premiums and the account value. But "what they don't tell you is where you're heading," says Compulife's Barney. Financial advisers and consumer groups say policy owners typically don't read the notices or understand them. They recommend that consumers request an "in-force illustration," which shows how the investments have been performing, and projects where the value of the policy is heading. For their part, insurance companies note that consumers have the option to buy a guaranteed policy, which avoids these problems, and that the terms of the policy are spelled out in the contract.

8. You can skip the tests, but you'll pay for it.

Getting a life insurance policy usually requires a medical history and exam, including blood and urine tests, and a possible echocardiogram, if the policy is worth \$1 million or more. Don't like needles or doctors? Some companies offer policies with the option to skip the pricking and prodding, and instead use a medical history and computer programs to evaluate applications and set premiums. But such no-test coverage can be much more expensive, and buyers usually can't get as much coverage. For example, our healthy 45-year-old non-smoking male would pay an extra \$400 per year for a \$500,000 20-year term policy that allowed him to skip the testing a difference of \$8,000 over the life of the policy. "Full underwriting takes more time, but the savings are dramatic," says Byron J. Udell, CEO of life-insurance site Accuquote.com.

Andy Hutchison, vice president of product development at Mutual of Omaha, says the company's no-medical-testing "Term Life Express" policies are very quick: A customer can be fully insured within about five days, compared to about a

month for a policy with the tests. "A lot of people don't want to go through the underwriting," he says. "This they get very quickly." But the company's quick policy is limited to a \$400,000 benefit, and isn't available to consumers older than 65.

9. Forget the extra insurance.

As many people with car loans, home mortgages or credit cards have discovered, dozens of life insurance companies offer what's called "credit life insurance," small policies designed to pay off specific debts if you die. The cost of the coverage varies by state, but it often looks relatively cheap at first a Wisconsin resident with a \$15,000 four-year car loan would pay about \$265 total to cover the principal and finance charges if the person died, according to a spokesman from the Wisconsin Department of Financial Institutions.

In fact, compared to term policies, which essentially do the same thing provide a fixed-dollar benefit for a finite period of time they can be quite a bit more expensive. A healthy 40-year-old could expect to pay about \$77 per year for a \$50,000 term life insurance policy; the same amount of coverage under a "credit life" policy would cost \$342 per year. It's more expensive because there's no medical underwriting, so there's no discount for being healthy, or not smoking, according to the Wisconsin spokesman.

For people without other life insurance, these policies meet a need, Scott J. Cipinko, executive vice president of the Consumer Credit Industry Association. They're fast, easy to get and don't require a medical exam, as most life insurance policies do. And, says Cipinko, not everyone wants a policy that lasts as long or insures as much as a term policy might.

10. You're too late.

According to Accuquote's Udell, the average life-insurance customer is a 48-year-old man with teenaged children and he's about 15 years too late. As people get older, the more assets they typically have, which can offset the financial impact of death; a 30-year-old with a baby, on the other hand, has relatively little, and years of income ahead of him. "You want to insure all the labor income you have yet to earn, and when you're young, that's enormous," says Eric R. Young, an economics professor at the University of Virginia. But the number of life insurance applications for people younger than 44 has dropped between 4% and 5% per year over the last three years. Meanwhile, the number of applications for people 60-plus has risen steadily over the same time frame: up 10% in 2010, up 13% in 2009, up 5% in 2008, according to the MIB, which tracks life insurance applications.

Of course, it's hard to argue that a healthy 60-year old should've bought that life insurance policy years ago, Udell concedes: If you haven't died yet, it's easy to feel good about all those premiums you didn't pay. But experts say that if someone depends on you for financial support typically a spouse or a child, but including other relatives or business partners life insurance is a way to protect them. That means any time life circumstances change, it's important to review your coverage, financial advisers say, after marriage or the birth of a child in particular.

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