6 myths about buying life insurance

Bankrate

Let’s talk about your death.

Not much of a sales pitch, is it? Yet that’s precisely the body under the sheet we’re delicately avoiding when we consider buying life insurance.

“They call it life insurance but it’s really death insurance. After all, you’ll never live to collect,” says Judith Hasenauer, principal at Blazzard & Hasenauer, P.C., a Florida law firm that advises insurance companies. “That’s why it’s often said that life insurance is sold, not bought.”

Because we tend to shy away from our own mortality, certain myths have grown up around life insurance, several of them promulgated by the life insurance industry itself. Myths such as the idea that life insurance is a good investment. You can’t negotiate a better rate. Consumers receive full disclosure. And if you wait too long, a guaranteed-issue life policy will save the day.

We invited life insurance underwriter, analyst and author Tony Steuer, along with life insurance actuary, former Vermont insurance commissioner and Consumer Federation of America expert James Hunt to join Hasenauer in playing pinata with these overstuffed myths about life insurance.

You’ve seen guaranteed-issue life advertised on cable TV and in AAA and AARP magazines. The ads promise that you won’t be turned down, regardless of your health.

But if you’re looking for a quick net-worth boost at death’s door or a last-minute cash windfall for your heirs, you’re unlikely to find it in a guaranteed-issue product.

“For the first two years, the death benefits are minimal,” Hasenauer says. “That two-year window is the suicide period, the contestability window where the company would contest that the information you provided was not correct.”

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Then the benefits step up, but not by a lot. “They’re not very big policies; you could never go and get a good estate planning-type policy,” she says. “They’re pretty close to burial-type policies — just enough to get you in the ground and pay the minister.”

The cost of these policies reflects their increased risk to the insurer. “They’re crazy expensive,” says Steuer, who’s also the director of financial preparedness for the insurance consumer group United Policyholders.

If you’re considering a guaranteed-issue product, Hasenauer recommends shopping around.

“There is a price and benefit) difference between the three-question and the 10-question policy applications,” she says.

“Life insurance is the last financial industry where compensation is not fully disclosed,” says Steuer. Instead, it’s buried so deep in the contract that it would take a forensic dentist to extract it.

That’s by design. The insurance industry has long maintained that divulging the commission on whole life, which Hunt says can typically run 85 percent of first-year premiums with annual renewal commissions of 7 percent for the next decade, would mislead or turn off those buying life insurance.

Despite this dated defense, disclosure is already required overseas.

“It’s something that is going to catch on more and more in the U.S.) life insurance industry,” Steuer says.

Until it does, Hunt suggests two workarounds:

Compare the first-year surrender value to the first-year premium. The closer the surrender value is to zero dollars, the more money is going into the agent’s pocket. There’s just one catch: You would have to have purchased the policy to get this information.
Get a competing quote from TIAA-CREF, which sells direct policies without commissions. This will give you a rough idea of how much commission your policy contains.

Life insurance, a good investment? Total fantasy, says Steuer.

“I liken life insurance to the casino industry,” he says. “How do you think they get these big, flashy

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buildings and these solid financials? Not by giving you this really great deal."

Every decade seems to bring another diverting sales technique. In the 1980s, it was the tax advantage of single-premium life policies, which resulted in the loss of said advantage when the wealthy started flocking to them as tax havens. Recently, corporate-owned life insurance suffered a similar flash and regulatory crash.

Steuer says one of today's biggest life insurance pitches, the tax deferral on the cash value buildup within permanent life policies, could just as easily evaporate in these astringent times.

"The problem is, 40 percent) or 50 percent of the buyers drop out within 10 years and never get a good return on their money," says Hunt. His recommendation? Consider buying term life insurance and stick the savings in your 401k) instead.

Next time you hear the siren song of life insurance "investing," Steuer says crank your iPod to drown it out.

"Insurance is insurance; it's not an investment vehicle," he says.

Yes, life insurers like to downplay the medical exam, and for good reason: They don't want you to know how seriously they take your health.

Hasenauer says the larger the policy amount, the more thoroughly your health will be scrutinized.

"If you're buying a million-dollar policy, you're going to go through a full medical exam by a doctor of the insurer's choice: bodily fluids, EKG and attending physician reports from everywhere. They may even get your prescription history. With that, they're going to know your medical history pretty well."

This information is collected by MIB Group, an insurance industry trade group, and insurers use it to assess your risk.

If you've ever applied for any insurance as a smoker, or if you use any nicotine products including a patch, you'll likely wind up in the smoker pool, even when you qualify for Medicare. Heck, some cancer survivors have a better chance of favorable rates than smokers do.

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“There’s a reason for it: It’s costly!” Hasenauer says.

Don’t try to hide it. “That’s a misrepresentation that could put your insurance policy in jeopardy,” she says.

What’s the best way to go about buying life insurance? Use one agent or several? One company or many? Use your multiline home-auto insurer?

Steuer recommends working with one agent or broker who writes for a dozen or more companies, especially if you have health issues.

“Statistically, less than 10 percent of people will qualify for the best available rates,” he says. “If you’re looking at 10 companies, you may qualify for the best available rate with one and not with the other nine. You need an agent that can work with the different underwriters to present your case.”

What about using several agents? “It doesn’t work out well because then you have to interpret all the stuff that you’re getting from the agents rather than hiring an expert to sort through it,” he says.

As for using your home-auto insurer? “You’ll probably pay 5 percent) to 10 percent more in premiums,” he says. “It’s real easy; you’re getting everything under one roof with a good company, and you have one agent to deal with for all your insurance needs and they know you pretty well. For some, that might be worth it.”

Some life insurance agents cast themselves in the role of passive messenger, handing down the best offers from on high. Why? Because it works out to their financial advantage 99 percent of the time.

A dedicated pro knows how to use those best offers as a first offer and dig for even better terms on your behalf. After all, they negotiate with those same carriers for their own share of the pie.

For example, Hunt cites a technique called “blending” that agents use to increase the first-year surrender value of a whole life policy by substituting no-load or low-commission term life that converts to permanent insurance over time.

“If someone tries to sell you a full-commission $1 million policy with zero dollars) surrender value in the

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first year, tell them you want at least 50 percent in the surrender column," he says.

Steuer says negotiation often comes down to a savvy agent seeking the highest bidder.

"Sometimes you'll say, 'Company A is willing to go standard rate) on this. Will you consider going standard on it as well?' So you're able to set up a negotiation," he says.

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