

8 Big Life Insurance Mistakes to Avoid

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Life insurance is an important monetary investment, and you don't want to buy an unsuitable policy or discover that you've purchased too much or too little. But if the fear of making a bad life insurance decision is stalling your effort, know that failing to buy life insurance at all can be one of the most costly mistakes you can make for your family.

"The data is clear," says Jack Dolan, spokesperson for the American Council of Life Insurers (ACLI), a trade group. "Americans are underinsured and they're not buying coverage in amounts that equal their needs."

An August 2010 report by LIMRA, an insurance research organization, revealed that ownership of individual life insurance has fallen to a 50-year low in the United States: 30 percent of households (35 million) have no life insurance coverage at all.

But ditching an inappropriate policy after paying premiums for several years is a terrible waste of money. We asked a variety of insurance experts to tell us the biggest mistakes people commonly make when shopping for life insurance.

Mistake: Grossly underestimating a family's life insurance need and the "value of human life." Marvin Feldman, president and CEO of the nonprofit Life and Health Insurance Foundation for Education (LIFE), says that people often substantially underestimate the amount of life insurance they should buy. There are numerous online calculators to help, including calculators from the LIFE Foundation and Insure.com's life insurance calculator.

Mistake: Undervaluing a non-working spouse. In addition to underestimating the cost of replacing the income of a working spouse, life insurance buyers often neglect to place correct value on a non-working spouse. Feldman says it takes about \$117,000 a year to replace that person, and "most people don't understand the impact of what a stay-at-home spouse saves a family."

Mistake: Buying a life insurance policy with premiums that increase over time. Too often, life insurance buyers find that they can't afford the ever-escalating premiums and must let the policy lapse, says Amy Bach, executive director of United Policyholders, a nonprofit dedicated to insurance education and consumer rights.

Mistake: Insufficiently reviewing all types of life insurance available. Dolan says that "term life insurance for young people in particular typically provides a greater bang for the buck than whole life insurance. . . . However, the lifetime of level premiums that comes with whole life insurance is unappreciated by too many people who think in the short-term. Whole life insurance, with its cash value, also promotes savings."

James Hunt of the Consumer Federation of America, a consumer advocacy group, cautions against cash value policies in general because so many buyers ditch them in the early years of the policy. "This is not to say that cash value policies can't be decent investments when held at least 20 years, preferably a lifetime," he says. But when people lapse whole life insurance policies, the "excess of premiums paid over term [life insurance] premiums . . . is lost."

A 2009 report from LIMRA on life insurance lapse rates shows that close to 12 percent of whole life policies lapse in the first year, 10 percent lapse in the second year and almost 7 percent lapse in the third year of ownership. By contrast, lapse rates for term life insurance were around 7 percent in years one and two and about 6 percent in year three.

Mistake: Buying a complicated cash-value life product without understanding its terms and payout conditions. Even if your financial situation indicates that whole life insurance serves your needs, Bach points out that buying a policy you don't understand is a financial blunder.

Mistake: Being talked into terminating or reducing — or not maximizing — contributions to retirement accounts. Hunt warns not to short-change your tax-reducing retirement accounts at work, such as a 401k), in order to afford a cash value life insurance policy.

Mistake: Sticker shock that prevents you from buying life insurance. Feldman says most people think life insurance is "too expensive" because they don't understand the true cost of insuring a life. He points out that life insurance is generally less expensive today than it's ever been in the history of life insurance products.

Mistake: Allowing an agent or broker to complete and submit the application for you. If you don't fill out your own application, Bach advises you to check it thoroughly to make sure the agent recorded the right answers.

When in doubt about life insurance

Your family's financial picture likely has many moving parts - income, retirement savings and investments that need to be balanced against mortgage payments, college tuition needs and other financial obligations. When in doubt about a life insurance purchase, consult a professional agent, advises Feldman. An agent can make a recommendation based on your situation — "they're not just selling you the lowest cost policy," he says.

The original article can be found at Insure.com: 8 big life insurance mistakes to avoid
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