

# THE LIFE INSURANCE COVERAGE GAP

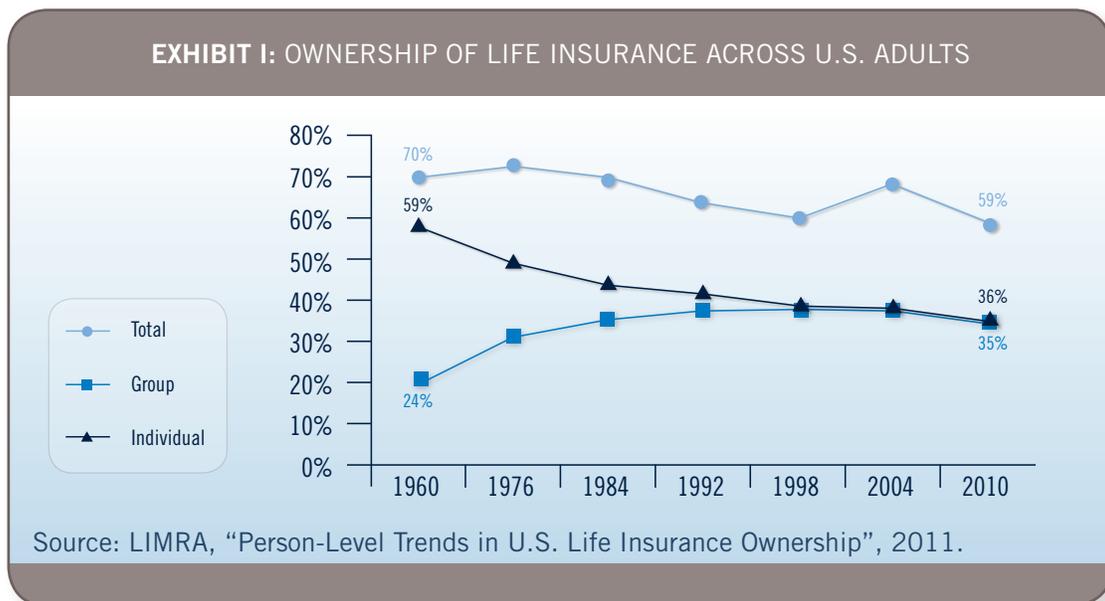
Strategies for  
Financial Professionals  
to Close the Gap

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## INTRODUCTION

Life insurance protects families from the negative financial consequences of a family member's death. Coping with the loss of a loved one is already difficult enough. Adequate life insurance can help ease this burden by providing surviving family members with the peace of mind of knowing that they can maintain their standard of living for a lengthy, or potentially indefinite, period of time.

Despite these benefits, ownership of life insurance has been steadily declining for decades and is currently at a 50-year low. As a result, many individuals either own no life insurance or too little life insurance. As shown in Exhibit 1, currently only 59% of U.S. adults own either individual and/or group life insurance—this means that four in 10 U.S. adults have no life insurance coverage at all. Moreover, only 36% of U.S. adults own individual life insurance, down from 59% in 1960.<sup>1</sup> The decline in life insurance ownership is particularly serious given the significant increase in dual income households over the last fifty years<sup>2</sup>—these households should have some level of coverage for both wage earners.



The life insurance coverage gap is exposing many families to the risk of significant hardship in the case of the death of a family member. Of the 35 million U.S. households without life insurance coverage, 11 million have children under the age of 18.<sup>3</sup> Among households with children under the age of 18, 70% say that they would be financially challenged if the primary

<sup>1</sup> LIMRA, "Person-Level Trends in U.S. Life Insurance Ownership", March 2011.

<sup>2</sup> LIMRA, "The New Reality – Examining U.S. Consumer Trends in the 21st Century", 2009.

<sup>3</sup> LIMRA, "Facts About Life 2010", September 2010.

earner died; 30% of households indicate that they would have trouble funding everyday living expenses after several months, and 40% of households say that they would immediately have trouble funding such expenses.<sup>4</sup>

It has been well documented that many consumers do not purchase any or adequate life insurance because they perceive it to be complex and costly, as well as a lower priority relative to other financial needs. For example, in a Prudential survey, 74% of consumers said that concerns about affordability prevented them from purchasing life insurance, and 50% said that life insurance is too complicated to purchase.<sup>5</sup> In addition, when consumers were asked in a survey to prioritize a list of nine common financial goals, they placed owning adequate life insurance toward the bottom of the list.<sup>6</sup>

It will be difficult for the life insurance industry to close the coverage gap unless it can increase the priority that consumers assign to purchasing life insurance. To that end, Prudential conducted an extensive set of consumer research that has highlighted three key reasons why consumers place a low priority on purchasing any or adequate life insurance.

- 1 Consumers believe that life insurance has a limited role.** Many consumers view the role of life insurance as a resource to support their family during a transitional period, rather than as a means to permanently replace a lost income. In a Prudential survey, 63% of individuals said that they purchased life insurance to cover funeral costs and final expenses; only 53% cited the need to replace a lost income.<sup>7</sup>
- 2 Consumers perceive high face amounts of coverage as excessive.** A majority of consumers in a focus group said that two to three times their annual income would be sufficient life insurance coverage. Underscoring this, the median amount of individual life insurance coverage owned in the U.S. is \$115,000, compared with the median household income of approximately \$50,000 in the U.S.<sup>8,9</sup> In addition, some consumers said that coverage amounts in excess of \$250,000 seemed exorbitant.<sup>10</sup>
- 3 Consumers believe that they are already adequately protected.** Some consumers elect not to purchase individual life insurance because they participate in a group life insurance program.<sup>11</sup> Consumers may also believe that their families are self-insured in the event they died. For example, as the number of dual income households continues

<sup>4</sup> LIMRA, “Facts About Life 2010”, September 2010.

<sup>5</sup> Prudential Financial, “2007 Life Insurance Thought Leadership Survey”.

<sup>6</sup> LIMRA, “Life Insurance in a Tough Economy”, 2010.

<sup>7</sup> Prudential Financial, “2009 Life Insurance Thought Leadership Survey”.

<sup>8</sup> The mean face amount of coverage is \$267,300. LIMRA, “Household Trends in U.S. Life Insurance Ownership”, 2010.

<sup>9</sup> U.S. Census Bureau, “Income, Poverty, and Health Insurance Coverage in the United States: 2009”, September 2010.

<sup>10</sup> Prudential Financial, “Consumer Insights Research”, January 13, 2011.

<sup>11</sup> Prudential Financial “2009 Life Insurance Thought Leadership Survey”.

to increase, families may refrain from purchasing adequate coverage due to the assumption that the second wage earner will be able to provide for the family in the event one of the wage earners passes away. In addition, consumers may assume that their spouses can re-enter the workforce if they are not working today. Finally, consumers may be relying on Social Security Survivors benefits or other financial assets to replace all or part of a lost income.

The two objectives for this white paper are to provide financial professionals with additional insights into the reasons why consumers assign a low priority to purchasing life insurance, and to outline a comprehensive set of strategies to help financial professionals close the life insurance coverage gap.

## WHY DO CONSUMERS ASSIGN A LOW PRIORITY TO PURCHASING LIFE INSURANCE?

Consumers place a low priority on purchasing any or adequate life insurance for a wide range of reasons, as illustrated in Exhibit 2. The remainder of this section explores these reasons in greater detail.

### EXHIBIT 2: WHY CONSUMERS ASSIGN A LOW PRIORITY TO LIFE INSURANCE

#### LIMITED VIEW ON THE ROLE OF LIFE INSURANCE

*"I have life insurance only to pay for my last expenses."*

*"I need to buy life insurance to make sure that my kids will be taken care of for a few years if something happens to me."*

#### PERCEPTION THAT HIGH FACE AMOUNTS ARE AN EXORBITANT AMOUNT OF COVERAGE

*"I'm working poor, so I need working poor insurance."*

*"Life insurance is not something to make my family rich."*

#### BELIEF THAT THEY ARE ALREADY COVERED

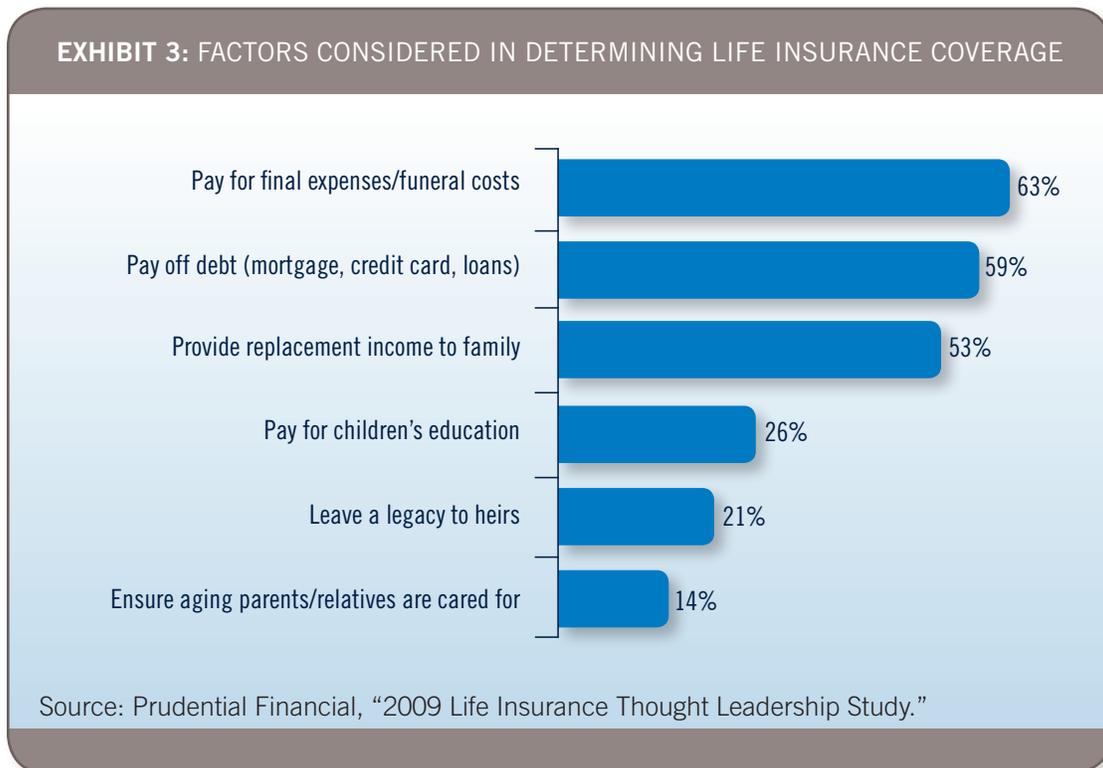
*"I already have coverage through my employer."*

*"My spouse can remarry if something happens to me."*

Source: Prudential consumer focus groups, 2009-2010.

### Consumers believe that life insurance has a limited role

Many consumers view life insurance as a transitional tool designed to help their families in the event of their deaths for a finite period of time, rather than as a means to permanently replace a lost income. As shown in Exhibit 3, consumers are more focused on purchasing life insurance to address short-term expenses, such as funeral costs or paying off debt, than to address long-term needs, such as replacing a lost income or funding a child's college education. This runs counter to the traditional industry view that life insurance is intended to provide families with long-term financial security in the event of the death of a family member.



The fact that only approximately half of consumers believe that life insurance is intended to replace an income contributes to the coverage gap by reducing the amount of coverage that consumers seek to buy.

### **Consumers' perceive high face amounts of coverage as exorbitant**

In focus groups, Prudential found that most consumers believe that “adequate” individual life insurance coverage is two to three times their incomes, well below the industry recommended eight to ten times ratio.<sup>12</sup> Based on this perception, and given that the median household income in the U.S. is approximately \$50,000<sup>13</sup>, the typical consumer appears to believe that \$100,000 to \$150,000 of life insurance coverage is sufficient. Consumers want to provide a “cushion” to enable their loved ones to continue their lifestyles for a period of time, but they “do not want to make them rich”.<sup>14</sup> Coverage amounts in excess of \$250,000 seem exorbitant to many consumers.<sup>15</sup>

The median level of household financial assets in the U.S. was slightly under \$30,000 in 2007.<sup>16</sup> It may be difficult for typical households to envision why they need life insurance protection that is many multiples of their current level of financial assets, not realizing the significant level of assets required to fund living expenses for several or more years. Similar misperceptions arise with respect to retirement planning. Some consumers believe that saving a few hundred thousand dollars is sufficient to prepare for retirement, not realizing that funding a retirement that could span decades may require a substantially higher level of retirement savings.

### **Consumers believe that they are already adequately protected**

Some consumers may believe that they do not need additional life insurance as they already participate in a group life insurance program, even though such coverage may terminate when an individual’s employment ends. According to a Prudential survey, 57% of respondents who lost access to employer-provided life insurance said that they had not considered the consequences of tying their life insurance coverage to their employment.<sup>17</sup>

In addition, consumers may believe that they are self-insured, because they assume that other financial resources will be available for their beneficiaries in the event of their premature deaths. For example, in dual income households, consumers may assume that income from the second wage earner will be sufficient to maintain the lifestyle of the surviving family in the event one of the wage earners passes away. In addition, consumers may believe that a non-working spouse will be able to rejoin the workforce and fully replace a lost income. Consumers may also be relying on other financial assets, such as retirement savings, to provide for their families in the event they passed away.<sup>18</sup>

<sup>12</sup> Prudential Financial, “Consumer Insights Research”, January 13, 2011.

<sup>13</sup> U.S. Census Bureau, “Income, Poverty, and Health Insurance Coverage in the United States: 2009”, September 2010.

<sup>14</sup> Prudential Financial research, July 29, 2010.

<sup>15</sup> Prudential Financial, “Consumers Insights Research”, January 13, 2011.

<sup>16</sup> The Federal Reserve Board, 2007 Survey of Consumer Finance (March 9, 2009).

<sup>17</sup> Prudential Financial “2009 Life Insurance Thought Leadership Survey”.

<sup>18</sup> LIMRA, “Emerging Risks in the Marketing and Distribution of Life Insurance and Annuities”, 2010.

Finally, consumers may be relying on Social Security Survivors benefits as a form of life insurance. For example, these benefits are available to surviving unmarried children who are younger than age 18 (or age 19 if attending elementary or secondary school full time) and a surviving spouse caring for the children.<sup>19</sup> Today, the maximum level of Social Security Survivors benefits available to a family is \$4,340 per month.<sup>20</sup>

Consumers' belief that they are already adequately protected lowers their urgency and motivation to purchase any or adequate life insurance.

## STRATEGIES FOR FINANCIAL PROFESSIONALS TO CLOSE THE LIFE INSURANCE GAP

Financial professionals are well positioned to help close the life insurance coverage gap, because they can educate their clients about the need for life insurance, help them determine the appropriate coverage level, and recommend appropriate products. Consequently, more than half of consumers (55%) prefer to learn about life insurance through a financial professional and 62% prefer to purchase life insurance through face-to-face interaction.<sup>21</sup>

Each financial professional relies on a different sales and education approach, reflecting an individual style, as well the unique characteristics of a financial professional's client base. Although the sales and education approach of each financial professional will naturally vary, all professionals should explicitly attempt to increase the priority that their clients assign to purchasing life insurance. This section outlines a set of strategies for financial professionals to accomplish this, while also addressing clients' concerns about the cost and complexity of buying life insurance.

### Strategies to Increase the Priority That Clients Assign to Purchasing Life Insurance

- 1 Proactively reach out to clients and prospects.** Nearly a quarter of households say that they want to speak with a financial advisor about their life insurance needs, but that they will probably not initiate contact with a producer or life insurer.<sup>22</sup> Executing a systematic program to reach out to clients and prospects is critical, because many consumers simply lack the urgency and motivation to take the initiative to reach out to a financial professional, even if they have determined that they need life insurance.

A proactive outreach program can take several forms. Financial professionals can reach out to prospects identified via referrals from existing clients or through other lead generation sources. Existing clients should also be included in any outreach program. For example, financial professionals could schedule periodic reviews with clients to determine if additional coverage is needed due to life events, such as the birth of a child

<sup>19</sup> Survivors benefits may also be available for surviving spouses as early as age 60 and dependent parents.

<sup>20</sup> Social Security Benefits Calculator, accessed May 10, 2011.

<sup>21</sup> Prudential Financial, "2010 Consumer Insights Quantitative Study".

<sup>22</sup> LIMRA, "Facts About Life 2010", September 2010.

or a substantial increase in income. A good time of the year to conduct annual reviews is at the beginning of a new year when people are organizing their finances for the upcoming tax season. Nearly a third of consumers say that they would like to participate in a review of their life insurance coverage levels at least once every two years.<sup>23</sup>

Social media provides a new vehicle for financial professionals to connect with clients. For example, some professionals are already using LinkedIn to interact with clients online by adding clients to their LinkedIn professional network. Once connected, financial professionals can use LinkedIn to easily communicate financial planning suggestions related to life insurance or other topics to clients. Like any other e-communication, when engaging in social media, producers must follow their company's and the industry's requirements.

- ② **Help clients develop a broader view of the role of life insurance.** Financial professionals should explicitly ask clients what they believe the purpose of life insurance is, given the fact that many consumers view life insurance as a way of supporting their family for a transitional period, rather than as a means to permanently replace a lost income.

If a client already views life insurance as a means of income replacement, then financial professionals can use tools such as a needs estimator to show the client how much life insurance he or she should buy. However, if the client views life insurance as a means to primarily provide transitional support for his or her family, financial professionals should engage the client in a discussion about the challenges that a surviving family may face without adequate coverage:

- Lack of resources to pay for health insurance if the family was relying solely on coverage through the deceased's employer.
- A lack of funding for a child's future college costs.
- A lower standard of living.

It can also be beneficial to engage both spouses when discussing the role of life insurance. This may help expose potential differences in how two spouses view the role of life insurance and generate a discussion to resolve these differences. For example, a non-working spouse may be uncomfortable with only purchasing sufficient insurance to provide transitional support if the working spouse passed away.

In addition, households often neglect to insure a non-working spouse. However, these households are not taking into account the critical services that a non-working spouse

<sup>23</sup> LIMRA, "Household Trends in U.S. Life Insurance Ownership", 2010.

provides for the family. When considering the various tasks a typical non-working spouse performs (if caring for children) and how much a family would have to pay a professional to provide these services, the total expenditure would be roughly \$61,000 a year.<sup>24</sup> Discussing such uses of life insurance is another way to broaden how clients view the role of life insurance.

**3 Generate an emotional need for life insurance within clients.** Unlike other purchases, buying life insurance provides little immediate gratification for the typical client. Financial professionals can address this issue by generating an emotional need within their clients for the benefits offered by life insurance. Telling clients true stories about other clients who have benefited from life insurance is one way to do this. Another way is to position buying life insurance as one of the most responsible things an individual can do for their families. Finally, another approach is to help clients visualize the peace of mind that they will enjoy for decades after purchasing life insurance, knowing that their family is protected if anything happened to them.

Exhibit 4 shows an example of Prudential's "Love Card", which provides an insured with the opportunity to write a message to his or her beneficiaries. The message is delivered with a death benefit if the insured passes away. Asking clients to write such a message serves to emphasize the emotional aspects of buying life insurance.

**EXHIBIT 4: PRUDENTIAL'S LOVE CARD**



- The "Love Card" is a message that an insured can write to his or her beneficiaries.
- The "Love Card" is delivered with the death benefit if the insured passes away.
- The "Love Card" helps emphasize the emotional aspects of buying life insurance.

<sup>24</sup> Fox Business, "The Mother's Day Index: How Much is Mom Worth This Year?", April 29, 2011. The U.S. Bureau of Labor Statistics is the original source cited in the article for this data.

The emotional value of life insurance was highlighted during the recent recession. When life insurance owners were asked in a survey, conducted during the recession, why they chose to keep their life insurance in effect while making other sacrifices, 93% said they did so because they believe that protecting their family and loved ones is a must.<sup>25</sup>

**4 Discuss the risks associated with the alternative forms of life insurance on which clients may be relying.**

A client may believe that his or her family is adequately protected either via existing group insurance coverage or via self-insurance, such as the possibility of a secondary wage earner providing for the family, a non-working spouse returning to work, or surviving family members accessing retirement savings. Some consumers may also be relying on Social Security Survivors benefits. There are risks associated with all of these forms of protection, which financial professionals should highlight for clients.

- **Group life insurance.** Many consumers are either provided employer-paid life insurance coverage or can conveniently purchase coverage at work. However, this coverage may end when an employee leaves an employer. Clients seeking to maintain coverage after leaving an employer may have limited funds to buy life insurance if they are out of work. In addition, coverage may be expensive or unavailable if a client develops health issues at this time. Purchasing some level of individual life insurance coverage to supplement existing group coverage can help clients avoid these risks.
- **Second wage earner providing for the family.** Dual income households may assume that the income from a second wage earner will be sufficient to provide for the family in the event the other wage earner passes away. However, it is likely to be difficult for many dual income households to maintain their standards of living after the loss of an income. In addition, dual income families need life insurance to protect against the possibility of both earners passing away at the same time.
- **Non-working spouse returning to work.** Given today's challenging employment outlook, it may be difficult for a non-working spouse to quickly rejoin the workforce and/or earn enough to fully replace a lost income. In addition, the return to the workforce by a non-working spouse may require a family to incur incremental childcare and related expenses, which life insurance benefits can help address.
- **Accessing retirement or other savings.** The value of a client's retirement savings fluctuates, depending on how the financial markets are performing. A client's survivors may be forced to access these savings at a time when markets are depressed. In addition, survivors are likely to have to pay taxes on early withdrawals from tax-advantaged retirement accounts, such as 401(k) or similar plans. Life insurance can help prevent the need to make such premature withdrawals.

<sup>25</sup> Prudential Financial, "The Value of Life in Tough Economic Times", August 2009.

- **Social Security Survivors benefits.** These benefits have limitations, such as age and payout restrictions. For example, Social Security benefits are available for children only until they reach the age of 18 (or 19 if they are attending elementary or secondary school full time). Therefore, these benefits cannot help fund college education expenses. In addition, there is a limit on the amount of monthly benefits that can be paid to any family. As a result, these benefits may not fully replace a lost income.

- 5 **Help clients visualize the practical value of a certain amount of life insurance coverage.** Many clients may view a face amount above a certain amount, such as \$250,000, as an exorbitant amount of coverage, hence reducing their motivation to purchase any or adequate coverage. Financial professionals should help clients envision what a recommended level of coverage could practically mean for their families. For example, financial professionals can discuss how a client's beneficiaries may use the proceeds from a life insurance policy to help generate an annual income. In today's low interest rate environment, generating even a modest annual income requires a substantial level of assets.

Alternatively, financial professionals can discuss how the proceeds of a life insurance policy can be used to help pay off a mortgage to ensure that a family can stay in its home. Financial professionals can also discuss how life insurance proceeds can be used to help fund a child's college education.

Discussing these types of examples is critical to helping clients visualize the practical value of a certain amount of life insurance coverage, rather than simply thinking of a certain amount of face coverage as an exorbitant, or unimaginable, sum of money.

- 6 **Discuss the full range of benefits that life insurance provides.** Financial professionals can increase the priority clients assign to buying life insurance by highlighting some of the less widely known benefits of life insurance.

- **Living benefits.** Many life insurance policies offer some type of living benefits to policyholders. For example, some policies provide policyholders with access to their death benefits if the insured is diagnosed with a terminal illness. This can be a valuable benefit for clients who are concerned about funding healthcare costs in the event of a serious illness.

- **Tax benefits.** Some clients may not realize that death benefits may not be subject to income tax. Unlike other types of income or inheritances, the death benefit from a life insurance policy is generally not taxable as income for the named beneficiary. Highlighting this benefit can help increase the perceived value of life insurance in the minds of clients.

- **Access to cash value in policy.** Some consumers may not realize the tax-advantaged withdrawal and loan benefits available on permanent life insurance policies. These policies accumulate cash value in the policy on a tax-deferred basis. Clients can access this cash value using withdrawals or loans on a tax-advantaged basis, which provides them with liquidity in times of need. However, clients should understand that loans and withdrawals can reduce death benefits and guarantees and may also have tax consequences.

**7 Target specific market segments with distinct protection needs.** The primary role of life insurance is to protect clients against the negative financial consequences of the death of a family member. However, financial professionals can increase the priority a client places on purchasing life insurance by explaining how life insurance also addresses other specific client needs.

- **Small business owner needs.** Life insurance can assist a small business owner by providing liquidity to facilitate the continued operation of a business or a transition of ownership in the event a business owner passes away. For example, life insurance can help fund buy-sell agreements to ensure that surviving business owners have the funds available to purchase a deceased owner's share of a business at a previously decided upon price. Targeting small business owners generally requires financial professionals to become familiar with a particular small business segment, such as medical practices.
- **Estate planning needs.** Clients with illiquid assets, such as real estate, business interests, or art, can benefit from incorporating life insurance into their estate plan, even if their estates are modest in value. For example, clients can leave an illiquid asset to one heir, while leaving the benefits of a life insurance policy to another heir to provide both heirs with a similar inheritance. In addition, life insurance can also be used to offset taxes, probate, and other costs that a client's heirs may face when inheriting an estate.

## Strategies to Address Clients' Concerns About the Cost and Complexity of Life Insurance

**1 Begin with term insurance for middle market households.** The typical consumer begins the life insurance purchase process anxious about the cost and complexity of life insurance. To help alleviate such concerns, it may be appropriate for financial professionals to initially focus on term insurance, particularly for clients with limited budgets who are primarily interested in protecting their families for the least cost. Introducing other life insurance products to such clients may only further complicate the buying process and reduce the likelihood of a sale.



A term insurance sale can help financial professionals cement a long-term relationship with a client. Financial professionals can work with term insurance buyers in the future to address other financial needs and evaluate whether it makes sense to convert the term policy to a permanent policy. Typically, clients can convert their term policy to either a whole life, universal life, or variable universal life insurance policy; however, certain restrictions may apply depending on the carrier.

Of course, if clients exhibit an interest in the other benefits of life insurance, such as the opportunity to save on a tax-deferred basis, financial professionals should introduce products such as whole life, universal life, or variable universal life insurance.

- ② **Demonstrate the affordability of life insurance.** Many consumers believe that life insurance is an expensive purchase. Financial professionals should strive to change this perception to ensure that clients do not use cost as an excuse to avoid purchasing adequate coverage. One way to do this is to present the costs of life insurance on a monthly basis since many consumers tend to make decisions in terms of how a purchase impacts their monthly budgets.<sup>26</sup> The monthly cost of term life insurance for a typical client may be less than the monthly cost of cell phone or cable television service.

Young consumers who may have never purchased life insurance are particularly prone to believing that life insurance is more expensive than it really is. In focus groups conducted with consumers under age 30, when attendees were told the price of a typical simplified issue term policy, 60% immediately became more interested in life insurance. Consumers in these focus groups had the perception that term life insurance is four or five times more expensive than it actually is.<sup>27</sup>

When discussing cost, it may also be helpful to highlight the fact that life insurance costs more the older one is, and may even be unavailable in the future if a client's health deteriorates. This may provide additional motivation for a client to complete a purchase sooner rather than later.

<sup>26</sup> LIMRA, "Improving Sales Presentations: Using Choice Architecture to Influence Buying Decisions", 2009.

<sup>27</sup> Prudential Financial, "Reaching Gen Y with Life Insurance is Easier Than You Think", 2010.



## CONCLUSION

The life insurance coverage gap is exposing many households to significant risk. However, there is a set of underlying reasons why consumers assign a low priority to purchasing life insurance, despite the risk that inadequate life insurance coverage poses to families. Financial professionals can help close the coverage gap by ensuring that their sales and education processes increase the priority that clients assign to purchasing life insurance, while also addressing clients' concerns about the cost and complexity of life insurance.

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