Strategy 8
Reduce the long-term cost of your insurance

When taking out insurances, you should consider paying level rather than stepped premiums.

What are the benefits?

By using this strategy, you could:

- pay a lower average premium over the life of the policy, and
- make your cover more affordable at a time when you need it most.

How does the strategy work?

When you take out insurance within or outside super, there are generally two ways you can pay your premiums.

You can opt for a **stepped premium** that is calculated each year in line with your age.

Or you can choose a **level premium** that is calculated each year based on your age when the cover commenced.

Level premiums are usually higher than stepped premiums at the start (as the graph below reveals).

However, over time, as stepped premiums increase, level premiums can end up cheaper – often at the stage in life when you need the cover most.

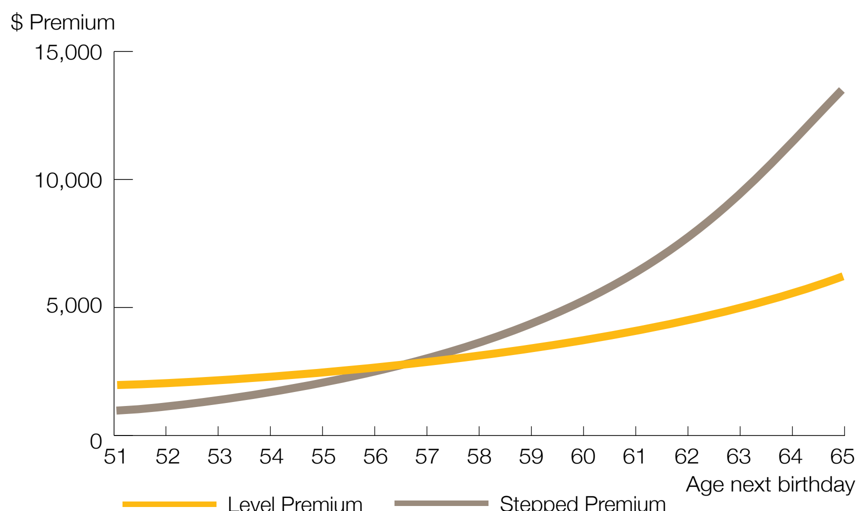
The premium savings in the later years can also make up for the additional payments in the earlier years, saving you money over the life of the policy.

The case study on the opposite page provides an example of the long-term savings that choosing level premiums could provide.

To find out whether you could benefit from paying level premiums, you should seek financial advice. A financial adviser can also help you determine the types and amounts of insurance you require and can review your needs over time to make sure you remain suitably covered.

Note: Choosing a level premium does not mean your premiums are guaranteed or will not change in the future. Level premium rates may increase due to rate increases, CPI increases and policy fee increases. However, unlike stepped premiums, level premiums don't go up by age-related increases.

Level vs stepped premiums



Insurance assumptions: Age 50, male, non-smoker, $500,000 in Life Cover increased by 5% each year. Based on MLC Limited's standard premium rates as at 1 November 2010 and excludes policy fee.

Case study

Tom and Harry (from Strategy 7) are both aged 50 and each own 50% of a concreting business valued at $1 million.

To protect their respective interests in the business, their financial adviser has recommended they execute a Buy Sell agreement (see Strategy 3) and fund the agreement by each taking out $500,000 in Life insurance in their super funds, where they could both make an after-tax saving of $396 on the first year's premiums and $21,609 over a 15 year period.

Their adviser also explains it will be even more cost-effective over the longer term if they pay level rather than stepped premiums. This is because, over the next 15 years, they'll both pay level premiums totalling $52,402 compared to a total of $75,719 if they choose stepped premiums.

Level premiums could therefore save them both a total of $23,317 over the next 15 years (or $15,575 in today's dollars[1]). This is in addition to the savings they could make by holding the insurance in super.

However, if Tom and Harry only needed insurance for a shorter time period (eg five years), it may be more cost-effective if they opt for stepped rather than level premiums.

For both Tom and Harry	Level premiums	Stepped premiums	Difference
Total premiums over 15 years	$52,402	$75,719	$23,317
Saving (in today's dollars)[1]			$15,575

Furthermore, if they both pay level premiums, the cost in year 15 (for example) will be $6,200 each, compared to $13,413 with stepped premiums. In other words, level premiums could be significantly lower in the later years, when the cover is needed most.

Insurance assumptions: For simplicity purposes, we've assumed Tom and Harry pay the same premiums. These premiums are based on MLC Limited's standard premium rates as at 1 November 2010 for non-smoking males, aged 50 with $500,000 in Life Cover increased by 5% each year and ignores the policy fee. In reality, they may pay different premiums based on factors such as their age, health and the amount of insurance each of them requires to protect their respective business interests. However, they are both likely to save money over the longer term if they select level rather than stepped premiums.

Note: This case study highlights the importance of speaking to a financial adviser about the best premium payment option when taking out insurance. A financial adviser can also address a range of potential issues and identify other suitable protection strategies – see Tips and traps.

Tips and traps

- You may want to take out part of your insurance using stepped premiums and use level premiums for the rest. This way, the premium in the earlier years will be lower than if you opt entirely for level premiums. Over time, you can then reduce your stepped premium cover as you build up more assets and potentially need less insurance. As a result, you could end up paying level premiums on most (if not all) of your insurance in the later years, and benefit from the lower premium costs associated with level premiums at that time.
- The earlier you lock in the level premium, the greater the potential long-term savings. This is because level premiums are based on your age when the policy commences and are generally lower if you take out the cover at a younger age. However, as you approach age 65, the difference between the two premium structures diminishes for new policies.
- Level premiums can make budgeting easier, because you have a greater degree of certainty regarding what your insurance is going to cost when compared to stepped premiums.
- It can also be more cost-effective over the longer term if you pay level rather than stepped premiums when using insurance for personal (ie non-business) purposes. To find out more about this and other personal protection strategies, see our 'Smart strategies for protecting you and your family' guide.

1 Assumes an inflation rate of 3% pa.