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Commentary

Why Whole Life Insurance Stinks

There are five reasons why no one should ever, ever even THINK of buying whole life. Right?

By Bryan Kuderna

Let's play a game...

The next time you find yourself in a group setting and the conversation dies down to that awkward, don't make eye contact silence, break the ice by blurting out, "So what do you guys think about whole life insurance?" I bet that this out of the blue question will generate a surprising amount of debate.

Whole life insurance stinks and here are the *indisputable* reasons why:

1.Commissions: Life insurance salesmen typically make a base commission of 55% of your first-year premium.

2.Financial entertainers say buy term and invest the difference is a better deal.

3.There's no need for permanent insurance, unless you want to spoil your kids and grandkids.

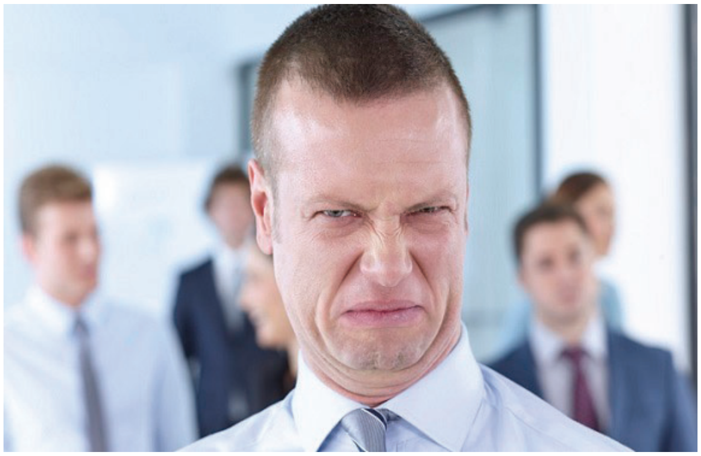
4.Cash value buildup takes forever and has a poor return.

5.Nobody has it.

Out of fairness, let's address each one of these arguments from an empirical standpoint...

1. Commissions are a reality of any sale, whether it be your home, car, medical device, or new TV. A salesman's true task is to motivate a buyer to act in their own best self-interests. Most companies will agree that repeat business and good will are the drivers of sustainable success. This validates the old saying, "Good news travels fast, but bad news travels even faster."

For the sake of deliberation, assume the agent across the table is a commission-driven financial sales representative, advising a client with $20k of a disposable income for "financial planning". Most investment



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advisors will charge a management fee that nets them 1% (some go much higher than this). A $20k annual investment over a 30-year study period earning 7% annually will generate $190,258 to the advisor. If another advisor were to allocate the same $20k annually to a whole life insurance policy for 30 years, he would receive $57,400 over the same period (assuming 55% first year commission plus 29 years of renewals at 8%). On either side of the coin, cost should only be an objection in the absence of value. Just because one product produces commissions does not necessarily make it wrong, just as another product with reduced fees does not make it better.

2. Buy term and invest the difference (BTID) is a strategy widely promoted by media talking heads and investment-oriented financial planners. This article will discount the financial entertainers of the world as their benchmark is purely total viewers/listeners. Rambling about the sexy stock market each day is exciting to an audience, whereas there's not much a host can due to spice up whole life insurance. A fitness magazine could publish one issue stating the need to follow the food pyramid and exercise for 60 minutes a day, very effective, but they'd be out of business after one month. "This month's secret to losing 20 lbs" is always more enticing.

An astute client should analyze the probability and practicality of a strategy. BTID obviously leaves more money available to allocate towards the markets. Assuming the client actually invests the difference every year, which takes a lot of discipline, this strategy may provide more liquid assets for the first 20 years than if whole life entered the plan. However, by year 20 the cash value inside whole life may have yielded a 5% to 6% taxable equivalent internal rate of return (assuming a 30% tax rate and whole life purchased on healthy 30-year-old male.), comparable to that of a moderately managed portfolio over the past 20 years. At this point the death benefit of a 20-year term policy will have expired, thus leaving the client with similar lifetime values, but significantly less death benefit for heirs moving forward. In short, the BTID approach offers greater early liquidity, but at the risk of market fluctuation and a temporary death benefit.

3. Who needs permanent insurance? So, after 20 or 30 years of term life insurance, your estate value drops overnight dramatically. This of course won't matter in retirement unless the client wants to spoil rotten future generations. Not so fast, without a death benefit in place, a retiree is forced to multitask with their portfolio for all retirement and legacy goals. Whereas an additional tax-free death benefit provided by whole life can act as a permissions slip for a retiree to maximize their pension benefits, spend down retirement assets, and enjoy Social Security without disinheriting their spouse. This tactic still puts parents first!

4. Cash values certainly don't boast the exciting ups and downs of the stock market, but that's OK. Most investment advisors will agree that fixed income needs to be a part of a responsible portfolio. Just as a client can't expect a term policy to last forever, nor can they expect their cash values to jump 20% in a year. The tax-deferred nature of whole life cash values and potential tax-free access provides a nice tax hedge, complimented by fluctuating dividends that can mitigate the interest rate risk felt in other investment vehicles.

5. Nobody owns whole life insurance anymore. In reality, whole life remains the most popular product in the industry, having accounted for 36% of life insurance premium in 2016, followed by index universal life at 21%, term life with 21%, and variable universal life at 6% (versus 33% in 2000), according to LIMRA's 2016 Life Insurance Sales Report.

As you can probably see, Whole life insurance stinks for quite a few reasons. But maybe, just maybe, it depends on what you're comparing it too and how it's used. If you find yourself wanting to own rather than rent, and discover how you can have more retirement cash flow with the same legacy, or more legacy with the same retirement cash flow, maybe this boring product around since the 1800s deserves another look.

CORRECTION: An earlier version of this article described the fee to the investment advisor incorrectly. The actual fee would be $190,258, or a little more than half of the figure given in the earlier version.

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