INCORRECT STATEMENTS MADE BY WHOLE LIFE CRITICS

By
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INCORRECT STATEMENT NO. 1

What they say:
Whole life insurance is credited with a very low return, less than 3% per year.

Why they are wrong:
The internal rate of return on premiums paid into competitive whole life policies held at least 20 years has historically been competitive with stable investments. In one recent study(1), a whole life policy issued in 1963 to a 27 year old male was actually credited with an average annual return of 5.60% per year from 1963 through 2012. This same policy was credited with an internal return in 2012 of 4.69%. However, since life insurance cash values can be withdrawn tax-free using a policy loan, the real rate of return a policyholder must earn in a taxable investment to equal the life insurance policy credited rate of return is much higher. In a 30% marginal tax bracket, this policyholder would have had to earn 8.00% per year in a taxable investment to equal his policy’s 5.60% credited annual return over the past 49 years. The current scale (which is not guaranteed) on many competitive whole life policies offered today produces an internal rate of return of approximately 4.2% per year if the policy is held long term, which would require a 6% average annual return on a taxable investment in a 30% tax bracket. This is highly competitive with the rate currently offered by stable accounts such as money market funds, bank CDs, and Savings Bonds.

(1) The Truth about Participating Whole Life, August 2012 by Richard L. Miller, CLU, ChFC.

INCORRECT STATEMENT NO. 2

What they say:
If you buy term life insurance instead of whole life, you can invest the premium savings in a growth mutual fund. By doing this, you will accumulate much higher earnings than by paying the same amount into a whole life policy.

Why they are wrong:
It is misleading and invalid to compare the returns of a stock market investment with the cash value growth of a whole life insurance policy. A balanced investment program normally includes a portion, such as 40%, allocated to stable accounts and a portion, such as 60%, allocated to growth accounts. Whole life insurance cash value is equivalent to a stable account investment because it is not subject to the risk of stock or bond market declines. A client who buys whole life insurance must invest other funds in equities to achieve an allocation of 60% to growth. The same client who buys term insurance and invests the difference in a growth mutual fund will have to allocate other funds to stable accounts in order to achieve the same 60% allocation to growth. As a result, a client who practices proper asset allocation will have the same amount allocated to growth accounts whether he buys whole life or term insurance. A term insurance owner with 60% of his investments allocated to growth accounts will not earn a higher return than a whole life insurance owner with 60% allocated to the same growth accounts.
To properly compare whole life with term insurance, the difference in premiums can only be invested in a stable account. This is so because buying term and investing the difference in a growth mutual fund will not result in more money allocated to growth accounts as long as the client practices proper asset allocation as outlined above. This means that a money market rate or a bank CD rate must be assumed in order to produce a valid comparison. A valid comparison must also assume that enough term insurance is purchased each year to match the whole life death benefit. Finally, the stable account earnings must be reduced by the client's marginal tax rate. When these assumptions are used, participating whole life cash values may exceed the values created by buying term and investing the difference by policy year 20. The margin in favor of whole life over buying term and investing the difference is enormous by life expectancy in many comparisons. In fact, the cost for term insurance may become so expensive that the side fund will run out of money well before the client's life expectancy age. Buying term and investing the difference may work for the first 20 years, but it is a recipe for financial disaster if used to maintain coverage until death.

INCORRECT STATEMENT NO. 3

What they say:
The cash value of a whole life policy is not paid to your beneficiaries at your death. It is kept by the insurance company.

Why they are wrong:
Dividends paid by a participating whole life contract can be used to purchase “paid up additions”, which increase the policy’s death benefit. The increased death benefit may equal or exceed the policy’s cash value. Universal Life can be set up with an increasing death benefit that equals the initial death benefit plus the full cash value account. However, a client who elects a level death benefit may actually incur a lower cost for coverage because the insurance company only charges for the difference between the face amount and the cash value, which is known as the “net amount at risk”. For example, a client who has a $100,000 level death benefit with $30,000 cash value is only charged for $70,000 of life insurance. The beneficiary would receive the $30,000 cash value account at the client’s death plus the $70,000 net amount at risk.

INCORRECT STATEMENT NO. 4

What they say:
If you buy term life insurance instead of whole life and invest the difference, you will accumulate enough money in 20 years so that you won’t need any life insurance. You will be able to drop the term policy before it becomes too costly.

Why they are wrong:
As explained in Statement No.2, only a stable account interest rate may rightfully be assumed in calculating how much will accumulate by investing the difference. If valid assumptions are used, the accumulated difference may not come close enough to the whole life death benefit to allow the term policy to be cancelled. For example, a male age 30 in a 31% marginal tax bracket who buys $500,000 of 20-year level term insurance instead of whole life insurance may accumulate only $126,222 in 20 years by investing his $4,670 annual premium savings in a stable “difference account” earning 4.0% per year. The client must still maintain $454,392 of term insurance on year 20 in addition to his $126,222 “difference account” in order to equal his 20th year whole life death benefit of $580,614, based on current scale. In this example, the high cost of term insurance is projected to deplete his “difference account” by age 70.
INCORRECT STATEMENT NO. 5

What they say:
You can buy term insurance and invest the difference in a Roth IRA. This would provide tax advantages similar to a whole life policy since Roth IRA earnings can be withdrawn tax-free after age 59½.

Why they are wrong:
Roth IRA’s are not available to clients whose annual income exceeds certain limits. Clients who are already making the maximum Roth contribution cannot contribute more. Clients who purchase whole life insurance can contribute the maximum allowed to a Roth IRA either now or in the future if they are otherwise eligible in addition to the amount they contribute to their whole life program. To properly compare a term and invest program to a whole life program, the term buyer must also be able to contribute the maximum to a Roth IRA if they are eligible in addition to the amount they contribute to their term and invest program.

INCORRECT STATEMENT NO. 6

What they say:
Insurance companies unjustifiably charge you interest to borrow your own money from your life insurance policy.

Why they are wrong:
Whole life insurance policy cash values continue to grow and may earn dividends even after withdrawn as a policy loan. An amount equal to some or all of the policy loan interest charged is credited back to your policy’s cash value. Policy loan interest is similar to loan interest charged on a 401(k) plan loan, which is credited back to the participant’s account. A tax free policy loan may be the best way to obtain needed cash value for many policyholders.

INCORRECT STATEMENT NO. 7

What they say:
Whole life policies do not perform as projected.

Why they are wrong:
Whole life illustrations include a projection of guaranteed values, which are always credited as long as required premiums are paid. In addition, whole life illustrations may include dividends or excess interest based on the issuing company’s current scale. This is not a projection of how the policy is expected to perform, but, rather a projection of how the policy will perform if the current scale is not changed. If interest rates decrease after a policy is issued, the current scale can be expected decrease as well. Conversely, if interest rates increase, the current scale can be expected to increase. The company's expenses and mortality experience will also affect the dividend scale. For example, the actual whole life policy referenced in Statement No. 1 was originally projected to accumulate total cash value of $47,612 by 2012 based on the company’s 1963 dividend scale. The policy actually accumulated cash value of $132,098 by 2012, more than double the original projection.
INCORRECT STATEMENT NO. 8

What they say:
Insurance agents recommend whole life insurance because it pays them a higher commission.

Why they are wrong:
Many successful life insurance agents subscribe to a strict code of ethical conduct, which requires them to always place their client’s best interest first. Professional career agents who have earned the CLU, ChFC, or CFP designation have extensively studied both permanent and term insurance. They are trained to recommend permanent life insurance only when it is clearly the best choice for their client. Life insurance agents do not normally achieve long-term success by recommending what pays the highest commission. They become successful by doing what is right for their clients.

INCORRECT STATEMENT NO. 9

What they say:
Cash value insurance is a supreme waste of money. Cash value life insurance is one of the worst financial products available.

Why they are wrong:
Historical data on the actual performance of top whole life policies proves the opposite of these outrageous claims. The study described is Statement No. 1 found that the client would have accumulated only $79,859 by investing his entire premium in Bank CD’s from 1963 to 2012. His whole life policy actually accumulated $132,098 of cash value in addition to providing insurance protection over 49 years.

Historical performance data of competitive whole life policies is readily available to Whole life critics, but is not included in the published books these critics have written. Why would they not include a fair analysis of this data? Clearly, it is because a fair analysis of this data proves that whole life insurance may be the best choice for long term coverage needs. Not only would it be embarrassing for a whole life critic to retract his or her position, but doing so could create significant potential liability from angry term insurance owners who discover they have been mislead. Policyholders who have cancelled competitive permanent life insurance or who have purchased term insurance that will eventually become too expensive to keep may have been irreparably damaged by the incorrect advice that has been given by these misinformed “financial experts”,

About the Author: Richard L. Miller CLU, ChFC is President of T&M Financial, Inc. of Topeka, Kansas and author of the Comprehensive Financial Planning System. His three-part article entitled The Truth about Participating Whole Life describes the historical evidence outlined in this summary. A copy of this article may be obtained by emailing rmiller@t-mfinancial.com.