Debunking The Myths Of Whole Life Insurance

Why pay more on medical school student loans?
Refinance with DRB to lower your rates.
• Low rates
• Easy application process
• No origination fee
• No prepayment fee
www.drbank.com/student
VIEW RATES
DRB
Darien Rowayton Bank

Yesterday, insurance agent Bob Whitlock explained in his guest post how whole life insurance works. There are more than 400,000 insurance agents in this country, and almost all of them would love to sell you a whole life insurance policy. If you buy a policy with premiums of $40,000 per year, the commission would typically be somewhere between $20,000 and $44,000 for that agent. As you might imagine, that commission can be highly motivating, especially given the median insurance agent income of $47,000. To make matters worse, many of the worst policies offer the highest commissions. As a result of this ridiculous conflict of interest, agents can often throw out some serious myths in an effort to persuade you to buy their product, which might explain the damning statistic that 80%+ of those who buy this product get rid of it prior to death. Perhaps that is why Dave Ramsey calls it the "Pay Day Loan of The Middle Class."

Intro To Whole Life Insurance

First, a little about how whole life insurance works. This product can be set up in many different ways, but in general you pay a monthly or annual premium for either a defined period of time, or until you die. The longer the period of time over which you pay the premiums, the lower the premiums. Whenever you die, your beneficiary gets the proceeds of the policy. Since every whole life policy is guaranteed to pay out if you just hold on to it to your death, the premiums are much higher than a comparable term life insurance policy. A whole life insurance policy, like other types of permanent life insurance, is really a hybrid of insurance and investment. The policy accumulates cash value as the years go by.

That cash value grows in a tax-protected manner, and you can even borrow the money in there tax-free (but not interest-free.) Upon your death, whatever you borrowed (plus the interest) is taken out of the death benefit, and the rest is paid to your beneficiary. (You get

the cash value or the death benefit, not both.) This investment aspect allows those who sell this product to find all kinds of creative reasons you should buy it and creative ways to structure it. The most extreme advocates may even argue that you don't need ANY other financial products during your entire life since whole life insurance can apparently take care of all your needs including mortgages, consumer loans, insurance, investments, college savings, and retirement. The problem is that for every use of whole life insurance, there is usually a better way to deal with that financial issue. In this lengthy post, I'll address 18 frequent myths about whole life insurance propagated by its advocates.

Myth # 1 Whole Life Is Great For Pre-Retirement Income Protection

Whole life insurance is not the best way to protect your income, term life insurance is. Before you retire, you can purchase inexpensive term life insurance to take care of your loved ones in the event of your untimely death. A 30 year level premium term life insurance policy with a $1 Million face value bought on a healthy 30 year old runs $680 per year. A similar whole life policy will cost more than 10 times as much, $8-10,000 per year. That is money that cannot be spent on mortgage payments or vacations, nor invested for retirement.

Myth # 2 Whole Life Is The Best Way To Get A Permanent Death Benefit

Whole life isn't the best way to get a permanent death benefit, guaranteed no-lapse universal life is. There are a select few people who need or want an insurance policy that will pay out at their death, whenever that may be. This can be useful for some unusual estate planning issues. However, there is a better product that provides this and is much less expensive than whole life insurance. It is called Guaranteed No-Lapse Universal Life Insurance. It does NOT accumulate any cash value, but simply provides a life-long death benefit. It only costs half as much as whole life insurance, so you won't be surprised to learn that the agent's commission on this sale will be far lower. Call me cynical, but I suspect that might be one of the reasons you've never heard of it. Whole life insurance provides a guaranteed death benefit that is PROJECTED (but not guaranteed) to grow slowly so that if you die at your life expectancy or later you'll leave behind a little more than the original policy death benefit.

A whole life policy I looked at recently projected the death benefit of a $1 Million policy,

bought at 30, would be $3.17 Million at death at age 83. That sounds great, almost like an inflation protection of the death benefit. Except historical inflation is something like 3.1%. At 3.1%, $1 Million now would be the equivalent of $5.04 Million in 53 years. A whole life policy would be devastated by unexpected inflation, since the dividends are backed primarily by nominal bonds, whose values would be murdered in a high inflation environment. Therefore whole life insurance is neither the best way to provide a guaranteed life-long nominal death benefit, nor a guaranteed life-long real death benefit. So what is it good for? How about a guaranteed death benefit that might increase if the insurance company feels like increasing it? Would you be willing to pay premiums that are twice as high for that? I didn't think so.

Myth # 3 Whole Life Provides A Great Investment Return

Whole life isn't the best way to invest, traditional investments are. When you pay your whole life premiums part of the money goes toward buying insurance, part of it goes toward overhead and profit for the insurance company, and part of it goes toward the commission for the salesman. The rest then goes into the cash value portion of the policy. Each year, the insurance company declares a dividend, and if there is $10,000 in the cash value portion and the dividend is 6%, then $600 gets credited to your cash value. The dividend is only applied to the cash value, not the entire premium paid, so the average dividend rate is in no way, shape, or form related to your actual return on the policy as an investment. In fact, the return on investment is generally negative for at least a decade. I recently analyzed a policy for a healthy 30 year old male with a 53 year life expectancy. The guaranteed return on the cash value was less than 2% per year AFTER 5 DECADES. Even if you use the insurance company's optimistic "projected" values, you're still looking at a return of less than 5%. In reality, you'll probably end up with a return of 3-4%. Considering you have to hold on to this "investment" for 5 decades, that doesn't seem like much compensation. If you have decades to invest, it is far wiser to take more risk with your investments and earn a higher return. An investment in stocks or real estate is likely to provide a return over decades in the 7-12% range. $100,000 invested for 50 years at 3% per year will grow into $438K. If it grows at 9% instead, you'll end up with $7.4 Million, or 17 times as much money. The rate at which you compound your long-term investments matters, especially over long periods of time.

Myth # 4 Insurance Companies Are Great Investors

Some agents believe that insurance companies can somehow get investment returns that you or I cannot find elsewhere and pass those great returns on to their policy owners. It can be illuminating to look under the hood and see what is really in the portfolio of an insurance company. In 2010, insurance company assets were invested 70% in bonds (almost all in run-of-the-mill corporate and treasury bonds), 1% in preferred stock, 10% in common stock, 6% in mortgages, 1% in real estate, 4% in cash, 3% in loans to their policy owners, and about 5% in "other." Thanks to the index fund revolution, an individual investor can buy nearly all that stuff for less than 10 basis points per year in expenses. Active management doesn't work any better for insurance companies than for mutual funds.

As you might expect, the returns on a portfolio composed primarily of treasury bonds (currently yielding 1-2%) and corporate bonds (currently yielding 3-4%) aren't particularly high. So where do dividends come from? Part comes from the return on the investment portfolio, part comes from the fees of those who surrendered their policies, and part comes from "mortality credits," which is basically money they didn't have to pay out to beneficiaries because fewer people died than they planned for (i.e. you paid too much for the insurance portion of the policy in the first place due to state regulations.) There are no magic investments that insurance companies can invest in that you cannot without the company. Every additional layer between you and the investment just increases expenses and lowers returns.

Tomorrow we'll talk about 5 more of the myths of whole life insurance, but for now, let's talk about these four. Agree? Disagree? Comment below! Please reference which "myth" you're referring to in your comment and keep comments civil and on topic. Ad hominem attacks will be deleted.

- Part 3
- Part 4

Today we continue our series on whole life insurance. On Monday we learned about the basics of whole life. Yesterday, we learned it isn't the best way to protect your pre-retirement

income, that it isn't the best way to get a guaranteed death benefit, that it provides low returns, and that insurance companies aren't any better at investing than mutual funds, pension funds, or intelligent individual investors. Today, we'll explore 5 more myths used by insurance agents to sell whole life.

Myth # 5 Whole Life Is A Great Asset Class

There are lots of asset classes worth including in a diversified portfolio, but whole life isn't one of them. Insurance salesmen generally resort to this argument once they've realized they can't convince you that whole life is a great investment in and of itself. They say that if you mix it into a portfolio of stocks, bonds, and real estate that it will improve the overall portfolio. However, you can call anything you want an asset class. Horse manure can be an asset class, but that doesn't mean you should invest in it. Think of it this way. If I told you I had an asset class with the following characteristics:

1. 50% front load the first year
2. Surrender penalties that last for years
3. Requires ongoing contributions for decades
4. Difficult to rebalance with other asset classes
5. Backed by the guarantees of a single company (and whatever you can get from a state guaranty association)
6. Requires you to pay interest to get to your money
7. Guaranteed negative returns for the first decade
8. Low returns even if you hold it for decades
9. Must be held for life to provide even a low investment return
10. Excluded from the investment for poor health or dangerous hobbies

would you buy it? Of course not.

Myth # 6 Whole Life Is A Great Way To Save On Taxes

Whole life isn't the best way to lower your investment tax bill, retirement accounts are. Many agents like to tout the tax benefits of whole life insurance, often comparing it to a 401K or a Roth IRA. The cash value does grow in a tax-protected manner, the cash value can be borrowed tax-free, and proceeds from the policy at your death are income (although not estate) tax-free. So some whole life advocates suggest you use whole life insurance instead of a retirement account like a 401K or a Roth IRA. However, a 401K or Roth IRA not only provides MORE tax savings and allows you to invest in riskier investments that are likely to provide you a higher return, but you also don't have to borrow your own money, nor pay interest for the privilege of doing so.

I've posted previously about the Three Ways A 401K Saves You On Taxes and on how Whole Life Insurance Is Not Like a Roth IRA. I've also posted about how tax-efficient investments in a Taxable Investing Account don't carry nearly the tax burden agents like to tell you they do. Are there tax benefits of investing in life insurance? Yes, but they are dramatically oversold.

Myth # 7 Whole Life Insurance Protects Your Money From Creditors

Insurance agents love to use this one on doctors, who can be paranoid about asset protection issues. However, they often don't mention (or perhaps even know) that asset protection laws are very state-specific. For example, in Alaska, only $12,500 of whole life insurance cash value is protected from creditors, but 100% of the money in your 401K or IRA is protected. West Virginia only provides an $8K protection. South Carolina protects $4K. New Jersey doesn't provide any protection. Many states do provide 100% protection for whole life insurance cash value, but you probably ought to look up your state's specific laws before falling for this myth.

Myth # 8 You Need Whole Life For Estate Planning

Cash value life insurance has some great estate planning features that can be very useful. However, the vast majority of people, including doctors, don't need those features. The primary benefit of life insurance is that you get a bunch of income-tax free cash at your death.

This can help with a lot of liquidity issues, such as ownership of expensive property or a private business. If you have two children that you want to share in your estate equally, and most of your estate is the family farm, they would either have to sell the farm, cut it in half, or have one buy out the other in order to share equally. However, if you also had a life insurance policy with the same value as the farm, one kid could get the farm and the other could get the insurance proceeds. Likewise, in the fortunate event that you have a very large estate (more than $5 Million for single folks in the federal tax code, but can be much less in some states), the life insurance proceeds can be used to pay the estate taxes. This would be useful even with a single heir to prevent him from selling a valuable property or business at fire sale prices in order to pay the tax bill.

Some folks also like to put life insurance inside an irrevocable trust to decrease the size of their estate and avoid estate taxes. While you can put simple taxable investments into the trust instead (and would likely come out ahead due to higher returns), trust tax rates can be quite high, putting serious drag on returns for tax-inefficient investments, not to mention the hassle factor. It's important to point out that it isn't the life insurance saving money on estate taxes, it's the fact that you're giving away your assets before you die by putting them into the trust.

However, the fact is that the vast majority of Americans, even physicians, and even including physicians with an "estate tax problem", don't need whole life insurance to do effective estate planning. Most people will die without any estate tax burden. Of those whose estates will owe some estate taxes, the vast majority have liquid assets that can be used to pay the taxes. Even if you want to reduce the size of your estate to prevent estate taxes, you can easily do so without purchasing life insurance. You and your spouse can give $14K each to any heir in any given year without any estate/gift tax implications. As an example, if you had 4 kids and they each had 4 kids and all 20 heirs were married, that's 40 people. 40 x $14K x 2 = $1.12 Million per year that can be taken out of your estate without paying any estate/gift taxes. It won't take long to get underneath the estate tax limit at that rate, no insurance needed.

Myth # 9 Whole Life Is A Great Way To Pay For College

Some agents even go so far as to suggest you use a whole life policy to pay for your children's

college. Can you do this? Of course. You simply take out policy loans and send that money to the university to pay tuition. But you're better off saving up for college using a good 529 for multiple reasons. First, you often get a state tax break by using a 529 that isn't available for whole life insurance. Second, you don't have to borrow money from your 529, you just withdraw it. No interest payments required. Last, but certainly not least, consider the time frame of college savings. Parents generally save for college over a period of 5-20 years. By investing that money aggressively, they can expect a return of 7-10%. Whole life insurance has very poor returns for time periods of less than 20 years. In fact, many times the cash value return on your "investment" in whole life is negative for at least a decade. It's important to make sure your money works as hard as you do, and your money is on vacation for the first decade in a whole life policy. Whole life advocates will point out that if you died, the death benefit could still pay for Junior's college, but it is far cheaper to cover that risk with term life insurance.

Tomorrow we'll talk about 5 more of the myths of whole life insurance, but for now, let's talk about these five. Agree? Disagree? Comment below! Please reference which "myth" you're referring to in your comment and keep comments civil and on topic. Ad hominem attacks will be deleted.

- Part 4

Today we continue our series on whole life insurance. This week we've learned how whole life works and that it isn't great insurance or a great investment. Yesterday we learned that whole life insurance isn't a great asset class, isn't the best way to save on taxes, isn't the best tool for estate planning, doesn't offer perfect asset protection, and is a lousy way to save for college. Today, we'll explore 5 more myths used by insurance agents to sell whole life.

Myth # 10 Whole Life Is A Luxury You Want

Insurance agents will occasionally fall back onto this argument when it has been pointed out that a client doesn't really have any kind of a need for a permanent death benefit. They admit that the client doesn't actually need whole life insurance. Then they try to sell it based on having it as a status symbol or luxury. "Sure, you don't need it, it's a luxury." A luxury is by definition something you don't need. I prefer my luxuries to be something that I really enjoy. So before buying whole life insurance as a luxury, ask yourself, "What do I really enjoy?" If it is owning whole life insurance, fine, buy some. But I bet most of us would prefer a luxury such as a nice car, a cruise with the grandkids, or perhaps a donation to a favorite charity.

Myth # 11 Whole Life Lets You Spend Down Your Other Assets, Providing Valuable Flexibility In Retirement

Whole life isn't the best way to ensure you don't run out of money, annuitizing some of your assets is. Whole life isn't the best way to deal with the second to die issue, properly structuring pensions and annuities is. Whole life agents like to come up with retirement scenarios that make you feel like you have to own or at least want to own permanent life insurance, especially for a married couple. For example, they'll talk about a pension that only pays out until the working spouse died. Or they'll talk about annuitizing some portion of your assets based on the life of only one member of the couple. Then they'll suggest that the proceeds of the whole life policy be used for living expenses by the second to die spouse. There is no reason to use a whole life policy in this way. If you want your pension to last until you both die, then select that option. If you want your annuity to last until you both die, then choose that option. Yes, it will pay out at a slightly lower percentage, but the difference between payouts is less than the cost of a whole life insurance policy that would cover the loss of that pension. It simply isn't the right solution to the problem. Does whole life insurance provide some flexibility in retirement? Sure, but the cost for that flexibility is too high.

Myth # 12 Whole Life Is A Great Way To Buy Expensive Stuff

Whole life isn't the best way to buy expensive stuff, saving up for it is. There are some really creative insurance salesmen out there advocating for systems such as Bank on Yourself or Infinite Banking. The basic scheme is this- by structuring your policy appropriately with paid up additions, you get a lot of cash value into your policy in the early years, such that you break

even in 3-4 years rather than 8-15 years. You also buy a policy that is "non-direct recognition." This means that when you borrow from the policy, the insurance company continues to pay dividends on the amount that was in there before you borrowed it out, so the policy dividends essentially cancel out the interest payments due on the loan. Now, rather than going to your savings account or to a bank to borrow money when you need a car, a refrigerator, or an investment property, you borrow from your whole life policy at essentially no cost. Further, the cash value in the policy that you don't borrow will grow faster than the money in a savings bank.

So what's the problem? The problem is that you have to buy a whole life policy you don't need. You might break even sooner than you would with a traditional policy, but there are still several years of negative returns and in the long-term, the same low returns. Is it better to earn 4-5% a year after 5 years or earn 1% a year starting in year 1? Well, for the first 6 or 7 years you're better off with the 1% a year savings account. Also, if interest rates go up from their historic lows, you're still locked in to this system for the rest of your life. It wasn't very long ago that I could get over 5% from a money market fund. It also seems to be very easy to finance a car at a dealership at extremely low interest rates. 0% or 1% are not uncommon. You're better off borrowing from them at 1% than from your policy at 5%. It's a similar issue with appliances and mortgages. You go through all this effort so you can borrow from yourself, then realize it's cheaper to borrow from someone else. Finally, if you don't need to make a purchase for 5 or 10 years, you've got time to invest in something likely to have a much higher return than a whole life policy. Are those who bank on themselves being scammed? Not necessarily, but they're generally oversold on the benefits of their scheme. Its advocates are primarily insurance agents looking to increase sales through creative marketing. Saving up is simply a better way to make big purchases than buying a whole life policy.

Myth # 13 Really Rich People Or Businesses Buy Whole Life Insurance So You Should Too

Whole life advocates, particularly those who advocate using your policy as a bank, like to point out that lots of very wealthy people and lots of businesses (including banks) actually buy

whole life insurance. While true, it is irrelevant for the typical person. Big businesses don't have access to the tax-saving retirement account options that a middle class individual does. Ultra-wealthy individuals have already maxed these out. When you have far more money than you can ever need, the return on your money doesn't matter as much. Bill Gates can afford to invest in something that provides returns of 2-5% because he doesn't need his money to work very hard. That's simply not true for the vast majority of middle to upper class people, including doctors. As discussed above, ultra-wealthy people also have more use for the limited estate planning benefits and asset protection benefits of permanent life insurance. In short, the low returns inherent in whole life are much less of an issue for them than they are for you.

Myth # 14 You Should Buy Whole Life When You're Young

Whole life salesmen like to point out that whole life is a lot cheaper if you buy it when you're young. While it is true that the premiums are lower if you buy a policy at 25 than if you buy it at 55, once you take into account the time value of money and the fact that you'll pay the premiums for 3 extra decades, it isn't any better of an investment at a young age than at an older age. Actuaries are very intelligent people, and for a risk that is relatively easy to model, like death, they can price insurance quite efficiently.

Aside from the lower premiums, there are two other reasons why it seems better to buy it when you're young. First, that commission is spread out over more years, so it has less impact on your overall returns. But the alternative of not paying the commission at all is far more attractive. Second, it's possible that you will either become less healthy or take up some dangerous sport later in life. This is one of the serious downsides of using life insurance as an investment- not everyone can use it. Either they don't qualify for it at all, or the price of insurance is so high that the returns on the investment are even lower than they would otherwise be. I don't see that as a reason to buy it when you're young, I see it as a reason not to buy it at all. Can you imagine if Vanguard sent a paramedic out to your house to draw blood prior to letting you buy their S&P 500 fund?

Tomorrow we'll talk about 4 more of the myths of whole life insurance, but for now, let's talk about these five. Agree? Disagree? Comment below! Please reference which "myth" you're

referring to in your comment and keep comments civil and on topic. Ad hominem attacks will be deleted.

This is the last article in our series on whole life insurance. This week we've learned how whole life works and that it isn't great insurance or a great investment. We also learned about the problems in using it to save taxes, protect assets, and plan estates. Yesterday we learned that it isn't a valuable luxury, isn't necessary for retirement planning, isn't a great way to buy expensive stuff, and isn't something you need to rush out to buy when you're young. Today, we'll explore 4 more myths used by insurance agents to sell whole life.

Myth # 15 Waiver of Premium Riders Are A Good Way To Protect Your Retirement From Your Disability

Whole life insurance isn't the best way to protect your retirement income from your disability, disability insurance is. Recognizing that whole life insurance premiums are really expensive and would be difficult to make in the event of disability, the insurance companies began offering a rider that waived the premiums in the event of your disability. Sometimes you don't even appear to have to pay extra for this benefit. Those who fall for this tactic are missing a couple of points. First, guarantees are not free. Every guarantee costs you money in the form of a lower return, whether the insurance company charges extra for the guarantee or "bakes it into the policy" so it is hidden.

Second, disability insurance is complicated and the definition of disability is all important. Most doctors who want disability coverage spend a lot of money getting a really nice policy with a broad definition of disability including "own-occupation" coverage because they want to make sure the company is going to have to pay in the event of their disability. The riders sold on whole life policies aren't nearly as comprehensive and are far less likely to be paid in the many gray areas that disabilities often fall into. You will almost certainly be better off buying a bigger disability policy rather than a whole life waiver of premium rider. Your

disability insurance may also offer a retirement protection rider. While these have issues as well (primarily in the way the benefit is paid out), they're better than trying to get your disability insurance from a whole life policy.

If you're planning an early retirement like I am, you may realize you don't need your disability coverage to protect your retirement contributions anyway, at least after a few years of heavy savings. Consider having a $750K portfolio at age 40. You figure you need $2 Million in today's dollars for retirement. You plan to save heavily so you can achieve that at age 50 and retire. What is the back-up plan if you get disabled and can't save all that money? Your disability insurance doesn't just pay to age 50. It pays to age 65. So you don't need your portfolio to cover those 15 years. You can also start getting Social Security payments by the time the disability payments run out. Since you don't have to touch your portfolio, it can continue to grow. If it grows at 5% after-inflation, by the time you hit age 65 it will be worth over $2.5 Million in today's dollars. Don't buy insurance that you don't need. But even before you have any kind of portfolio, the best way to protect your retirement savings is to buy MORE disability insurance, not to try to get it from a whole life policy. Even if you could use the extra coverage to provide your retirement portfolio, you need to be able to put it into an investment with a high return, which whole life is unlikely to provide. An aggressively invested taxable account is just fine since your main income if disabled, your disability insurance benefits, are tax-free.

Myth # 16 You Should Exchange Your Lousy Old Whole Life Policy For A Shiny New One

Since an agent gets a new commission every time he sells a new policy, even if he replaces an old one from the same company, he has a serious conflict of interest in making recommendations to you. I interact with lots of insurance agents on this blog, and none of them agree with the others about what a "properly-structured" whole life policy is. That means if you go to a second agent, he will almost surely tell you that there is a better way to do it. However, for it to be worthwhile to exchange one policy for another the original policy has to be absolutely horrible, especially after a couple of decades. The reason for this is that the poor returns on whole life insurance are concentrated into the early years. I took a look at a

policy recently. This was set up as an investment with paid up additions for the first 25 years. It was the agent's best attempt at maximizing the returns of a policy. Here is how the annualized returns looked:

	Guaranteed	Projected
First 10 years	-1.84%	0.98%
Next 15 years	2.55%	5.47%
Next 25 years	1.99%	5.13%

This demonstrates that the poor returns are highly concentrated in the early years. With this particular policy, the returns actually decrease after 25 years because that is when you stop making paid up additions. With a more traditional policy the third row would be slightly higher than the second row. But the moral of the story is that you should buy the "right policy" first, and even a crappy policy that is more than 10 years old is going to be better than a brand new better policy. This is also the reason that it can be a good idea to keep an older whole life policy, even if buying it in the first place was a mistake. It's also noteworthy to see how little risk the insurance company is actually taking, since it isn't even guaranteeing that your cash value will keep up with inflation.

Myth # 17 Whole Life Is The Only Way To Pass Money To Heirs Income Tax Free

Whole life isn't the only way to pass money to heirs income-tax free at your death. In fact, it isn't even the best way, a Roth IRA is. When you die, your heirs get an insurance death benefit that is free of income tax. What agents often fail to mention, is that just about everything your heirs get from you when you die is income tax free. Thanks to the step-up in basis at death, anything outside of a retirement account, including furniture, automobiles, stocks, cash, mutual funds, and real estate is all revalued on the day of your death. Since the basis is now the same as the value, there are no capital gains taxes due. Inheriting a retirement account can be even better, especially a Roth account where the taxes have already been paid. You can take all the money out the same year you inherit it and not pay any taxes at all. Or, you can "stretch it", taking withdrawals gradually over decades until you die.

Meanwhile, it continues to grow tax-free. You can stretch an inherited tax-deferred account too, but you do have to pay taxes on any money withdrawn from the account.

Myth # 18 With Whole Life, There Is No Way I Can Lose Money

People invest in whole life insurance because they like guarantees. The insurance company guarantees that you'll get a certain rate of growth on your investment and it guarantees a death benefit. The guarantees, however, aren't worth nearly as much as people often assume. For instance, the guaranteed scale of any whole life insurance policy guarantees that your money will grow slower than the historical rate of inflation, despite sticking with it for half a century. Before deciding to trust a single company with your life savings, you might want to consider what happens if it goes out of business. There are state insurance guarantee associations that will cover the cash value and death benefit of your policy, but how much will they really cover? You might be surprised how little it is. In my state, only $500K in death benefit and $200K in cash value is covered, NO MATTER HOW MANY POLICIES YOU OWN. Your state is probably similar. No wonder agents are always talking about the long-term viability of their insurance company. It really does matter! Now I don't think the risk of any given insurance company going out of business in any given year is very high, nor do I think a typical purchaser is likely to end up with exactly the guaranteed growth rate. But before buying, you should realize that investing in whole life insurance isn't the risk free proposition agents like to present it as.

Summing It Up

Whole life insurance is a terrible investment if you don't hold on to it to your death. Since the vast majority of people surrender their policies prior to death, it is a terrible investment for the vast majority of those who purchase it. If you want to invest in it, then you need to place a very high value on its unique aspects and not mind it's serious downsides.

The ideal purchaser of whole life insurance should:

1. Need or desire a guaranteed, but possibly slowly increasing, life-long death benefit,
2. Understand that the guarantee/contract essentially relies on the insurance company

staying in business for as long as he lives for any policy of reasonable size,
3. Live in a state that protects 100% of the cash value from creditors,
4. Have some estate planning liquidity issues,
5. Be in excellent health,
6. Pursue no dangerous hobbies,
7. Not mind having low returns on his investment despite holding it for decades,
8. Have serious philosophical aversion to using traditional financing resources such as banks and credit unions (or simply just saving up for what you want to buy),
9. Have already maxed out all available retirement accounts including backdoor Roth IRAs and HSAs, and
10. Be willing to hold on to the policy until death no matter what changes in his financial life in the future.

The fact is that only a tiny percentage of the population, far smaller than the number of people who have been sold these policies historically, meets all or even most of these criteria. Whole life insurance remains a product designed to be sold, not bought.

What do you think? Agree? Disagree? What other myths do whole life advocates spread? Sound off in the comments section! Please reference which "myth" you're referring to in your comment and keep comments civil and on topic. Ad hominem attacks will be deleted.

When I originally started this series, it was intended as a stand-alone four part series, not an ongoing series. However, it seems that my blog is an absolute magnet for whole life insurance salesmen and I continue to have dozens of comments and emails on the subject every week. I've noticed a few new myths that agents are using to sell this stuff (and argue with me) and will add them to the list in this post. There are lots of new readers since the series originally ran back in December, so to get you up to speed I recommend you read parts 1-4 first.

Why pay more on medical school student loans?
Refinance with DRB to lower your rates.
• Low rates
• Easy application process
• No origination fee
• No prepayment fee
www.drbank.com/student
DRB
Darien Rowayton Bank
VIEW RATES

Myth # 19 Life Insurance Should Not Be "Rented"

This one is pretty easy to see through, but you still see agents using it frequently. Since everyone "knows" that it is better to own a home than rent one, the agent says something like "You wouldn't rent your home for the rest of your life would you? So why would you rent your life insurance?" Basically, the agent is referring to the fact that if you use term insurance after age 60 or so, it becomes more and more expensive each year, just like renting a home. But unlike a home, you don't need life insurance after you become financially independent. When you only need a home for a year or two or three, it is a better idea to rent than to buy. When you only need life insurance for a decade or two or three, it is also a better idea to "rent" than to buy. The opportunity cost of "ownership" is simply too high.

Myth # 20 Banks Own Life Insurance So You Should Too

This is a frequent one heard from the Bank on Yourself/Infinite Banking crowd. An underpinning of this school of thought is that the greedy banks are taking over the world so you should only do your financial work through the trustworthy insurance companies. To be honest, I don't have massive distrust for either one of these industries. Both industries have mutually-owned options (mutual life insurance companies and credit unions) where, like Vanguard, the customers own the company. The agents like to point out that banks actually own whole life insurance as part of their "Tier One Capital," the money used to determine if the bank is adequately capitalized or not. This is somehow to make you fear that the banks know something you don't, like the financial world is about to implode and any of those using banks instead of insurance companies for their financial needs are going to go broke. Tier One Capital is a measure of a bank's financial strength. Banks use less than 25% of their Tier One Capital to buy single premium whole or universal life insurance on a group of employees. The bank owns the policy and is the beneficiary. When the employee keels over, the bank gets the cash. The bank is buying the policy primarily for the death benefit, not because the return is particularly high.

Tier One Capital is highly regulated and it is difficult for a bank to include riskier assets such as common stock (aside from that of the bank, which makes up most of Tier One Capital) and REITs in its Tier One Capital. When you are stuck choosing between low-risk/low-return investments, then you can understand why a bank might consider something like cash value life insurance with part of that money. However, individual physician investors investing for retirement have fewer restrictions on their investment options for their retirement. Most of them have significant need for their retirement money to grow. The returns available with cash value life insurance generally are not high enough for them to reach their goals. Even so, consider what a bank does with most of its Tier One Capital- it buys the only stock it can, it's own. If whole life insurance was so awesome, you'd think the bank would use all of its Tier One reserves to buy it. In short, doctors aren't banks, so doing what banks do isn't necessarily smart.

Myth # 21 Corporate CEOs Own Whole Life Insurance So You Should Too

Agents, particularly of the Bank on Yourself type, love to point out that the golden parachutes

for many highly-paid CEOs include cash value life insurance policies. However, just as the financial situation of a bank is dissimilar from that of a physician, so is the financial situation of a CEO making $10 Million a year different from that of a physician. When you're making a gazillion dollars a year, rate of return on your money becomes much less important and thus the benefits of whole life (asset protection, tax, estate planning etc) become relatively more important. It isn't that returns on whole life magically get better. Again, if you are in a position that you only need your long-term money to grow at 3-5% nominal per year, then feel free to invest in whole life insurance. Most of us, however, need higher growth. Remember that a doctor making $200,000 per year and a CEO making $10 Million per year are in very different financial circumstances and what works fine for one will not necessarily work well for the other.

Myth # 22 Banks Failed During The Great Depression, but Insurance Companies Didn't

This myth again preys on the fears of a global economic meltdown. In 1933 there were two holidays. The first was a "Banking Holiday" in which the banks were closed for 10 days as sweeping regulatory changes took place. The second was an "Insurance Holiday" in which for a period of nearly six months you could neither surrender your cash value life insurance policies for cash, nor borrow against them. Aside from this holiday, 14 percent (63 companies) of life insurance companies actually DID fail during The Great Depression. In fact, if they would have actually marked to market the bonds and mortgages they held, they would have ALL been insolvent. Reforms were put in place during The Great Depression that fixed many of the problems leading to bank failures and the banking holiday. However, these reforms were never put in place for insurance companies.

Myth # 23 After-Tax, Whole Life Returns Are Better Than Bond Returns

This one usually goes like this. "If you can buy a bond yielding 5% and are in a 45% marginal tax bracket, the after-tax yield on that is just 2.75%. A whole life policy with a "tax-free" internal rate of return of 5% is better." This is an apples to oranges comparison. What is the 1 year return on that whole life policy? 2.75% sounds a whole lot better to me than a -50%. Even at 10-20 years, the bond is still way ahead.

I wrote about a physician who was pleased with his 7% return on his whole life policy bought in 1983 (don't expect to see that again any time soon). Except that he could have bought a 30 year treasury that year yielding 10.5%. 10 years later, as his whole life policy is breaking even and interest rates have dropped, the bond purchaser has not only already more than doubled his money just from the coupon payments, but the capital gains on that bond added another 50% to his return. That investor would have done even better purchasing equities in 1983, the start of an 18 year bull market. A bond, which can be sold any day the market is open, simply cannot be compared in any fair manner to an insurance policy which must be held for life to have any decent kind of return. Besides, most physician investors can hold taxable bonds inside retirement accounts instead of a taxable account anyway. That retirement account not only provides for tax-protected growth like a whole life policy, but also a tax-rate arbitrage between your marginal rate at contribution and your effective rate at withdrawal, further boosting returns.

Even if your only choice is between buying bonds in a taxable account and buying whole life insurance, keep in mind that even at today's low interest rates you can still buy Vanguard's Long-Term Tax Exempt Muni Fund yielding 3.17%. The guaranteed return on whole life insurance cash value, held until your life expectancy, is about 2% and the projected return is only ~5%. Realistically, you should probably expect a return of 3-4% over the long term on that policy. Of course, if you actually wish to cash out of that policy instead of borrowing from it (and paying interest for the right to borrow your own money), the earnings are just as taxable as any taxable bond fund. And if you want your money in a mere 10-20 years, you're going to come out way behind with the life insurance.

Now, if you really understand how whole life insurance works and you think its unique features outweigh its significant downsides, then feel free to run out and purchase as much as you like. It truly does not bother me. I do not make any money if you buy whole life, nor if you decide to buy something else. However, if you are like most, once you understand it, you

won't buy it and in fact, if you already have, you'll probably be looking for the best way to get out of whole life insurance. Don't feel bad. 80% of those who purchase these policies surrender them prior to death, 36% within just five years. You've got to ask yourself why so many people who were apparently intending to hold this product for the next 40 or 50 years suddenly changed their mind. I'm sure it has nothing to do with it being inappropriately sold to the financially unsophisticated by insurance agents facing a terrible financial conflict of interest with their clients. Whole life insurance is a product made to be sold, not bought. It is a solution looking for a problem that exists for very few, if it exists at all.

What say you about these five myths? Are there any I haven't yet hit in this series? Comment below!