Who needs whole life?

THESE POLICIES OFTEN COST TOO MUCH FOR TOO LITTLE PROTECTION.

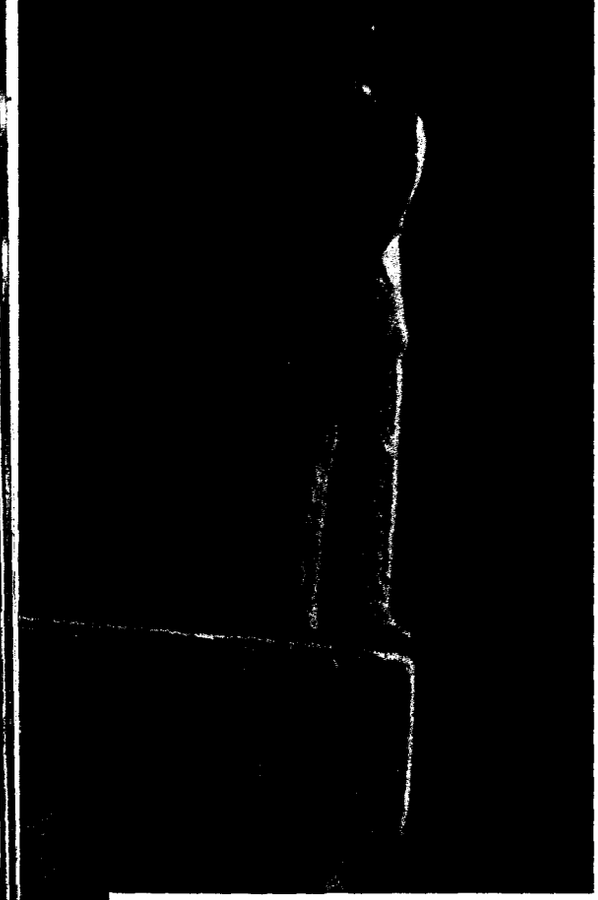


Photo by Jeffrey Camp

A vigorous septuagenarian who's the proud father of a preschooler may want a cash-value policy that combines life insurance with an investment product. His young family will need insurance protection until he's well into his 90s, but at his advanced years, term insurance would be expensive—if it's available at all. Likewise, tycoons who have run out of other tax shelters or who face complex estate-planning issues might want to give whole life a look. By paying insurance premiums until they die, they will enable their heirs to use the policy's tax-exempt death benefit to pay inheritance taxes. But if you're an ordinary wage earner who's in reasonably good health and whose kids will be on their own by the time you retire, your best bet by far is to stick with lower-cost term and find more lucrative ways to invest what you save on premiums.

For the overwhelming majority of consumers, cash-value policies cost too much, and they often deliver both too little protection and an inadequate return on your investment (see the glossary on page 34). Worse, cash-value insurance has been tainted by abusive sales practices and widespread fraud. Massive class-action lawsuits brought against some of the nation's biggest insurers have resulted in court-ordered awards of billions of dollars in restitution to victimized policyholders (see "Churned," below).

A problematic product

Insurance agents like to call cash-value policies "permanent insurance" intended to last a lifetime. But few people need life insurance once they retire or after their loved ones no longer depend on them for support. That's a point even some members of the insurance industry itself appear to recognize. "It's not an all-purpose product to meet everyone's needs," says a spokesman for the American Council of Life Insurance, the industry trade group. Here are some of the major ways buying a whole-life policy can lead to trouble:

You may end up underinsured. Many agents, eager to close a deal, want to sell you as much whole life as you're willing to buy. But because annual premiums for these policies are so much higher than they are for term, you're apt to end up settling for one with a death benefit insufficient to meet your survivors' needs. For example, a healthy nonsmoking man 40 years old can expect to pay $3,000 per year for a whole-life policy with a face value of $250,000. Premiums for a competitively priced term policy, by contrast, would cost him one-fifth as much.

Commissions and fees are steep—and often undisclosed. Your entire first year's premium for a whole-life policy typically goes to pay sales commissions and other expenses, and the drain may continue for as long as 15 years. Other hidden administrative costs may be built into your premium payments. Metropolitan Life, for example, hits policyholders with interest charges that run between 15 percent and 20 percent per year simply for the privilege of making monthly

Churned *Beware of insurance-agent scams*

For many consumers, life-insurance agents suffer a big credibility problem, and for good reason. Investigators in more than a dozen states have conclusively demonstrated that during the past two decades, agents representing some of the biggest companies that sell whole-life policies routinely defrauded their customers. They misrepresented their products and induced customers to use the cash value in their old policy to buy a new high-commission policy—a practice known as churning.

The victims are usually older people, like Stanley Janco (right) of Valrico, Fla., who have paid on their policy for 20 years or more. Agents urge the policyholder to cash in an old policy for a new one with a higher face value—with the unwritten promise of no extra premiums. After the value of the old policy is consumed by premiums on the replacement, the consumer is presented a bill for ruinously high new payments.

Since 1995, life-insurance companies including John Hancock, Metropolitan Life, Prudential, and Transamerica Occidental have agreed to pay billions of dollars in fines and restitution to policyholders who were churned, but many more companies are expected to be the targets of state and civil actions. A Prudential spokesman insists that "abusive sales practices are problems of the past." But Keith P. Vanden Dooren, a Florida assistant attorney general, calls industry sales practices "an ongoing fraud committed against an unwary public."

If you think you've been churned, what you can do? First, complain to the company, and contact your state attorney general's office. Since the flood of lawsuits, insurers are now quick to make amends to victims of this insidious practice. But never cash in an existing whole-life policy until any promises made by an agent are committed to writing.

Should you dump your whole-life policy?

You've paid premiums for years, yet you have little gain to show for it, and the policy doesn't provide the insurance protection your family needs. Should you simply abandon it? The answer isn't always clear-cut. You'll lose all or most of your investment if you drop a cash-value policy within the first five years. Beyond that point, you'll want to weigh your options carefully.

Without competent professional analysis, it's nearly impossible to tell if a policy you hold will ever become a decent investment. The nonprofit Consumer Federation of America offers a service that will evaluate your existing policy or one you may be considering and tell you its rate of return, year by year, compared with other types of investments. You can contact the service at 202 387-0087; there's a $40 charge for the first policy you have analyzed, $30 for each additional one.

What will you discover when you crunch the numbers? Consider, for example, a variable-universal-life policy from Western Reserve with a face value of $200,000 and annual premiums of $2,218. It has a cash value after one year of just $64. Not until the end of year 10 would you be able to redeem the policy for slightly more than the $22,000 you'd have paid in.

If you have managed to accumulate a gain, you may want to make a tax-free transfer into a better policy—preferably one from a low-load company where your future gains won't be devoured by fees. The IRS will let you switch the cash buildup in one life policy to another or roll it into an annuity. But never cancel a policy until you have a replacement signed, sealed, and delivered.

▶ Getting more cash value from your policy

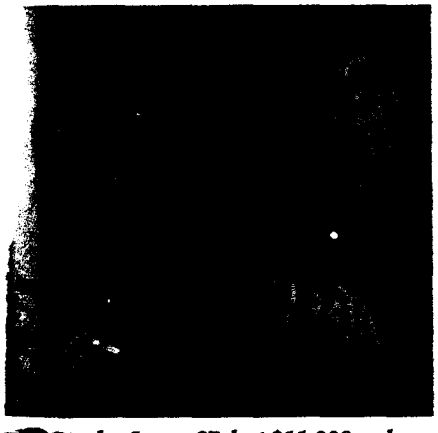
If you must buy a cash-value policy, consider one that charges low commissions. Your equity will accumulate faster, as the table shows.

	Total cash value accumulated				
Policy name	**After year 1**	**After year 5**	**After year 10**	**After year 20**	**Rate of return**
Low-commission					
Ameritas Universal Life	$2,899	$15,029	$34,749	$101,747	6.25%
Federal Home Life Universal	2,706	15,132	34,971	103,405	6.50
Schwab Universal	2,556	16,346	37,585	104,967	6.30
Full-commission					
Metropolitan Universal Life	0	12,458	31,819	86,911	5.75

Based on a $250,000 universal-life policy for a male nonsmoker, age 40, paying a $3,000 yearly premium.

payments instead of a single annual payment. Overall, commissions and charges like these cut deeply into the total investment earnings from a cash-value policy. Case in point: An IDS Life Insurance variable-universal policy with a "12 percent gross" return will end up yielding just 9.1 percent over 20 years once all fees have been siphoned off.

Projected returns are often unrealistic—or mythical. Agents are skilled at using reams of computer printouts to show how, with little or no risk to you, the value of your investment in an insurance policy will compound over time. But those projections are only as good as the assumptions that go into creating them, and too often the underlying assumptions are bogus.



Stanley Janco, 67, lost $11,000 and saw his premiums jump after Prudential churned him into a costly new policy.

Most buyers bail out early—and suffer big losses. For many consumers, keeping up with the steep annual premiums of a cash-value policy can be an unsustainable financial strain. Fully one-half surrender their policy during its first 10 years, long before they've acquired much equity in their investment. James Hunt, an actuary for the Consumer Federation of America, estimates that policyholders lose $6 billion a year through such early surrenders.

Recommendations

If you're one of the few consumers for whom a whole-life policy may make sense:

• **Always compare term.** Never buy a cash-value policy until you've determined what you'd pay for term insurance. For the vast majority of insurance buyers under age 50, term will almost surely cost less. If you're concerned that your health might deteriorate before your need for life-insurance protection ends, consider buying 10-year, 20-year, or even 30-year level-premium term before you commit to a whole-life policy. Premiums are higher for these longer-period term policies, but chances are they will still be more affordable than whole life. Most term policies contain provisions that make them convertible to whole life should that need arise.

• **Buy the right amount of protection.** Use the worksheet on page 38 to gauge your family's needs, and buy sufficient coverage to meet them. To keep premiums more affordable, price low-load policies like those in the table above.

• **Don't be distracted by a policy's purported investment potential.** Insurance agents like to emphasize that a policy's gains accumulate, tax-deferred, until you begin to withdraw the proceeds. But even the best whole-life policies don't begin to become a decent investment for about 15 years. Avoid buying one unless you are prepared to go the distance. CR

▶ For more information

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