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Life Policies: The Whole Truth

By Leslie Scism

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The recent market turmoil is rekindling interest in a financial product designed to provide safety and stability: whole-life insurance.

The trick, advisers say, is to find a policy that combines reasonable fees and generous dividends—and that isn't always an easy task.

Whole-life sales spiked after the 2008-09 financial crisis, when many families fled to them for safety and guaranteed annual dividends. Since then, sales of the policies—which combine life insurance with a "cash value" account—have continued to grow.

In a whole-life policy, the insurer pays an annual dividend, of at least a guaranteed minimum amount, and the account rises tax-deferred.

Yet many of the policies still have the same issues they always have had: often-steep agent commissions, high cancellation rates and annual costs that can be both high and difficult to understand. As with other life policies, the price depends on the buyer's age and health.

TIAA-CREF and Guardian: two oft-recommended purveyors of permanent-life insurance policies ASSOCIATED PRESS; GUARDLIAN LIFE INSURANCE COMPANY

While sales of individual life-insurance policies, as measured by annualized premiums, rose 3% in the first quarter to an estimated $3.05 billion, compared with a year earlier, whole-life premiums increased 10% to $982 million, according to industry-funded research firm Limra.

Certain types of "universal life," a cousin of whole life, also have seen stronger sales. Both whole- and universal-life policies—which are both also called "permanent life"—are designed to be in place until a person dies. Term-life insurance, by contrast, is basic coverage that pays out if death occurs in a specified period. During the first quarter, term-life premiums edged up by 1% to $663 million.

Many small investors, feeling burned by the financial markets, are using permanent-life policies in place of other investments.

George Carapella, a tax preparer in Staten Island, N.Y., soured on stocks and funds after the tech-stock and housing bubbles burst. The investments "didn't work out," the 53-year-old says. "Too many crashes. I said, 'Who am I kidding?'"

Instead, he bought a $500,000 whole-life policy from National Life Group, a policyholder-owned insurer in Montpelier, Vt. Mr. Carapella says he likes that the insurer invests the money in bonds and real estate.

Here's what to consider before shopping for a whole-life policy.

Many people aren't good candidates for whole life.

Under a whole-life policy, the insurer deposits your premium, less insurance costs and other expenses, into a cash-value account. Currently, many insurers are paying 4% to 6% annual dividends, with guaranteed minimums of 2% to 4%.

Individuals are able to withdraw tax-free much or all of what they put into a whole-life policy, though they must follow strict rules; if not careful, policyholders can end up owing taxes.

The policies can make sense for people who need insurance and have maxed out contributions to 401(k)s and other tax-advantaged plans, advisers say. But many buyers underestimate how difficult it can be to pay the premiums year after year, and they end up canceling their policy before they break even.

In a study released in December, the Society of Actuaries found that 20% of whole-life policies are terminated in the first three years, and 39% within the first 10 years.

Early dropouts would have been much better off in cheaper term-life insurance, advisers say. "One needs to keep a cash-value policy at least 20 years to amortize the acquisition costs and produce a decent investment," says James Hunt, an actuary at the Consumer Federation of America, an advocacy group.

Your agent has an incentive to sell whole-life policies.

Agents and their managers typically receive upfront commissions and other compensation totaling well over half the first-year premium. That means very little of the premium goes into the cash-value account. The industry defends these commissions as fair compensation for agents' services.

Brian Fechtel, an agent who runs a website called BreadwinnersInsurance.com, recommends "blended" policies, which combine permanent- and term-life components in a way that holds down costs while still providing the tax-advantaged benefits of permanent-life coverage. Agents earn less in commission on these policies, so they might not readily pitch one.

Policies can have other high fees that will eat into the value of your account.

There are annual charges for the insurance itself, often higher than what term-life insurance costs if bought as a stand-alone policy, the Consumer Federation's Mr. Hunt says. There also are administrative costs.

And there isn't an easy way to compare these costs across companies. "Cash-value policies are impossible for laypersons to penetrate," Mr. Hunt says.

Costs can go up, and dividends can go down.

In their pitches, agents typically use "illustrations" to project the cash-value account's growth over time. Mr. Fechtel calls these "fanciful sheets of numbers" because there is no certainty they'll work out.

Under state regulations, agents must show a worst-case scenario, reflecting maximum allowable costs and the guaranteed-minimum dividend rate. Many agents dismiss the gloom-and-doom as unlikely to occur.

Yet with interest rates at ultralow levels, many insurers have been ratcheting down their dividend payments, and many are nearing the guaranteed minimums, according to financial advisers and stock analysts.

What to do. To find a reasonably priced policy, you could hire a fee-only life-insurance adviser, or use the policy evaluation service offered by the Consumer Federation of America at www.evaluatelifeinsurance.org. It typically costs $90 for the first analysis and $65 for each additional one.

The federation's Mr. Hunt and some financial advisers like the low-cost universal-life policies issued by TIAA-CREF, which sells through staff employees.

Peter Katt, a fee-only life-insurance adviser in Mattawan, Mich., recommends mutual insurers, which are owned by policyholders. The four biggest are Guardian Life Insurance Co. of America, Massachusetts Mutual Life Insurance, New York Life Insurance and Northwestern Mutual Life Insurance. These firms have track records for delivering value, Mr. Katt says, including long histories of generous dividends.

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