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Whole-Life Insurance, Long Derided, Gets New Lease

By Leslie Scism

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If you haven't already, you are likely to hear the pitch soon: Whole-life insurance—the fuddy-duddy stuff your grandparents owned—was a shining star during the financial crisis.

Massachusetts Mutual Life Insurance Co., New York Life Insurance Co. and others have been playing off the disappointing performance of many competing investments during the financial crisis to boost whole-life policies, which combine insurance with investments.

Thanks to conservative investments in bonds, whole life—and its cousin, universal life—delivered positive returns during the financial crisis. But before you sign up for a policy, beware: You will pay hefty premiums and, in most cases, a steep up-front commission that eats up your first-year premium, leaving little of it for investment.

Whole life and universal life often are best for people with plenty of money to invest beyond their 401(k)s, but only if held until death.

Both are “permanent” insurance: The policies are designed to provide a death benefit, however long you live. “Term” insurance, by contrast, protects you for a given period but builds no value. For young people, premiums for term life are much lower than for permanent insurance.

Term life is the “default recommendation” for most consumers, particularly those on tight budgets, says James Hunt, an actuary with the Consumer Federation of America.

Under a whole-life or universal-life policy, the insurer deposits your premium, less insurance costs and other expenses, into a “cash value” account. Your money is invested mostly in corporate bonds, and insurers typically promise minimum interest payments of 3% to 4%.

Investment gains are tax-deferred, and you are able to withdraw tax-free much or all of what you put into the policy. The policies are a good way for many people who have maxed out contributions to 401(k)s and other tax-advantaged plans to save for a variety of purposes before they die, says Peter Katt, a fee-only life-insurance adviser in Mattawan, Mich.

Term life gained popularity as the proliferation of mutual funds in the 1980s and 1990s expanded savings options, and “buy term and invest the difference” became a mantra.

Of course, anyone who invested the difference in stocks may still be smarting over losses from the recent market meltdown. And some wealthy taxpayers who invested directly in bonds would have had trouble matching the investment returns of a good whole-life policy after taxes.

Those in a high tax bracket “would have a hard time making term life and a bond fund work better than a good whole-life policy,” Mr. Hunt says—provided they don't surrender the policy and incur income taxes.

Over 20 years, Mr. Hunt says, the annual investment return on whole-life policies from the best insurers approaches a tax-deferred 4.5% (tax-free if held until death), after adjusting for the value of the insurance and assuming dividend schedules don't continue to decrease.

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It makes a difference where you buy your policy. Look for a company known for both low annual costs and solid investment performance. Mutual insurers, like Massachusetts Mutual, New York Life and Northwestern Mutual Life Insurance Co., owned by their policy holders, often fit the bill.

Another prospect is TIAA-CREF. The firm sells its policies through salaried staff, rather than commission-paid agents. Your policy can build up cash value faster since the insurer isn't using

your initial premium to pay a big commission.

The all-important point is that whole life's performance edge plays out over decades, so don't purchase it if you aren't confident you can stick with it.

Consider a 40-year-old male buyer of a typical \$1 million policy, paying an annual premium of \$17,750, according to figures worked up by David Barkhausen, who runs fee-only Life Insurance Advisors Inc. in Lake Bluff, Ill. Thanks to the agent commission, just \$1,251 of the premium makes it way into the cash-value account the first year.

It isn't until the 12th year that the buyer's cash value totals the premiums previously paid. After 20 years, this policy has a \$518,068 cash value, or a 3.8% annualized return.

One way to enhance returns is to buy a "blended" policy that includes lots of term insurance, and then bolster the whole-life component over the years. Commissions are lower than on a traditional whole-life policy.

If a 40-year-old male buys a blended policy with a \$17,750 premium, his cash value totals \$50,762 at the end of the third year. After 20 years, it totals \$594,861—a 5.1% average return.

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