12 Questions to Ask Before Purchasing Whole Life Insurance

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Should you buy whole life insurance? The short answer is, "Probably not." If you're interested in the long answer, keep reading!

In this post I'm going to present an easy to use checklist you can go down when considering the purchase of any type of "permanent" or "cash-value" life insurance such as whole life, index universal life, or variable universal life insurance. Each of these types of insurance combines a death benefit that pays out whenever you die with an investment account of some type that acquires cash value. You can borrow the cash value tax-free but not interest-free throughout your life, and then when you die, whatever death benefit wasn't already borrowed out goes to your heirs. These policies tend to be plagued with high fees, commissions, and insurance costs which reduce the return to investors. They are also dramatically oversold. For instance, ~80% of those who purchase whole life insurance policies surrender them prior to death. This is mostly because agents are highly motivated by big commissions to sell these policies inappropriately based on a number of myths.

Any time I talk about these polices, I'm always very careful to qualify my statements, using terms such as "probably," "almost surely," "most people including doctors," and similar. The careful reader notices that wiggle room, and then wonders if he may be one of the exceptions who might benefit from one of these policies. This checklist demonstrates those rare exceptions.

 # 1 Do you have a NEED for a permanent death benefit?

One example of this need is a particularly illiquid estate where a large percentage of the estate is tied up in small businesses, a family farm, or real estate that cannot be readily liquidated at death to pay any estate taxes due (be sure they're actually due, most doctors won't owe any federal estate taxes) or to be split up amongst the heirs. Another example might be somebody who will never be financially independent but has a special needs child depending on his income. There are also a few business uses where it makes sense, such as insuring the lives of partners so that the other partners have the money to buy out their heirs upon the death of a partner. Basically, you are asking yourself if you have some insurance need that can be covered with term life insurance at a reasonable cost. If so, you have no need for a permanent death benefit, and ought to really think twice before buying a permanent insurance policy.

 # 2 Do you prefer leaving heirs a guaranteed amount rather than what will probably be a larger, but not guaranteed amount?

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As a general rule, and especially with whole life and index universal life, there will be more money left to heirs simply by investing the money in tax-efficient stock index funds and real estate. Thanks to the step-up in basis at death, these investments are passed income tax-free to heirs just like life insurance. But if you die well before your life expectancy, the heirs would have received more with the life insurance. There is also the possibility that your investments will underperform the life insurance, but over long periods of time, this is very unlikely unless you die early.

 # 3 Do I place a high value on one of the "side-benefits" of life insurance?

Just like the death benefit isn't a free lunch, neither are any of the side benefits of cash value life insurance. These include pretty good asset protection in many states and the ability to "bank on yourself" (borrowing frequently from the policy to buy consumer items or investments.) But if you highly value them, it may be worth accepting the high costs and low returns of permanent life insurance.

 # 4 Can you pay the premium annually?

Usually, you get a discount for purchasing a policy on an annual, rather than a monthly basis. However, even if you don't, this is still a good question to ask yourself. If coming up with the money to pay the premium annually is a big deal to you, then you are probably buying too large of a policy and ought to rethink it. For a typical doctor in mid-career who has decided he likes whole life insurance, coming up with a $10K annual premium should not be a big deal. However, coming up with a $100K annual premium is. That should be a tip-off that you're buying too much of this product.

 # 5 Do you have any doubt whatsoever that you will be able to make the required premiums?

Premium payments are due every year for decades, and sometimes until the day you die. Agents will often show rosy projections where the dividends from the policy may cover those payments after just a decade or two, but those dividends aren't free. If you're using dividends to pay premiums, the cash value and death benefit aren't growing as quickly as they otherwise would. Too many doctors discover after just a few years of making large premium payments that they no longer can or want to pay them. Then they are stuck with a difficult decision about what to do with the policy.

 # 6 Have you consulted with a professional who does not sell

insurance about whether or not you should buy this policy?

Most of the purchasers of whole life insurance never talk to anyone about it other than the guy selling the insurance. A second opinion seems prudent before purchasing something that will cost you hundreds of thousands of dollars, no? Be sure there is no financial relationship between the two people advising you on this purchase.

 # 7 Have you reviewed at least 5 policies of the type you are interested in purchasing?

How many houses did you look at before purchasing your residence? You will likely spend more on this policy than that house, so why are you only looking at one policy? Looking at multiple policies (preferably from multiple agents) will help you to see the downsides of each policy. They'll be very quick to point out the problems with "the other guy's policy."

 # 8 If purchasing a VUL, are you able to purchase the same investments you would purchase without the VUL?

Variable Universal Life insurance policies basically put mutual funds inside a life insurance wrapper. If you would not purchase the equivalent of those funds outside the wrapper, don't purchase them inside the wrapper. Most VULs are filled with lousy investments. Combine that with the costs and commissions of insurance, and most of these policies end up being serious losers.

 # 9 If purchasing a VUL, are you confident that your tax savings will be more than the insurance costs?

The reason most docs purchase VULs is as another retirement account. If they can get a VUL with solid investments, the real question to ask prior to purchase is whether the insurance costs or the tax costs will be higher. If you are not sophisticated enough to run the numbers on this decision yourself (or at the very least with the assistance of a trusted advisor with no financial conflict of interest,) you probably should not be purchasing the policy. Taxable accounts are a reasonable or even superior alternative most of the time.

 # 10 Have you read the entire Debunking the Myths of Whole Life Insurance series?

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The insurance agents who sell whole life are master salesmen. They receive a lot of training in sales and surprisingly little in finance. When considering a life insurance purchase, you should have a very different mindset from when you sit down with your CPA to review your taxes. It should be a bit more like the mindset you have when you are going to purchase a car at a dealership. The "Myths" series will demonstrate the arguments the agent will use to try to sell this policy to you. Understanding why they are myths will ensure that if you choose to buy a policy, you will buy the right policy for the right reason.

 # 11 Have you maxed out your tax-advantaged accounts?

Purchasing permanent life insurance prior to maximizing all of your tax-advantaged savings accounts is almost always a mistake. Most doctors (and even their advisors) aren't even aware of some of these accounts. It is idiotic to fund a VUL (and pay the associated insurance costs) as an extra "tax-free" retirement account when you haven't even maxed out a personal and spousal Roth IRA (which has no insurance costs.) These accounts definitely include the following:

- 401(k)
- 403(b)
- Profit-sharing plans
- Individual 401(k)
- Backdoor Roth IRAs
- HSA

and probably include many of these:

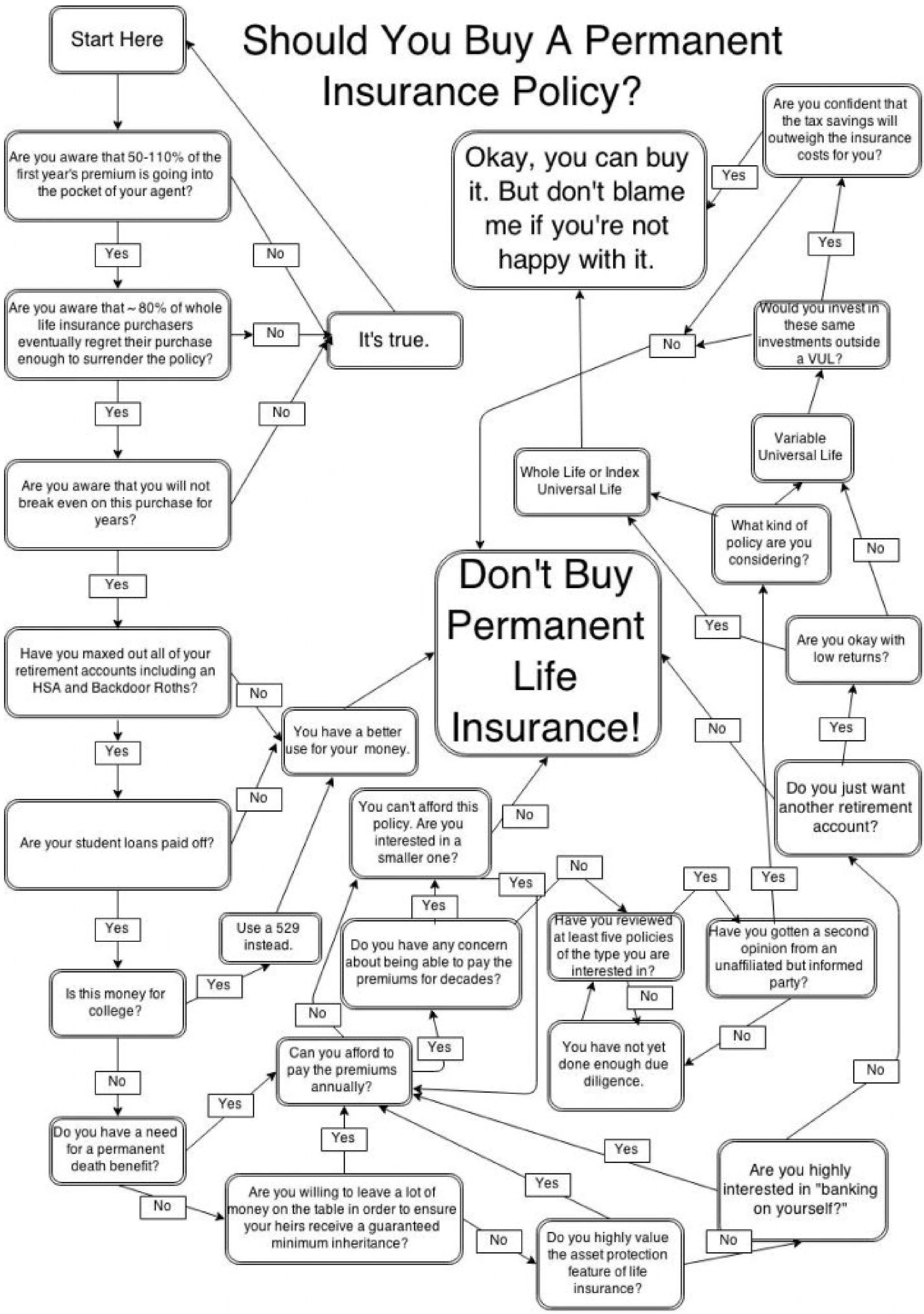
- 457 Plans
- Defined Benefit/Cash Balance Plans
- 529 Plans or Education Savings Accounts
- UTMA/UGMA Accounts

If your insurance agent is suggesting you should purchase permanent life insurance INSTEAD of using most or all of these accounts, that should raise a huge red flag in your mind.

 # 12 Is the policy set up in the best way to reach your goals for the policy?

These policies can be set up in many different ways. Policies set up to maximize the death benefit, to maximize the return on the cash value, or to facilitate frequent borrowing from the policy are all designed differently. While you can use any policy for all of these needs, it is going to be less than ideal unless used for its intended purpose. Unfortunately, most policies are set up to maximize the commission to the agent, rather than to maximize ANY benefit to you.

I decided to put together a flow chart to help you with your decision. It ended up being pretty complicated, just like these policies. Click on it to enlarge.


Start Here
Should You Buy A Permanent Insurance Policy?
Are you aware that 50-110% of the first year's premium is going into the pocket of your agent?
Yes
No
Are you aware that ~ 80% of whole life insurance purchasers eventually regret their purchase enough to surrender the policy?
No
It's true.
Yes
No
Are you aware that you will not break even on this purchase for years?
Yes
Have you maxed out all of your retirement accounts including an HSA and Backdoor Roths?
No
You have a better use for your money.
Yes
No
Are your student loans paid off?
Yes
Use a 529 instead.
Is this money for college?
Yes
No
Do you have a need for a permanent death benefit?
Yes
No
Are you willing to leave a lot of money on the table in order to ensure your heirs receive a guaranteed minimum inheritance?
Yes
No
Can you afford to pay the premiums annually?
Yes
No
Do you have any concern about being able to pay the premiums for decades?
Yes
No
You can't afford this policy. Are you interested in a smaller one?
Yes
No
Don't Buy Permanent Life Insurance!
Okay, you can buy it. But don't blame me if you're not happy with it.
Are you confident that the tax savings will outweigh the insurance costs for you?
Yes
Yes
Would you invest in these same investments outside a VUL?
No
Variable Universal Life
Whole Life or Index Universal Life
What kind of policy are you considering?
No
Yes
Are you okay with low returns?
Yes
No
Do you just want another retirement account?
Have you reviewed at least five policies of the type you are interested in?
Yes
Yes
Have you gotten a second opinion from an unaffiliated but informed party?
No
No
You have not yet done enough due diligence.
No
Are you highly interested in "banking on yourself?"
Yes
Yes
Do you highly value the asset protection feature of life insurance?
No
No

What do you think? Do you think this decision is this complicated? Agree with my reasoning? Disagree? Did you buy a permanent life policy? Are you happy you did? Sound off in the comments section!