

Newspaper Presents

Dumber Than Dirt Award

TO: Life insurance companies that sell cash value life insurance —

- Whole Life
- Universal Life
- Single Premium Life

Page Six — The Springville Herald — April 22, 1987

That's Life

The third annual Dumber Than Dirt Award

by Roger Sturman

This year, the Dumber Than Dirt Award goes to the nation's insurance companies. They continue to come up with one stupid product after another in hopes of separating us from our hard earned money. The two latest moronic products are "Single premium Whole Life," and "Universal Life." There are many other names for these products, but as a rule of thumb they are CASH VALUE life insurance policies.

The insurance industry is notorious for trying to figure out ways to get their hands on your money. They will keep it for your whole life and then when you die or retire they will give it back to you plus a small amount of interest. The larger amount, the money they have made by investing your funds, will be put into their own pockets.

Single Premium Whole Life is the newest (and dumbest) product the industry has ever spawned. They ask the American public to pay \$10,000.00, for instance, for an insurance policy. When you die, they will give it back to you with a little interest. Would you believe people are actually buying the stuff — even though they could get better interest at their local bank? Some of the policies are much more expensive, running into the \$50,000.00 range.

The thing you want to watch for are the terms "current rates," and "guaranteed rates." The word "guaranteed" does not mean the lowest rate. It usually means the highest rate the insurance company will charge. The term no one wants to discuss in "N.E.Y." or Net Effective Yield. That's the real cost of your insurance and how much you can expect your cash value insurance policy to be worth after one year or five years. Most insurance agents haven't even been instructed as to "N.E.Y." by their employer, so

they may just give you a blank look when asked about it.

Universal Life has been around about five years now, and was praised by the industry as being a little bit better than Whole Life. It isn't! In fact, if your insurance agent has switched you from Whole Life to Universal Life, your cash value may be all gone. It is held by the insurance company under the disguise of extra charges and penalties. If you had \$4,000.00 built up in a cash value policy, for instance, and then switched to Universal Life, your \$4,000.00 may no longer exist.

The insurance companies have introduced this product to stop the large numbers of people who are switching to low cost "Term" life insurance. The problem is that only those people who are trained to read the language of the policy can understand what the heck they bought. There is one sure thing about an insurance policy, though, if it doesn't state, in exact words within the body of the policy, what you thought you were buying — it isn't so. Even separate papers are considered "proposals" and not binding on the policy.

Another not-so-nice thing that the insurance industry likes to do is to sell a thing called "Annuity." An annuity is just the opposite of life insurance. With an annuity, you give all your money to the insurance company and they will pay you back a little bit at a time. They like to do this with death claims for widows that are beneficiaries of large sums of money. Using annuities, the insurance company gets to keep your money and pay you only a small amount while they operate their business on the interest of the balance. One type of annuity actually goes back to the insurance company on the death of the beneficiary. In other words, you

may have to outlive the payout period of the annuity or the insurance company will not continue payments to your heirs. Isn't that nice?

Insurance companies are the wealthiest institutions in America and they continue to find new ways to use our money to fatten their own pockets. Life insurance is very important to a young family, but not really practical for the elderly. Life Insurance should only be used as "income replacement." In spite of that we continue to see advertisements on TV showing senior citizens how to spend their money for insurance. When the policy comes it is generally for \$1,000.00, not even enough to pay for a funeral.

Many folks that are in their fifties and above have insurance that they have been paying on for years. Some of those policies have reached the point where the amount paid in equals the amount that the insurance company will pay out. Annual policy fees are being charged just to keep the policy in force. Owners of that type of policy are actually self insured, but are paying the insurance company for the privilege.

If all of this seems confusing to you, I am not surprised. We, the public, have been told for years that we are not smart enough to manage our own money. Most of us have come to believe that and have acted accordingly all of our lives. The insurance companies have taken advantage of that philosophy and continue to legally rob us of our life savings.

I saw an interesting sign the other day, it said "CAUTION, IT HAS BEEN DETERMINED THAT INSURANCE COMPANIES CAN BE HAZARDOUS TO YOUR WEALTH."

COMPARATIVE RATES OF RETURN IN INVESTMENT INSTRUMENTS¹¹

% RETURN

Minus 100%	Cash Value Life Insurance Held for 1 Year
Minus 9% to Minus 19%	Cash Value Life Insurance Held for 5 Years
Minus 4% to Plus 2%	Cash Value Life Insurance Held for 10 Years
Cash Value Life Insurance Held for 20 Years	2% to 4.5%
State and Local Government Bonds (Aaa)	5.2%
Passbook Savings Deposits	5.25%
State and Local Government Bonds (Baa)	6.12%
U.S. Treasury Bonds	6.99% to 7.67%
Savings Certificates of Deposit	5.75% to 7.75%
Corporate Bonds (Aaa)	8.02%
Corporate Bonds (Baa)	8.97%

2. Returns on new forms of cash value insurance are unreliable.

Once consumers started getting wise to the low return they were earning on cash accumulation in life insurance policies, the industry began designing new insurance plans that featured higher yields. Universal Life was their answer, a type of life insurance that attempted to couple term insurance with an investment plan. Some of the forms of Universal Life featured variable interest rates tied to T-bills and other market indicators. Universal Life, or "UL," as it is called in the industry, was supposed to be the wave of the future.

Unfortunately, recent examinations of the product show that UL's promised returns may have been just that — promises.

A February 1986 *Wall Street Journal* article, titled *Return on Universal Life Insurance Can Be A Lot Less Than Expected* expressed concern that UL policies were not living up to their sales pitches. Look what one actuary interviewed by **WSJ** had to say:

"There are so many claims being made about high interest rates paid on policies. But when they subtract all these charges, the yield may not be anything like that."

And two years later, in a March 1988 *Wall Street Journal* article titled *Lagging Returns on Universal Life Plans Create Disenchantment Among Holders*, it appears that the case against Universal Life still exists:

"[A Universal Life policy] has limited guarantees, and much investment risk is transferred to the holder."

And, a professor of insurance added:

"With Universal Life policies, insurers face an 'era of disillusionment' during which 'it will be difficult to rebuild public confidence in the industry'."

"I don't think most agents know they are screwing their friends and relatives by selling them whole life."

Michael Lynch, Federal Trade Commission****

U.S. TREASURY DECISION NUMBER 1743

This question (Dividends) was argued at great length and in full detail before the Internal Revenue Department and before Congress during the early months of 1911. The income tax clause of the Tariff Bill of 1911 proposed an income tax on Life Insurance dividends. Representatives of companies featuring participating insurance vigorously protested against this tax. The arguments and contentions of these companies are clearly set forth in the following quotations from UNITED STATES TREASURY DECISION NO. 1743:

"Reduced to final analysis the contentions of the various companies are...

"That dividends declared by participating companies are not dividends in a commercial sense of the word, but are simply refunds to the policyholder of a portion of the overcharge collected, which overcharge is merely held in trust by the company issuing the policy. Annually, or at stated periods, all, or a portion thereof, is returned to the person holding the policy...

It was vigorously contended by counsel, representing certain of these companies that it was necessary at the outset to disregard entirely the policy contracts, the published literature, the representatives of officers and agents, the sworn returns of state authorities, and to consider the proposition only after items had been eliminated; that owing to the urgent need of business and the competition of insurance companies, it was necessary, in order to secure new business, to convince the prospective policyholder of the desirability of the same, and that this commercial necessity had resulted in the companies making misrepresentations of facts as to DIVIDENDS to prospective purchasers of insurance, and that names and designations, having a single specific meaning in the commercial world and which were therefore attractive to prospective policyholders, had been adopted to represent transactions which they now hold are entirely different from what their name implies and represents, and from which the policyholder himself believed he was receiving, and that business necessities had caused a continuance of these misnomers. It was represented that, in fact, there were no dividends, but merely a refund of overcharges, which, for reasons above stated, were usually referred to as dividends."

In this connection, it is interesting to note how life insurance dividends are referred to in the present Federal Income Tax Regulation 94. In article 22, on Gross Income, Regulation 94, this statement appears: "Amounts received as a return of premiums paid under life insurance, endowment, or annuity contracts, and so-called DIVIDENDS of a mutual insurance company which may be credited against the current premium, are not subject to tax."

Individual Insurance Agent's Study Program

Practice Exam No. 9

Whole Life

True or False

- _____ 1. The cash values in a cash value policy are owned by the insurance company and NOT BY the insured.
- _____ 2. If the insured under a whole life policy should die, his/her family ordinarily DOES NOT receive BOTH the face amount of the policy and cash values.
- _____ 3. The insured must pay the interest if he/she borrows from the cash values.
- _____ 4. If a policyholder decides to withdraw all of the cash values without paying interest or premium, he/she must surrender the insurance protection.
- _____ 5. The cash values in a cash value insurance policy cannot in most states be legally described as "savings."
- _____ 6. The cash values in a cash value insurance policy cannot qualify as an IRA.
- _____ 7. The "dividends" received under a participating life insurance policy are really a "partial return of a deliberate premium overcharge."
- _____ 8. It could take as long as six months for someone to receive the cash values from a company, should they decide to withdraw.
- _____ 9. According to the 1979 FTC Staff Report, the average rate of return paid to whole life policyholders of policies studied that year was estimated to be from 1.2 to 1.85%.
- _____ 10. The policyholder can purchase a higher face amount of insurance protection for the same premium dollar with term insurance than with cash value insurance.
- _____ 11. The return on whole life insurance is generally less than current market rates on most savings and investment instruments.
- _____ 12. If a policyholder has a \$100,000 whole life policy with \$25,000 of accumulated cash values and borrows his cash values, his beneficiary would collect only \$75,000 at his death.
- _____ 13. The return (without dividends) on a whole life policy is fixed from the sale of the policy and will not increase in relation to market rates.
- _____ 14. Projected dividends on whole life policies are not guaranteed.
- _____ 15. An insurance company will usually have a larger gain on a \$100,000 whole life policy than for a \$100,000 term policy.
- _____ 16. The "net insurance cost" of cash value insurance increases each year despite the payment of a lifetime level premium.
- _____ 17. A cash value policy is really a "decreasing term" policy and a cash value and the burden of protection gradually shifts to the cash value.
- _____ 18. The American Council of Life Insurance in a 1974 document stated that "the life insurance industry was on a self destruct course if it continued its present emphasis on individual whole life products."
- _____ 19. Life insurance is for dying and investments are for living and the two should never be combined.

THE FACTS ABOUT UNIVERSAL LIFE

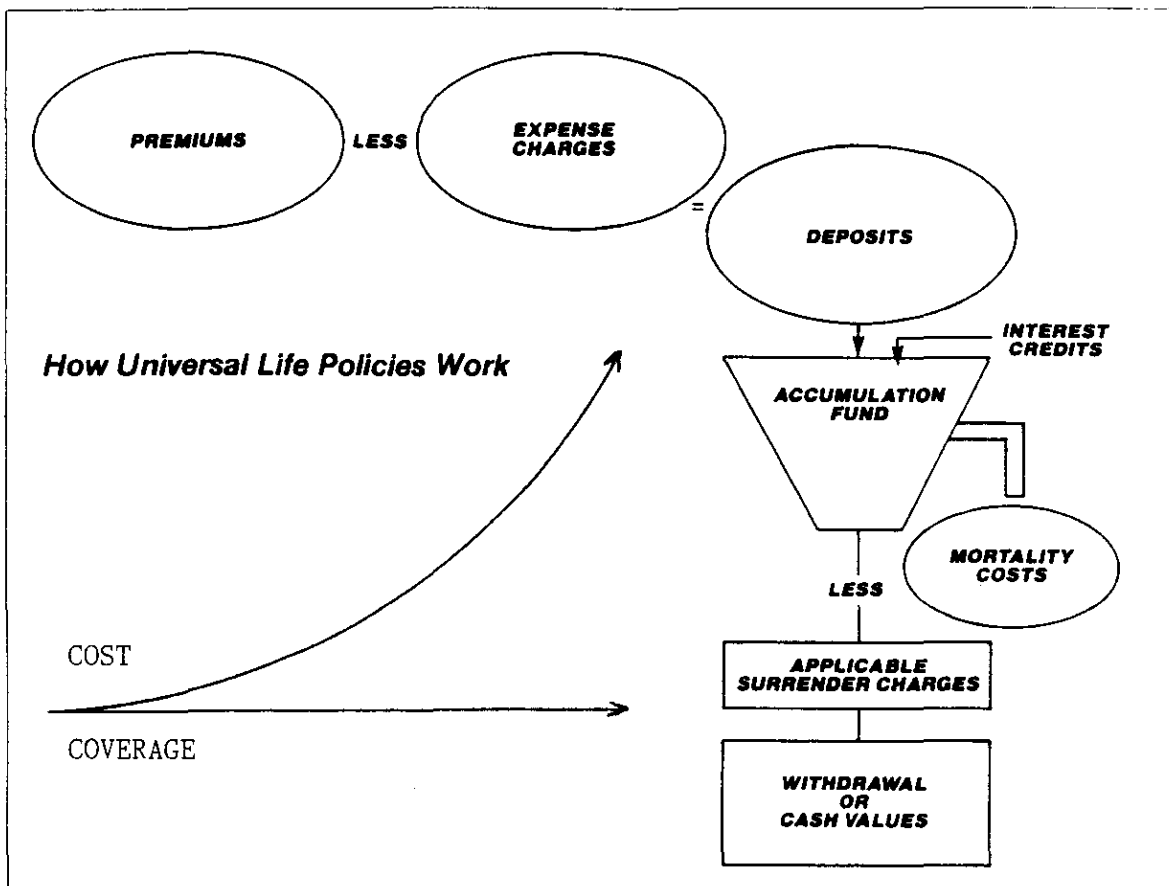
A Universal Life policy essentially splits a whole life policy into separate components of term insurance and an accumulation "side fund," while providing more flexibility than exists under traditional whole life policies.

Normally, a premium (which is flexible) is paid to the life insurance company. From that premium, certain stated expenses are deducted and the remaining premium is deposited into the side fund.

From the side fund, mortality charges are deducted and the remaining money in the side fund accumulates at a certain interest rate. The interest accumulation rate is sometimes tied to a money market or T-bill rate with certain modifications.

The chart below shows how Universal Life policies work: You pay your premium. That premium, minus the company's administrative charges (which include sales commission), is deposited into your accumulation fund.

Out of that fund comes your mortality cost, and other charges levied by the company, and any cash you withdraw. (Sound like a lot of charges? We'll talk more about those later.) What goes *into* your account is whatever interest rate the company decides to pay you on your cash accumulation or is required to pay if the interest is linked to a T-bill rate or something similar.



For training and educational purposes only.

WHAT'S BAD ABOUT UNIVERSAL LIFE

1. Hidden Charges
 - A. Administrative charge - 5% to 10%
 - B. Sales Charge - 25% to 70%
 - C. Surrender Charge - up to 100% (this is a KILLER, especially if client didn't know about it)
2. Too confusing, complicated
 - A. Do you understand all the charges in your policy?
 - B. How does the company decide the interest rate they will pay?
 - C. How do they decide what your mortality charge is?
 - D. How much of your premium is going to mortality charge, charges, savings?
 - E. Did you know the possibility exists that your policy could lapse (no cash, no insurance), even if you pay your premiums on time (majority of policies)?
3. Can't afford the amount of insurance you need
 - A. \$150,000 - 200,000 is really minimum for most families
 - B. Can't afford that much with universal life
4. Bundling
 - A. You're not in charge of your own financial destiny, an insurance company is (Isn't that exciting?). Remember variable loans at bank?
 - B. If 10 years from now, you don't like the interest rate you're getting, or the mortality charge they're taking, what will you do? Cancel? What if you're uninsurable? Borrow? That's exciting, huh!
 - C. Doesn't allow you to move to other investments, as ANY OTHER REAL INVESTMENT DOES!
 - D. You're charged sales charge, administrative charge on total premium, not just the investment part.
 - E. Insurance and investments are two different things, not one.
5. Doesn't qualify as an IRA
 - A. You pay taxes on EVERY PENNY of premium you pay in a universal life policy, not in term and invest the difference in an IRA.
 - B. Understand the advantages, necessity of an IRA

WHAT'S GOOD ABOUT TERM AND INVEST

1. Simple, no frills, no gimmicks, pure death protection.
2. You can invest in an IRA outside your insurance policy.
3. You control your own financial destiny. Nobody can take care of your family like you.

Individual Insurance Agent's Study Program

Practice Exam No. 10

Universal Life

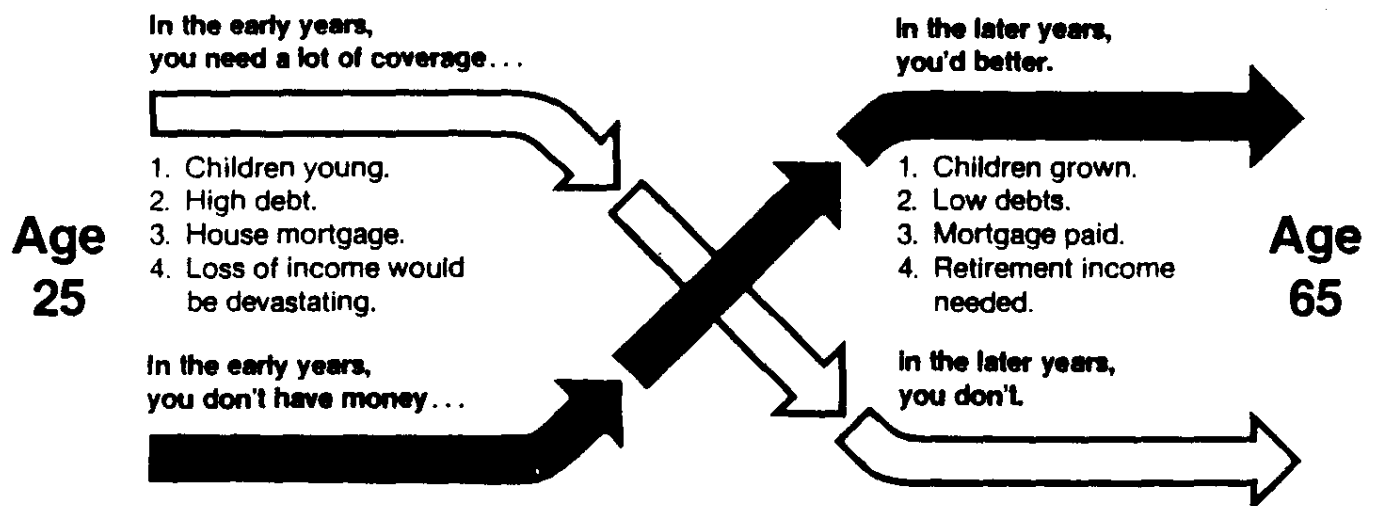
True or False

- _____ 1. The interest over the guaranteed rate on the cash accumulation of a Universal Life policy is often controlled by the insurance company and can be changed at its discretion.
- _____ 2. The insurance and "investment" components of a Universal Life policy are bundled together and cannot be separated.
- _____ 3. The higher advertised interest rates on Universal Life policies are not paid on the first \$1,000 of cash value.
- _____ 4. The cash accumulation in Universal Life policies cannot qualify as an IRA.
- _____ 5. If current proposed legislation passes, new Universal Life policyholders could be subject to taxation on the build-up of their cash accumulation fund.
- _____ 6. If a policyholder chooses the option of skipping a premium payment, that payment is not eliminated, but is taken from the cash accumulation in the policy.
- _____ 7. Contributions to an IRA are tax deductible while contributions to a Universal Life policy are not.
- _____ 8. The better measure of the return on the cash accumulation of Universal Life policies takes into account all fees and insurance costs, and the advertised rate does not give you enough information about the "real return."
- _____ 9. If a policyholder wishes to withdraw a portion of the cash accumulation portion of a Universal Life policy, he must often pay a "surrender charge" of either a lump sum or a percentage of the amount he withdraws.
- _____ 10. A Universal Life policy is simply a "glorified" cash value insurance policy.

The Theory of Decreasing Responsibility

The basic concept behind my beliefs about term insurance protection is a simple theory with a long name — the “Theory of Decreasing Responsibility.” It simply means that your need for insurance is greater when your responsibilities are greatest, i.e., when your children are young, you have a mortgage payment and so forth. As you get older, your responsibilities decrease — children are grown and on their own, routine payments are reduced, your home is paid for. This is the time that you need very little “death protection” in the form of insurance, and should rely instead on accumulated cash for your retirement years.

The Theory of Decreasing Responsibility illustrates the wisdom of term insurance as a wise insurance choice. You buy low-cost, high coverage term in your early years, and “invest the difference” between the cost of term and whole life insurance in a promising investment program. As you grow older, your insurance coverage decreases, and your accumulated savings, hopefully, increase.



Remember Your Goal

Your major goal is to become self-insured by age 65 or sooner. Life insurance protects your family until you've had time to build financial security. Term insurance, in my opinion, best fills that temporary need.