



“On The Money Report”

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THE MOST COMMON LIFE INSURANCE MISTAKES TO AVOID

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Life insurance is one of the most important purchases an individual or a business will ever make. It can pay huge dividends to avoid the pitfalls into which a buyer can so easily fall. The mistakes listed below have been made over the years and continue to be made every day. Also listed below are some solutions.

Each of these mistakes (pitfalls of purchasing and owning life insurance) has two things in common. First, each has potentially serious consequences in terms of both expense and aggravation. Second, each one can be avoided, or, if caught in time, can be corrected quickly and inexpensively. There are relatively simple solutions for each of these mistakes.

The real irony of all these errors is that they do not involve complex tax or other laws. Even if you are not a professional advisor, most of these mistakes can be spotted easily.

1. Failure to have a life insurance policy reviewed at least every three years.

This is the worst mistake life insurance owners and trustees of life insurance trust make. Life insurance is not a buy it, put it in a drawer, and forget it product. Like all investments, it needs to be monitored and reviewed on a regular basis to insure it is meeting the goals it was designed to meet. It is incredible how many ex-wives receive life insurance death benefits instead of the current spouse. The amount of insurance bought 10 years ago as sufficient is often not adequate now, because inflation has eroded the purchasing power of the proceeds.

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But the most important reason to have a policy reviewed is that when you purchase life insurance you are shown an illustration of what might happen if the interest rate and the cost of insurance were to remain constant. It cannot happen. The policy will not perform as illustrated. Interest rates and the cost of insurance will change over time. The only part of that illustration that is true is the guarantee figures. We have gone through an extended period of low interest rates and market returns that have caused the policy performance to be less than was illustrated when purchased. It means more dollars will be required to meet policy charges. It is almost certain that if you have owned a cash value life insurance longer than five years, it is in financial trouble. It needs to be reviewed.

Write to the insurance company and request an “in force” ledger illustration to be sent to you. At the same time, request written confirmation as to the primary and contingent beneficiaries. Then meet with an independent fee basis financial advisor to see how best to fix the policy.

2. Not selecting appropriate beneficiaries or changing beneficiaries when necessary.

There are tax ramifications to the beneficiary you select. For instance, naming your estate as the beneficiary would result in the proceeds being included in your taxable estate. This also means your creditors have full access to the life insurance proceeds. Last but not least, it means the proceeds will probably be subject to the expense, aggravation, and delay of probate.

Death, divorce and change in family dynamics can cause a need to change in beneficiaries. An adult child that is financially irresponsible or becomes disabled emotionally, physically or mentally may need trust set up for them to assist in managing their inheritance.

Be sure the beneficiary designations of all life insurance, group life insurance, pension owned and individually owned policies name the person or organization or entities you want to receive the proceeds of the policy.



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3. Failure to name at least two contingent or backup beneficiaries.

If a named beneficiary dies before the insured, the proceeds will be paid to the insured's estate. (Read mistake #2 for details.)

The fact is, you should name at least two contingent or backup beneficiaries and two back up guardians in wills, trusts, pension or profit sharing plans, IRAs, 401(k), and HR-10s. Name more than two back-ups if the beneficiary is a “special needs” person who is physically, mentally, or emotionally challenged. You should consider naming one or more charities as ultimate beneficiaries in case the personal beneficiaries you've name pre-decease you.

4. Purchasing the wrong type of insurance.

In other words, purchasing cash value life insurance for a short term problem or purchasing term insurance to cover a permanent need. Covering a mortgage is a short term commitment. Paying estate taxes is a permanent need. Providing for a spouse's financial welfare is also a permanent need. Individuals seem to overlook the fact that term insurance self terminates or becomes too expensive to carry as they get older. At age 75 or 80, the spouse suddenly has no safety net because the term insurance terminated and the investments have not done as well as planned.

There have been dozens of new types of permanent policies that have come to market in the last few years; policies that require lower outlay than those in the past, and these should be considered.

5. Relying on rules of thumb to calculate your insurance needs.

This is not a guessing matter. All too often, individuals never accurately figure out the real cost of the living expenses of the survivor (net after tax, after inflation.) A big part of being under insured is that individuals seldom consider how little after/tax after/expenses (trust and management fees) income is produced by money-market, mutual funds, or stock portfolios.



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Have a through insurance analysis done to determine what you and your family will need if the insured dies by an independent fee basis financial planner. It is too important a matter to be guessed at.

6. The business owner has not investigated to see if the business can provide more cost or tax efficient life insurance.

It is probably costing more than necessary if the insured is paying for coverage entirely with after tax dollars. A business owner should review the cost and coverage with the view of the business paying for some of his life insurance needs.

7. Making policy proceeds directly payable to minor children, or to handicapped or emotionally immature or financially irresponsible individuals.

Children have different needs or different abilities to handle various sums of money. “Equal is not necessary equitable.” It is imprudent to pay a lump sum of any size to a spendthrift child or to an individual with no financial management experience.

Set up a trust for the insured spouse and children and name the trust as recipient of the policy proceeds. Where the policy proceeds are modest or a trust is impractical or just not desired, a very cost effective alternative is to have the policy proceeds paid out under a “settlement option” that can give a consistent monthly payment over a long period of time.

8. All the insurance is owned by the insured.

All life insurance owned by an individual is included in the estate for estate tax purposes. If the estate never exceeds the federal exclusion amount in the year of death, this may not be a problem.

Set up an Irrevocable Life Insurance Trust to own the life insurance policies.

9. Life insurance has been purchased or treated as though it were a commodity.



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All life insurance - even from the same company - is not equal. The apparent lowest price or the highest possible return are not the always the mark of the right policy. Recent history proves the danger of shopping for the lowest priced policy.

Life insurance purchase requires the assistance of a professional, knowledgeable advisor. It is specially designed to meet a specific purpose in the most cost effective and tax efficient manner. It should be tailor made for you and your family’s needs and concerns and reviewed on a regular basis.

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10. Replacing an existing life insurance policy without first evaluating all options.

Today a secondary market exists where a life insurance policy that is no longer affordable, or wanted, can be sold for more cash than if you let it lapse. This option is called “Life Settlement.” There can be income taxes owed when a life insurance policy is sold. A professional independent financial advisor should be retained to help you sell any life insurance policy.

Keeping and repairing an existing policy is always preferable to replacing or selling one. It is usually more cost effective. If an in force policy cannot be saved, or effectively replaced then selling it is the best option. Never let any policy lapse without first having it evaluated for its market value.

Be aware anytime a life insurance policy is sold, the insured owner’s family loses wealth.

You can prevent having to replace or sell a policy by having your policies reviewed on a regular basis, and taking preventive action early so you are not put in the position of having to sell a life insurance policy for a loss.

11. Paying premiums other than annually.

All insurance companies offer Modal Premiums or “Factional” premiums that allow you to pay other than annual. There is a cost for that convenience. If your annual premium was \$599 and



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the monthly option was 53.91 then your monthly Annual Percentage Rate (APR) would be 17.2%. If the quarterly payment was \$161.73 then the quarterly APR would be 21.5%. If the semiannual payment was \$317.47 then the semiannual APR would be 25.5%.

This cost of convenience applies to all insurances. You can find out what the APR is for any payment plan by going to www.theinsuranceforum.com and click on APR calculator.

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