



“On The Money Report”

By Steve Pomeranz, CFP

Host, *On The Money!* WXEL 90.7 FM

AVOID THE MOST COMMON LIFE INSURANCE MISTAKES

RANDOLPH J. SHINE, CFP, MBA

Because life insurance is one of the most important purchases an individual or a business will ever make, it's important to avoid the pitfalls into which a buyer can so easily fall. Below are some common mistakes that have been made over the years and I still continue to see every day.

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 and if caught in time, be corrected quickly and inexpensively.

The real irony of these most common errors is they do not involve complex laws and are easy to correct even if you are inexperienced.

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

- This may be one of the worst mistakes life insurance owners and trustees of life insurance trusts 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 continues to meet the original intended goals. For example, it is surprising how many ex-wives receive life insurance death benefits originally meant for the current spouse.

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“On The Money Report”

- The amount of insurance considered sufficient and purchased 10 years ago is often not adequate now, because inflation has eroded the purchasing power of the proceeds.

The most important reason to have a policy reviewed is that the initial illustration of what might happen is based on assumptions that interest rates and the cost of insurance will remain constant. Because these two factors can vary significantly over time, most policies will not perform as originally illustrated. The only part of the initial illustration that can be counted on is the numbers posted in the guarantee column. The point of fact is that over the years, we have seen interest rates fall significantly and we have gone through an extended period of low interest rates which have caused many policies to underperform as originally forecast. The result has meant that many policies have failed to live up to their original projections and now require large amounts on additional premiums to stay in force. As a matter of fact, it is almost certain that if you have owned a cash value life insurance longer than five years, it is in financial trouble and will need to be reviewed.

To find out the status of your policy, write to the insurance company and request an “in force” ledger illustration be sent to you. As an additional safeguard, request written confirmation of the primary and contingent beneficiaries-just to be sure it conforms to your wishes. Then meet with a qualified professional to see how best to fix the policy.

2. Using life insurance as an investment for tax-free income in the future.

Some questionable life insurance policies have been sold as investments promising retirement income. These programs have names like “LEAP”, “Infinity Banking”, and “Missed Fortune”. Watch out for a sales pitch urging you invest as much as you possibly can into a cash value life insurance policy for 10 years or more promising that you can borrow the money you need “income tax-free” in future years.

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“On The Money Report”

This program can work in the right circumstances and is designed for people with substantial resources. Resources that might be needed to in order support the policy in future years if necessary. Unfortunately it is sold to those who do not have the financial capability to support the program’s many financial pitfalls.

If you own a policy like this, see a qualified professional and have your policy reviewed as soon as possible.

3. Selecting inappropriate beneficiaries or changing beneficiaries when necessary.

It’s important to remember that naming certain beneficiaries can have unintended tax ramifications. For example, naming your estate as the beneficiary would result in the proceeds being included in your taxable estate. This not only means your creditors would have full access to the life insurance proceeds, but it also means the proceeds will probably be subject to added expense and delay during probate.

Death, divorce and change in family dynamics can also cause a need to change beneficiaries. An adult child that is financially irresponsible or becomes disabled emotionally, physically or mentally may need a trust set up for them to assist in managing their inheritance. Be sure the beneficiary designations of all life insurance, including 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.



“On The Money Report”

4. 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.)

5. Purchasing the wrong type of insurance.

One should be careful to purchase a policy that fits the intended need. For example, purchasing cash value life insurance for a short term problem or purchasing term insurance to cover a permanent need may cause problems in the future.

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 the insured gets older. If a term policy ends at age 75 or 80, the spouse would have no safety net causing a possible hardship if other assets were insufficient to support him or her.

As life expectancy continues to expand, the cost of insurance has come down to reflect this. Therefore, it may be possible for someone who purchased a 10 year level-term policy 6 or 7 years ago to replace it with a new policy for the same or less cost today and possibly extend the coverage out another 10 years.

In the past few years we have seen dozens of new types of permanent policies come to market with policies that require lower annual premiums than those sold in the past. These new policies should actively be considered.



“On The Money Report”

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

Figuring out the right amount of insurance is no guessing matter. All too often, individuals never accurately figure the real cost of the living expenses of the surviving beneficiary (net after tax, after inflation). People often under-estimate the amount of income their beneficiary would need because they seldom calculate the right amount of the taxes and expenses which will be paid and therefore under-estimate their future net income.

Have a thorough insurance analysis done by a qualified professional to determine what you and your family will need if the insured dies. It is too important a matter to be guessed at.

7. Business owners may be over-paying for insurance because they aren't aware of ways to provide more cost efficient and tax efficient 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.

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

Children have different needs and differing abilities to handle various sums of money. Sometimes it is a fact that: “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



“On The Money Report”

out under a “**settlement option**” that can give consistent monthly payments over a long period of time.

9. 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.

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

All life insurance - even issued from the same company is not equal. It can be a mistake to choose the lowest price premium or highest possible projected return because as we stated before, future results can vastly differ from those originally projected.. This leads to increasing lapse rates which can cause policy holders to lose money unnecessarily.

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



“On The Money Report”

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

Today a secondary market exists for policies that are no longer affordable or wanted. Many policies can be sold on the secondary market for more cash than the alternatives of allowing the policy to lapse or being surrendered back to the issuing insurance company. This option is called **‘Life Settlement’** and does contain some attractive features. However, it is complicated and must be carefully be analyzed before making any decisions. For instance, there can be income taxes owed when a life insurance policy is sold. Once again, it is important to retain a qualified professional to help you before any policy is sold.

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

Whenever a life insurance policy is sold, most often 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.



“On The Money Report”

12. Paying premiums other than annually.

All insurance companies offer Modal Premiums or “Factional” premiums that allow you to pay monthly quarterly and annually. The monthly and quarterly payment has an added cost. For example, if your annual premium is \$599 but the monthly option only requires a payment of 53.91, you actually end up paying \$47.92 more per year. This actually equals a monthly Annual Percentage (APR) of 17.2%!

This cost of convenience applies to all insurance. You can find out what difference you are paying by going to www.theinsuranceforum.com and clicking on the APR calculator.

**SHINE FINANCIAL INC.
1191 E. Newport Center Dr. Suite 107
Deerfield Beach, FL 33442
954-428-4007**

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