Sound Financial Bites 084 - Basics of Life Insurance Part 4

Episode Transcription

“You would want any insurance company you acquire life insurance from to at least be a 90 on the Comdex.”

Paul Adams: You need to make that decision, learn enough about it. This is at least a million-dollar decision in your financial life, maybe more. Own it from the company that you're going to feel comfortable with for a long horizon of time, and make sure there's a contractual ability to convert it if you want to maintain that ability.

Welcome to Sound Financial Bites, where we help you with bite-sized pieces of financial and life knowledge to help you design and build a good life. The knowledge that has been shared from stages at conferences, pages of national business magazines, and clients living across America, our host, Paul Adams, now brings directly to you.

Paul: Welcome back. This is part 4 of our 7-part, excruciatingly long series on life insurance. Why? Because people all acquire life insurance and almost nobody takes the time to just spend a little bit of their knowledge and mental capacity to learn about how life insurance works, one of the few multi-million-dollar decisions that clients can make, that you can make, and people just sort of take whatever's put in front of them. They just buy a term policy, they buy this kind of policy, they don't ask much about the insurance company, or its ratings, or anything else.

We're going to, here in part 4, just give you a brief overview of the types of insurance companies, the kinds of things you want to be aware of. Number one, we're going to talk about --

Cory Shepherd: And welcome to our life insurance series. We like to do these like James Bond movies where there's the teaser intro, just really gets you in, and then they go to the opening credits. I'm Cory Shepherd, President of Sound Financial Group, and this is Paul Adams, our CEO, and we are back in our series here talking about life insurance.

Paul: Okay, thank you so much. My mistake. Hence why Cory's here to produce all of these episodes and control the cameras because I will just rant. He also makes sure to work with the editing team and make sure that if I -- I think I might start. I don't cuss very often, but maybe I'll just drop one every now and again. He can just get it bleeped out.

Life insurance companies types, two major distinctions of life insurance companies: one is a stock company, and the other is a mutual company. A stock company operates like many companies that issue stock out in the marketplace. A stock company, like Pepsi, let's say, Pepsi has a fiduciary responsibility to who? Sitting on the board, who are they responsible to? Well, they have safety concerns, if you will, for the soda pop drinker, but they don't have a fiduciary responsibility to them.

In fact, their highest concern is for the stockholder. It's their responsibility to make sure the stockholder is cared for, because if something goes wrong in the company, they need to make sure that they can say, "We made the best decisions we could for the stockholders," who they're held responsible to.

Cory: We all like it that way. It's good for the economy.

Paul: Super good for soda. Yeah, people wouldn't buy stock if that wasn't the Board of Director's responsibility. Car companies, etcetera, it all works great. Life insurance can be a little bit different, and it has to do with the horizon of time that's being dealt with. So, if you own life insurance and you're in your 40s, there's a pretty high likelihood that contract is going to stay enforced 40 more years, especially if it's whole life insurance as that likelihood and the ability to be around that long or at least as long as you are.

Here's the problem. How do you make sure that that company stays aligned with what you care about? Well, what are boards of directors of major companies concerned with? In stock companies, they're very concerned with the quarterly. Everything is based upon the quarter, what was our revenue, what was our profit, did we need to downsize to do something, did we need to go offshore for something this quarter? Capital investments need to be recovered very quickly.

It's a very different ballgame assessing things in a quarterly basis, especially when what you need from that insurance company is a 40-year-from-now promise. That's what we're really transacting for is a promise that, if this happens to me, you guys will do this thing for my family.

Okay, that's your stock company. A mutual life insurance company has a very different standard. A mutual life insurance company, the easiest way to think about it is the board of directors are sitting around, Paul Adams goes and owns a life insurance policy, and they all sit around and go, "Well, what are we doing today to keep this 50-year-from-now promise to Paul Adams when he's likely to actually die?" That is a different horizon of calculation and a different horizon for making decisions than, say, the stock companies.

"A huge amount of the total purchasing of guaranteed universal life insurance policies come from stock companies."

When we own a life insurance policy, especially if what we want is a participating whole life policy, which we're going to get more into how life policy works, how dividends work, and how it could be used as a financial tool. But, aside from all that, what is key is that we need to own it with a company that, as that whole life insurance policy does better, as they do better with their investments, they're sharing those profits back with the policyholders.

Now, it should go without saying, but I'm going to mention it, that you would want any insurance company you acquire life insurance from to at least be a 90 on the Comdex. Comdex is an amalgamation of several different rating agencies, like AM Best, Standards & Poors, Fitch, and they bring all of those together to one numerical rating.

A company in their 90s are some of the strongest insurance companies out there, and because we need them to be really strong right now because they got to keep that promise for a very long time. So, owning it, we can own a stock company or a mutual company, and not surprisingly, if we go all the way back to that second video where we talked about guaranteed universal life, it's sold not entirely, but a huge amount of the total purchasing of guaranteed universal life insurance policies come from stock companies.

Cory: Hold on a second. Let me get straight what you're saying, because this might have just clicked for me a different way for the first time. You explain stock companies as the fiduciary duty of the board of directors is to the shareholder, and that's important, otherwise no one would want to buy stock in companies.

Paul: Yes, agreed.

Cory: Are you saying that, of course, then, no one would want to buy life insurance from a non-mutual company if the fiduciary duty wasn't to those policyholders? Of course not. Maybe. We're not saying that, although it's worth thinking about.

Paul: Yes, and especially the types of contracts where if they move the needle, it benefits the stockholders at the cost of the policyholders. That's key. Because, I want you to think about here in Washington state where we're sitting right now, there's a great deal of apples grown, and the apple farmer really cares about the apples at least until they're grown and they can sell them to the wholesaler.

That's important, but that's getting cared for differently because they're just caring about them as much as necessary at the lowest amount of cost possible to get them sold off the wholesaler. Think about that. The policyholders of stock insurance companies are being cared for enough to make sure that the shareholders will still buy the shares. But, in fact, if they robbed a ton of money from the shareholders and gave it wholesale to the policyholders, that wouldn't work out well.

“This is at least a million dollar decision in your financial life, maybe more.”

Mutual life insurance companies, what they're doing is they're sharing all of their profits back to the mutual policyholders, and over time, their experience on reserves, their experience on mortality goes back to all of the policyholders, and that money going back to the policyholders in the form of dividends can accumulate tax-free in those contracts. We'll get deeper into that in our next video.

Here is what I want you to consider, is that even if you own term insurance right now, especially if you're in your income-earning years, you may want to explore, deeply, acquiring that term life insurance from a company that's a mutual company that has a participating whole life insurance policy.

Here's why. That policy can be converted to whole life insurance without any insurability. So, if in year 18, if you've got something with a 20-year term and a 20-year conversion privilege, you can go back to your health 18 years ago, your new age but your old health, and say, "I want to still acquire whole life insurance insurance as if I was that healthy." Big difference.

Cory: Where that's becoming huge for me is for the person who is, for whatever reason, philosophically opposed to permanent insurance, which I believe those people may not have read the academic research about permanent insurance and how it could be part of the portfolio, but let's say you are a, "I only want term insurance," person for whatever reason. If you're 18 years into a 20-year term policy and you develop some kind of terminal illness.

Paul: Yeah, nothing that's going to wipe you out today, but they're like, "Meh, five years. You got five years."

Cory: Yeah, or even if you've got 18 months and you've got a two-year term. You don't want to hope to die inside of 18 months. You want the ability to respond to what happens in your life because there may be a reason that's strategically better to do that. That's why you want it to be convertible.

Paul: Convertible term insurance is more expensive than these non-convertible term insurance policies from stock insurance companies. Why? Because, they have to build in, they have to build in the ability, the cost of having done that. Why? Not because they're taking care of stockholders. It's because they're taking care of all the other policyholders that showed up there before you.

Now, you want to maintain that conversion privilege, you may want to convert all of it, part of it, or some of it. One day, you don't have to if it expires like regular term insurance. But, here's the big deal. Term insurance is so inexpensive that, let's say, it's costing somebody $800 a year to get a huge amount of term insurance, to own the term insurance convertible might be $1,000.

The $200 price differential is going to make no difference, but the difference it might make if you needed to convert it one day may be life-changing difference, and that's what we want to do is make sure we're protecting against those catastrophic losses and for the best replacement ratio you can. So, that's why we would acquire at least some, if not all, of our life insurance that's term insurance from a mutual life insurance company so that it could be convertible.

“We need to have that waiver of premium in case we covert it.”

Now, when it comes to buying some insurance from stock companies, here's what I find is best. As long as somebody's healthy -- by the way, there's lots of stock companies. Someone may not be healthy enough to come on board with a mutual life insurance company because they are more picky. They're not trying to meet a quarterly premium number because they're keeping 50, 60-year promises, so they may be more stringent.

We do go to the stock companies periodically when somebody has a health concern or if a portion of their life insurance, we realize, will never ever need to be converted, like it's a short-term business reason or something like that. We might go out to market, get the cheaper term insurance that's not going to be convertible to whole life. Now, it is convertible to overfunded term insurance. You can convert it to universal life, going back to our second video in the series.

What I want you to know is just apply for it with one of those mutual insurance cares. Now, here's the type of care you might look at. You might look at Ohio National Guardian, MassMutual, New York Life, Northwestern Mutual, Penn Mutual. Those are like some major carriers out there, all mutual life insurance companies, all with 90+ Comdex ratings that all have term insurance. Now, you have to make sure it has the right writer on it, but term insurance that's convertible for the full span of the term. You can acquire that, leave it on the shelf. If anything needed to be around more permanently, you now have the option. Most importantly, like caging up the 800-pound gorilla, you keep that on your side of the table, your choice for later.

Cory: I'd like to give some self-appreciation inside of this moment, and especially for you, Paul, with what you just said. I have seen videos from financial gurus and insurance company representatives that actually say, "Eh, don't mess around with any of those writers. They're just moneymakers for the insurance company adding that little extra profit," and some of that may be true.

There are definitely some, like an accidental death writer, probably adds a little money for the insurance company, and it's very unlikely to do anything for you in the future, but there are a few keys, like the strategy of having a policy be convertible and taking the time to think about what that's worth and that it's actually worth taking that extra cost, and I think that's important that we have these conversations versus just it's the old-fashioned, "Give someone an idea that they need less than they thought to give some trust and they'll take your recommendation."

Paul: I won't say where I learned it, but there was an insurance sales course very, very early in my career. I've now been doing this -- I think it's just crossed 20 years.

Cory: Nice. Happy anniversary.

Paul: Well, I was out of town for 40 days with my family. I think it crossed 20 years. We've been doing it a long time. Here's the thing. When I was very young, I was in an insurance sales course, and one of the things they brought up was, "Well, you can talk to people about their needs, show them they don't need as much as they thought they needed, and that's going to endear trust and you get them to transact with you."

"There are things that can prevent you from owning life insurance, that's why the conversion is so important."

There are many, many sales techniques out there that are specific to the insurance industry, and those same people that are good at sales may also be competent professionals in designing the policy. But, what we want you to do is separate the sales techniques from the end result that you want. So, for instance, somebody says, "Well, all you want is death benefits, so we're just going to get you guaranteed universal life and the cheapest company out there."

Yeah, it probably makes a lot of sense to find out what the financial ratings are of the insurance company, what alternatives would look like, like what if I did a fully-funded universal life or a whole life insurance policy. Would those work also? What's going to happen to the death benefit over time? What if my reason to have life insurance goes up?

All those things are valid questions, and what you want to listen for when somebody is -- once again, some salespeople are incredibly competent and take wonderful care. But, if you find that your objections are being overcome instead of feeling like you're getting educated as to the differences in things, that's when you may want to back off a little bit, gather a lot more data, and then enter back into that conversation. That's it.

You're going to have reasons to own some life insurance, perhaps, with a stock company that's really not convertible to anything truly permanent. I think it's one of the big misnomers, we talked about all the problems in episode 2 of this where we're covering that this universal life insurance could just go away before we do, and the problem with it going away before we do is it's not really permanent, and one of the biggest confusions out there is you'll read writers writing about it, and they'll collapse universal life with whole life.

They will say nothing about the distinction, most of the time, between a stock company and a mutual company. In fact, the biggest problem is the only people that usually will talk about it are people that work for mutual life insurance companies, and then they may not be that tempered. They're not taking the times to say, "Here's where a stock company would make sense."

What we're saying is you need to make that decision, learn enough about it. This is at least a million-dollar decision in your financial life, maybe more. Own it from the company that you're going to feel comfortable with for a long horizon of time, and make sure there's a contractual ability to convert it if you want to maintain that ability.

Last, but not least, there's something called waiver of premium: big deal, especially in a convertible term insurance policy. A lot of people overlook this. Waiver of premium is if you get disabled, they will pay that term insurance policy for you, which is great, but the problem is people go, "Well, that's kind of expensive. I'm paying quite a bit for that waiver of premium, but term insurance is so expensive, that's not going to crush me."

We need to have that waiver of premium in case we convert it. That's the only way. If we're unhealthy now, if we have, say, a problem with our back now and we convert that term policy that was $1,000 a year, and now we've chosen to convert that to a whole life policy, we're going to over-fund - we're going to talk about the IRS limit in our next episode - against the IRS limit, and now we're going to be putting $20,000 a year into it, well now we can't acquire waiver of premium on that policy because they go back and say, "Oh, did you have waiver of premium, disability waiver of premium on your term policy? If not, we're not going to allow that to make the transition with the conversion."

If you're looking to buy life insurance, going all the way back to our last episode and this one, apply right away. If you're thinking about it, as quickly as possible, go find an agent, find your existing agent. If you want to go through and tighten all your planning, reach out to us, we'll share with you our philosophy, and if you want, you can apply to become a client, you can go through our assessment process, perfectly happy to do that.

But, get life insurance in progress somewhere, because once it gets issued, you can choose to take it or not. You have all the power of the pen. You can accept it or decline it when it comes through. In fact, every state at least allows for a 10-day free look, even if you change your mind five days after you got the policy, you can have all your money refunded, but there are things that can prevent you from owning life insurance. That's why the conversion is so important, that's why you got to pay attention to your medical records, and why you want to make sure you control the power of pen as what you do with that life insurance policy later.

We look forward to having you on the next episode where we're going to go deep into how to acquire life insurance and use it as more than just a life insurance death bed only tool.

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