

ALL IS FAIR IN LOVE AND WAR...

AND LIFE INSURANCE?



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First and foremost, let us make one thing very clear, life insurance has very legitimate purposes for many people planning for their, and especially their loved ones', future. **That said, in my experience, no single product is more widely abused by commission hungry salesmen than life insurance.**

In my view, any insurance is a difficult pill to swallow. There is nothing worse than paying for something that has a low probability of ever paying off. That said, I do carry health insurance, property insurance, etc., to avoid one event in my lifetime derailing my family's well-being. Still the odds are never in your favor. It is the same reason that I always pass on the extended warranty. No insurance company or warranty company turns a profit without taking advantage of the statistical probability that they will come out far ahead in your relationship. If you think differently ask yourself a question: In Vegas, would you rather play the role of the house or the player? Remember, the house always wins.

As with any tool, life insurance is only practical to the degree it addresses the task at hand. Can you cut a tree down with a butter knife? Probably, but I would prefer to use it to spread my butter on toast and leave the tree cutting to a chainsaw. Same applies to life insurance. While life insurance does offer solutions to some financial issues, it comes at a high price: policies carry high, often hidden, expenses, life insurance policies are generally very inflexible, and the opportunity cost of life insurance can cost families millions.

The following are some situations where life insurance may make sense, how it might be pitched to you, and some useful suggestions on

other, often less expensive, but more efficient, solutions for the same issues.

Income replacement for your family: Time after time families must put in place a contingency plan in case one spouse were to pass away and the family loses a source of income. Life insurance can bridge the gap until your savings and other assets catch up to your income at which point you can self-insure. Most often in these situations, families are talked into permanent life insurance policies which are very expensive (high commissions for the agent touting these policies). Consider instead a term life policy which gives you much higher coverage levels for far less yearly outlay. With your savings, work on building up your nest egg. As the saying goes: "Buy term and invest the rest".

Paying off debts for your family: This goes hand in hand with the previous section of income replacement. One strategy in conjunction with income replacement is to match outstanding debts with life insurance coverage in case one spouse passes away. Again, usually overly expensive and unnecessary policies are typically recommended. Consider term instead and only carry manageable debt loads, if possible.

For business owners: Funding liquidity or buy-sell agreements is a classic and practical use case for life insurance. This is an extremely valuable tool to make sure that if a business owner passes away neither the business nor family members of the deceased suffer financial distress at the time of losing a loved one. Making sure that succession planning documents are in place is necessary to successfully navigate a closely held business owner passing away.

Providing liquidity for your estate: If there are many large illiquid assets, one might consider life insurance to protect loved ones from having to sell at fire sale prices. Additionally, it may be helpful to have some life insurance to hold over a family during the settling of one's estate. For large illiquid estates, there may be some tax due which could be covered by life insurance proceeds. Imagine the business owner where the value of their business is the preponderance of their net worth. Passing away could trigger an estate bill and a lack of liquidity can leave the estate and loved one's scrambling. Consider building up liquid reserves during your lifetime.

Estate tax planning: Minimizing the possibility of paying an estate tax is a key consideration for wealthy families. There is nearly no more punitive tax than dollars which have already been taxed as income or gains during your lifetime getting taxed again at your demise. Life insurance can be a valuable tool in minimizing or dealing with the estate tax (warning this is only true if it is properly set up). Consider instead lifetime gifting, irrevocable trusts, and a whole host of other techniques that only cost you for upfront planning and nominal maintenance costs.

Income tax planning: Taxes are feared by many, and rightfully so, because there are few more punitive financial outcomes than large income tax bills. It is true that permanent life insurance offers some financial flexibility in terms of tax planning but consider the high costs. Consider instead utilizing retirement planning tools at your disposal like 401ks, DB plans, IRAs and especially ROTHs.

Asset protection: It is true that life insurance cash values can be protected from creditors

in the event of litigation. That said it is an expensive form of protection and has other limitations. Consider instead family LLC's, homestead exemptions, Domestic Asset Protection Trusts, and ERISA assets. All of these are legitimate reasons to have life insurance, but more often than not, there are other, far less expensive ways to achieve similar goals. Life insurance expenses are among the highest in financial services generally ranging from 3-5%. One must ask, is life self-insurance the best option for me and my loved ones?

The myths pertaining to life insurance are as important as some of its use cases. I have seen some deceiving statements regarding life insurance and my hope is to address in advance some of the most common commentary used by salesmen in selling life insurance.

Everyone needs it: This is an extraordinary misstatement and salesmen often use emotional arguments to convince people life insurance is always necessary. Dark pictures of what would happen to one's family if no life insurance were purchased are oftentimes painted. The truth is that the use cases are very specific and other options should be exhausted before turning to life insurance.

It is a great way to invest and returns are guaranteed: The truth is, the often high and hidden costs of life insurance can erode returns over many years, costing purchasers millions in opportunity cost. Additionally, guaranteed returns are usually lower than advertised from hidden imbedded costs and deceiving language. Remember, the illustrations that agents provide to you often have fanciful assumptions with very little chance of coming true.

The costs are as advertised: Many life insurances policies are sold with glossy color pages that are filled with vibrant colors and charts. In this section they may even list some costs that go along with the policy, but be wary because usually the hidden costs are buried within the fine print of a several hundred page policy.

The more life insurance the better: Remember life insurance should be considered a means to an end. You should scrutinize how much of your income is going to life insurance and if you truly need all the coverage being discussed. Too many times I see life insurance face values far exceeding needs and far too great of a proportion of income going towards life insurance. Remember that these policies are inflexible and can be punitive if you are not keeping up with the original terms of the contract. They can be a double whammy if markets sink, just as your net worth is decreasing you may have to contribute more to a policy.

Permanent is always better: I've heard this many times before, "Why would you pay for something like term when it will expire some day and you'll be left with nothing to show for it?". The reason being largely has to do with opportunity cost. Typically, term life insurance is far cheaper than permanent insurance and with that savings you can invest or save. Also, permanent life insurance typically has negative rates of return for the first few years the policy is place, meaning you have paid more into the policy than the cash value is worth. Additionally, for situations where large coverage amounts are needed, term policies can be the only viable option. Remember, commissions for permanent policies with all the bells and whistles are far higher than plain vanilla term policies so think twice of what is being pitched. I have seen priests and widows taken advantage of by life insurance salesmen.

One company that is notorious for pushing life insurance policies to unwitting friends and family often push parents to buy life insurance on their children. It is my belief there is no legitimate reason to buy life insurance on your child. There are few other industries where the conflict of interest is so prominent. Life insurance salesmen look at their product as the only solution to problems...when you are a hammer everything is a nail. Why do insurances salesmen repeatedly recommend products that are expensive and complex? Because these typically carry the highest commissions. A Yale study claims that up to 60% of the wealth created from life insurance sales accrues to the agent and the insurance company versus the purchaser of the policy. It is the reason that life insurance companies make billions in profit each year. We must understand that we cannot depend on the law to protect us from predatory sales tactics. Many sales people make their living taking advantage of the relatively lax regulation of those following the suitability standard versus those that are fiduciaries. The latter being one who must always work in your best interest. It is truly a buyer beware marketplace.

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QUESTIONS?

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