Wait, Some People Need (or Want) LIFE INSURANCE

Editor's note: David Cordell's March column, "I Don't Need Life Insurance" touched on an important and compelling topic—one that generated reader feedback and received attention in *The Wall Street Journal*, which published a set of articles on March 18, "Do Most People Need Life Insurance?"

COLUMNS | Insurance

I Don't Need Life Insurance

by David M. Cordell, Ph.D., CFA, CFP®, CLU®

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DON'T YOU JUST LOVE rules of thumb? For example, as a rule of thumb, there's no problem getting a table at my wife's favorite restaurant on Thursday nights. That rule of thumb was reliable, until the time when our anniversary fell on a Thursday. Aargh!

Rules of thumb in financial planning aren't always reliable, either. For example, one rule of thumb is that the amount of life insurance needed is seven to 10 times annual income. Sometimes it makes sense, and sometimes it doesn't. Even when it works, it's a pretty lame way to approach an issue worthy of serious analysis.

Do I Need Life Insurance?

I don't need any life insurance! Until a few months ago, I had a policy with a seven-figure death benefit, and I let it lapse. No more monthly checking account drafts for me.

Is this heresy in a journal committed to financial planning? I know that life insurance is a critical component of a financial plan, but consider my situation. My children are on their own (more or less). My wife is a retired teacher with a pension, and I have reached full retirement age. Although I still draw a salary, we are blessed to have accumulated enough money to provide a comfortable retirement for my surviving spouse.

My employer provides a $20,000 death benefit if I die while employed, and $10,000 if I die while retired. We have plans for inexpensive cremation and have already purchased a columbarium niche at our church. We don't have debts that need to be paid off upon my death, so there's no need for a lot of immediate cash. Even if there were, we have sufficient liquid assets that are accessible quickly.

Monte Carlo analysis provides a back-door way to consider the relative need for life insurance.

We don't have legacy issues such as business ownership or a farm that could be problematic to divide equitably among heirs, so we don't need a death benefit for estate equalization. My will is structured so that my wife receives everything and the vast majority passes to her as a beneficiary or as community property. Almost nothing will go through probate, and probate is cheap in our state anyway. It would be nice if we had enough wealth to worry about generating cash to pay for federal estate taxes upon the second death, but we don't. Since we live in a state with no inheritance tax, that isn't an issue.

I should mention that my life insurance policy was a 20-year, level premium version purchased when we had three minor children. I could have continued that policy at a reduced death benefit for a substantially increased premium. I also looked at the possibility of a smaller policy since my family's need for income replacement is no longer an issue. But why buy something that my wife doesn't need?

The point of having life insurance on an income-generating individual in a family situation is to replace the income. That is the human life value concept of Solomon S. Huebner, founder of what is now called The American College of Financial Services.

Although I still have earning capacity, it is excess capacity at this point. It is not earning capacity that I want to insure. Rather, I want to insure a lifestyle. Notwithstanding the fact that my death would deprive my wife of, ahem, the pleasure of my company, I don't want her quality of life to decline because of finances. On the other hand, I don't want to use life insurance to help her ascend the social ladder after I die! The capital needs analysis approach is appropriate in my case.

What Will Happen to Expenses?

Although my death would cause only a modest decrease in retirement income, the outflows would shrink considerably.

There will be one less car to purchase, insure, fuel, and maintain. Medical and health insurance expenses will drop in half. Travel expenses will decline by half, especially since my wife will have no reason to travel by herself just to get away from me. Food purchases, especially for ice cream, will decrease by more than half. The wine and beer bill will drop by at least three-fourths

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Dear editor,

In reference to the column by David Cordell, "I Don't Need Life Insurance," you do need life insurance because your grandchild could be born special needs requiring 24/7/365 care.

I am talking from experience.

— Withbert W. Payne, CPA, CGMA, FCA

Dear Dr. Cordell:

Thank you for your column, "I Don't Need Life Insurance" in the March issue of the *Journal*. As a planner for 38 years, I have heard many people say those words and every single time they were right. The person saying it will be dead, and as far as I can tell, "you can't take it with you" is probably correct. However, many people have bought it anyway. Using your column as a guide, I would like to share how I would approach this discussion if you engaged me as a CFP® professional.

1. The "rule of thumb" is only as lame as the use to which it is put. It is an excellent way to get a client thinking about how much and what kind of insurance they should own. My rule of thumb statement is not used to provide an answer; it is to provide a start to an important discussion. I would add, "… plus any debt you would like to pay off, $100,000 per child not yet in college, and any money you would like to leave to charities."

After getting this minimal data, figure out the number, subtract their net worth, state that number. The question I would ask you after you and I together figure out your number is, "Does that sound about right to you?" You will say yes, no, or I don't know. And now off to the races discussing what the right amount and kind of insurance makes sense to you. You are now engaged with the right question.

2. You mention having "sufficient liquid assets that are accessible quickly." I see that you don't have a need for life insurance death benefits for the immediate liquidity the contract provides at death, but life insurance has changed since the days of 20-year term. Your possible future is not just raising kids then dying. For example, "What will happen to expenses?" is a great question. Life insurance can also provide liquidity to pay for extended care expenses through acceleration of the death benefit while you are alive but needing care. This feature will protect all those liquid assets from decay due to exorbitant care costs. This helps ensure you and your spouse can use your savings as planned while alive.

Your discussion really is about the death benefit, but you did say "life insurance," implying a life insurance contract. And there are other ways to use insurance contracts for needs aided by benefits paid at death. There are also life insurance contracts that pay out the face amount while alive without requiring qualifying health issues. You can be perfectly healthy, for example, and have 10 percent of the death benefit paid to you per year for 10 years starting at age 85. That benefit can help the "what if things turn bad financially" issue to provide a longevity insurance benefit. Our planning would include possibilities such as this and then I would ask you, "So, what do you think about this?" You would be engaged in the right questions.

3. "How much capital does my wife need?" leads me to ask if your wife was involved in this discussion on life insurance? A discussion about the future financial health of a spouse must include that spouse as the primary decision-maker. Your wife may have a different view on every assumption you make including extended care costs, her lifestyle after you die, leaving money to the kids (grandkids), funding charities, etc. After 38 years in the financial world, I have sufficient experience with widows to know that they almost always say something like, "I know my husband wouldn't have wanted this, but now it's up to me so here is what I am going to do."

4. Monte Carlo simulation. I agree that this is a great discussion tool, and open and broad discussion is foundational to financial planning. I have one question: What if reality comes along and you and your wife are in the left-hand tail, the failure of the plan? There is a risk of that. You seem to be OK with risk to your wife's financial future (and yours if alive); is your wife OK with that?

What if not only bad investment returns move you to the left-hand tail? What about unplanned-for cash outflows such as extended care, paying for a child's drug rehabilitation, caring for a grandchild, pension plans going broke? Insurance at its heart is risk transfer. If insurance can move you out of the left-hand tail, maybe that benefit is worth the cost? Betting on a "sure thing" at the track is probably OK, but betting on a 95 percent sure thing with you and your wife's lifestyle has some planning issues. Thus, it is important to focus on the right questions.

5. Legacy planning. You bring up costs associated with dying, but what about wanting to do something at your death that benefits others? "The University of Texas at Dallas proudly announces the endowed chair of the Finance Program named in honor of our deceased distinguished faculty member, Dr. David M. Cordell!" That has a nice ring to it! And if you announce your irrevocable intention to do so and fund it with life insurance, you might get better tickets to the Comet baseball games—a living benefit. This is a "want" not a "need." If there is something a client wants to guarantee will happen, insurance is a risk-transfer contract to provide certainty closer to 100 percent (subject to the financial condition of the life insurance company, paying the premiums, state guarantee funds, etc., and I agree 100 percent results are subject to risk).

I do not intend here to say you should buy a life insurance contract. I intend to say that your column simplified the issue to an extent that could sway some clients to not buy life insurance. I like your question, "Is this heresy…?" I believe the heresy is over-simplifying an issue to a point of possibly endangering the financial futures of clients. I intend to counsel financial professionals to not over-simplify this issue. If financial professionals are not experts at this risk management question, they should find competent help to integrate into the planning process.

I realize that the limited length of the column probably prohibited you from fully explicating your situation and thinking. Having agreed with that, I would simply state that your premise of using Monte Carlo analysis to justify the answer to the question, "Do I need life insurance?" is dangerous planning.

And, given all the other issues that should be discussed, the question really moves to, "Do I want, does my spouse want, do my kids want, does my charity want life insurance on my life to guarantee specific financial goals are met?" I would say that you are now asking the right questions.

—David F. Smith, Ph.D., CFP®, CLU®

Response from David Cordell:

Thanks to Mr. Payne and Dr. Smith, whose letters prove that someone actually reads my column!

Most of the points they raised relate to the many uses and benefits of life insurance contracts, and I fully agree with them. Still, life insurance, although very flexible, is not a free good, and it is increasingly less free in my age bracket. Further, while life insurance contracts can be used for various purposes, they are not always the most efficient approach.

Yes, life insurance proceeds could provide funds for the unlikely case that I will have a disadvantaged grandchild, although it is looking increasingly unlikely that I will even have grandchildren. It could also provide a larger legacy for my children, although unless something extraordinary happens, my wife and I will leave much more to our children than our parents left to us. Yes, we could bequeath a substantial legacy to charities or to our church, which is already included in our wills. All those goals are admirable, but they fall out of the realm of "need."

I certainly needed a death benefit in my earlier life, and I was insured more than adequately. I didn't take the position that a death benefit should assure that the then-current lifestyle could be maintained. Rather, I wanted to insure that my family would be able to experience the lifestyle that we would eventually achieve if I were to live for an entire career. Life insurance was a critical aspect of my personal financial plan in those years. The question raised in my column, however, is whether I need life insurance in my current situation.

As to the suggestion that my wife may not have had a voice in the decision to let my policy lapse, fear not! We bought our policies at the same time, and we let them lapse at the end of the 20-year term after a reasoned and thorough investigation and discussion. She doesn't have a need for life insurance either. ■

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