Supplement to

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an uncommon guide to navigating the consumer culture

Expanded Information on Life Insurance

The book provides an overview about life insurance. This discussion is intended to provide more detail for someone who is about to shop for life insurance.

Life insurance is an important aspect of big-picture planning, especially when you have people depending on your income for their well-being. It might be that you are supporting aging parents or a disabled sibling but, for most people, their dependents are their children.

You need the most life insurance when your last child is born. This is when you have the greatest number of dependents and they will need financial support for the longest period of time. In contrast, by the time your children have left home and you've paid off the house, you may need very little life insurance.

The purpose of insuring your life, after all, is to replace your income so your family is supported when you are no longer alive. For most families, the absence of one income would make life very difficult. It could mean the surviving spouse would have to sell the family home and move the children to smaller, unfamiliar surroundings.

It could mean a stay-at-home parent has to put the children in daycare and go out to work. The issue here is twofold: The family probably chose to have one parent staying home because they felt that was the best way to raise their children. If that parent is required to go to work after the death of the other because of a need for money, the children will not get the intended upbringing. Secondly, most jobs do not generate sufficient income to pay for daycare as well as food, a mortgage, car payments, car insurance, and clothes for a working parent and growing children. Covering living costs with adequate insurance allows you to provide for these needs.

Life insurance exists to fill the gap by replacing missing income and it takes more than a $20,000 policy to do that. Yet the unfortunate truth is that many people are greatly underinsured, probably for two reasons: First, they have no idea how much life insurance they reasonably need. And second, they were convinced to buy the wrong type of insurance, one that is so expensive they can't afford the amount they need even though they know how much that is.

How much life insurance?

When you start talking with life insurance sellers, things can seem complicated very quickly. My recommendation is to think it out in advance. B*efore* you have a meeting or telephone conversation with an insurance agent, determine how much life insurance you need. There's actually nothing mysterious about doing this. Think in four general areas to simplify the process:

1. Immediate cash needs
2. Loan repayment
3. Replacement income
4. Children's education

Immediate cash needs should be covered so your family will not have to take out a loan (and pay interest) to cover immediate personal costs such as your funeral, income taxes, and fees associated with processing your will. These are sometimes spoken of as "final expenses."

Loan repayment ensures that large items are paid off so they do not drain the family's resources. Your mortgage is the largest and most obvious one. Arrange to have enough insurance to pay off the outstanding mortgage balance. That will go a long way to ensuring your family can live comfortably if you are no longer there to make the monthly payments. The same is true for other secured loans such as the family car, recreational vehicle, or cottage. If the family is unable to make payments on these items, they will be repossessed. Providing insurance money to pay off the balances means the items are owned free and clear, and will remain in the family. Your life insurance should also cover your outstanding credit card balances and lines of credit, because outstanding unsecured debts such as these must be repaid from the estate and could take away from money your family needs.

Replacement income is intended to provide ongoing support for dependents until they leave home. Therefore, the younger your children are, the more money you will need in this category. Calculate this amount by counting the number of years until your children reach independence and multiply that by a yearly amount for support. A common figure for this yearly amount is 70–80% of your current combined family income, based on the premise that the family will not need the full amount when there is one less person making up the household.

Children's education can include whatever you want it to. As a general guideline, if you were intending to provide a four-year post-secondary degree, you'd likely need to allow about $60,000 per child. This amount would be considerably higher if they'd be living away from home.

Once you've made your decisions, record the amounts under each category and total them. This is **what you need**. Then make a list of **what you already have**—the amount of your investments and the face value of any existing life insurance. This list is meant to be only those things that can be turned into cash, so don't add in the value of the house, car, or furnishings, since the family will need these to carry on with their lives. Once you have the totals of what you need and what you have, simply apply this formula:

What you need – what you already have = **insurance to fill the gap**

You can find online calculators[i] to help you determine how much insurance you need, but I suggest doing it manually first. Calculators are convenient, but they often mask the logic of the process and then we lose the sense of what we're really trying to do. It's better to get clear on what you need by walking yourself through the process first. Then double-check with an online calculator if you like. Even at that, you are not ready for an appointment with an insurance salesperson yet.

In order to make your way through the intricacies of life insurance and the sales pressure you will likely encounter when shopping for it, you need some fundamental information about the purpose and types of life insurance. This understanding is essential for you to be able to assess what's right for you and why.

We buy insurance to reduce our financial risk…

Insurance of all kinds is based on the principle of ***spreading the risk***. To do this, the insurance company collects money from a large number of people who wish to have their financial risk protected if a particular event occurs. From the pool of money collected each year, the company pays some out to those participants who experience the insured event. The yearly rates paid by the participants are determined according to the probability of the insured event occurring.

Car insurance is a familiar example for most of us. We pay for insurance each year and hope that we never have an accident. But if we do, we're grateful that the costs of repairing both vehicle damage and personal injury are covered by our insurance because they could range from a few thousand dollars to a million or more if there is a liability lawsuit.

If you have a poor driving record—say several accidents and a conviction for dangerous driving—your insurance rate will be higher than someone with a clear record because you present a much greater risk of having an accident. Since there is a strong chance that a large sum from the money pool will be spent due to your actions, you are required to put in more to compensate.

When it comes to life insurance, our activities and choices—smoking, engaging in hobbies such as parasailing, or working in an occupation such as law enforcement, for example—can also affect risk and therefore our life insurance rates. Age, on the other hand, is a factor that affects us all. Statistically, our chances of dying are greater as we age, so life insurance costs more as we get older. The good news is, we need the most when we have a young family and that's when our rates are lower—*if* we buy term insurance.

Types of life insurance…

All life insurance can be divided into two fundamental types: term and cash value (also called whole life, universal, or permanent) insurance.

Term insurance provides protection against the insured event and is as straightforward as car insurance. ***Cash value insurance***, on the other hand, has a "savings" component in addition to protection against your death. I've always thought it odd that we would give our insurance company extra money to save and invest for us. If your car insurance company asked you to do that, you'd wonder what on earth they were thinking! But somehow, we've accepted it as reasonable when buying life insurance.

I suspect that's due to a lack of information combined with lots of sales pressure. It's often said that life insurance is sold, not bought. This statement highlights the reality that it's the seller who is in charge in the transaction, not the buyer. My eyes were opened on this point during the second year I taught consumer economics. I had an evening class in which there were several mature students with full-time day jobs. One worked in general insurance at a company that also had a life insurance division. He told us about one of the life insurance salesmen who regularly received monthly commission cheques of $9000. That was an enormous monthly income at the time, and one of the other employees asked him how he did it. He reportedly shrugged and said, "It's easy. I just don't leave until they sign what I want."

What he wanted was for them to buy cash value insurance, which has much higher premiums and pays the seller a significantly larger commission than he would get if the customer bought term insurance.

So you can see the industry has set up the system to suit its revenue-generating needs, and the salesman who wants to earn good income knows what he has to sell. I don't mean to suggest that all insurance sales representatives are deliberately selling products they think are bad for you. In fact, the companies provide them with plenty of training to convince them that the expensive product is also the best for the customer. But is it? Not usually.

The ins and outs of cash value insurance…

To understand how a cash value policy works to your disadvantage, we need to start with a few definitions. Then we'll compare rates for the two different types and see what's what. ***Face value*** is the amount of money that will be paid to the beneficiaries when the insured person dies. The ***beneficiary*** is a person who receives all or part of the face value of the policy. The ***premium*** is the amount paid regularly, either yearly or monthly, to keep the policy in effect.

For purposes of our comparison, we'll look at rates for a male, age 30, non-smoker, in excellent health, who requires a face value of $450,000. That sounds like a lot but Tom, the insured in our example, has three preschool children. When you think of replacement income and eventual post-secondary education, it adds up. It is only because they are renting and have no mortgage or other debt that his insurance needs are not even higher.

The chart below shows two scenarios for Tom to get his $450,000 of insurance. To make the comparison as fair as possible, these figures are for policies from the same company, obtained using an online Canadian quote site.[ii] To obtain my information, I looked at several sites and found this particular one the best for information-gathering. Most calculators, I discovered, are being used as sales prospecting tools and required me to give my name and telephone number before I could get the information. This one did not, so you can use it to research your own life insurance costs without having to field sales calls afterward.

Face value required: **$450,000**		
Type of insurance	**20-year term policy**	**Cash value policy**
Provides	protection only	protection + savings
Premium	$333/year ($30/month*)	$3072/year ($276/month*)

* If you multiply the monthly figure by 12 in each case, you'll discover that the total you get is larger than the yearly amount shown. Monthly payments are a bit higher because they have to be processed twelve times a year rather than just once. This is typical when you pay monthly rather than yearly.

As you can see in the table, this company's cash value insurance is more than nine times the cost of term. I found there were similarly large differences in the term and cash value products of other companies, with cash value always substantially higher.

What happens to the extra money you're paying? It goes to the seller's commission, and a small amount is put into the "savings" portion of the policy, to become what is generally called the ***cash surrender value.*** This builds up slowly, but after ten or fifteen years, might amount to several thousand dollars[iii] on a policy the size of the one in our example.

One of the selling points for cash value insurance is that you can borrow the cash surrender value when you need access to cash. Suppose it amounted to $10,000 when Tom was ready to buy a house about ten years after taking out the policy. He could borrow the money from his cash surrender value and use it for his down payment. The insurance company will charge him interest on that money because it is a loan. He might wonder why, when it's referred to as savings. Nevertheless, Tom may decide to go ahead and borrow the money because it is his best option to get his down payment in place.

Consider this scenario: A month after taking a cash value loan from his life insurance policy, Tom dies in a car accident. How much money will his beneficiaries receive? Remember that the face value of his policy is $450,000. Since the face value is defined as the amount that goes to the beneficiaries, it seems logical that they would receive $450,000. Remember, though: there is an outstanding loan of $10,000. This has to be repaid, so the beneficiaries will actually receive $440,000 in this case, instead of the full $450,000.

Consider another scenario: Tom doesn't like the idea that the cash value loan would potentially reduce the amount paid to his family, and so decides on a different approach to accessing the money for his down payment: He will withdraw the cash surrender value instead of taking a loan. And he can. What do you think would be the consequence of his withdrawing the cash value of his policy? Well… it will close his policy and he will no longer have insurance. He will have the $10,000 for his down payment, but this is not a good time in his life for him to be without life insurance.

Imagine a third scenario: Tom decided *not* to take the loan from his cash surrender value, so when he died the cash surrender value was intact. In this case, how much went to his beneficiaries? You might think it would be $460,000—the face value plus the cash surrender value. Actually, his family will get only the face value of $450,000. And the cash value? It stays with the insurance company. Here's how it is explained by one industry website:

> Cash value is what the policy is actually worth *to the policy holder* [all italics mine] at any given time.… *When the insured person dies, the cash value of a life insurance policy ceases to exist.*… The reason that cash value disappears when the insured dies is that you may receive *either* a death benefit or a cash value from a whole or universal life policy, but not both.[iv]

So, although your insurance agent may speak about the death benefit and savings, they are mutually exclusive. You get one or the other, but not both.

Why, then, wouldn't you just go for the death benefit and build up your own savings? Then you *would* have both.

The advantages of term insurance…

What would be the situation if Tom had originally bought a *term* policy for $450,000 rather than the cash value policy? With the term policy, there would be no cash to access so he'd need to find another way of getting his down payment for the house when the time came. However, when he died his beneficiaries would receive the full face value of $450,000 from his term policy.

Not only that, but the premiums of the term policy were much more affordable at $333 each year instead of the $3072 that cash value insurance would cost. Our example describes that he had the policy for ten years before he died in a car accident. The following chart shows how much he would have paid out over that ten-year period, depending on which type of policy he'd originally bought.

Required face value: $450,000		
Type of policy	*Premiums*	*10-year total*
Cash value	$3072 x 10 years	$30,720
20-year term	$333 x 10 years	$3,330
	Extra paid for the cash value policy	**$27,390**

Do you see what's odd about this? Tom paid considerably more into the cash value policy than the $10,000 he was able to borrow back; in fact, it was almost three times as much. Wouldn't it have made more sense for him to have bought term insurance and invested the extra money himself?

Even if he had just invested it in a guaranteed investment certificate paying low interest, he would have been further ahead. Then, when he died after ten years of paying for the insurance, he would have had a term life insurance policy plus ten GICs from the money he saved each year by paying for term instead of cash value insurance. Even a quick glance at the chart below shows it's a much better option than the cash value policy, which is structured to provide *either* the face value *or* the cash value, but not both. With term insurance, you get *both* your face value and any independent savings you have accumulated.

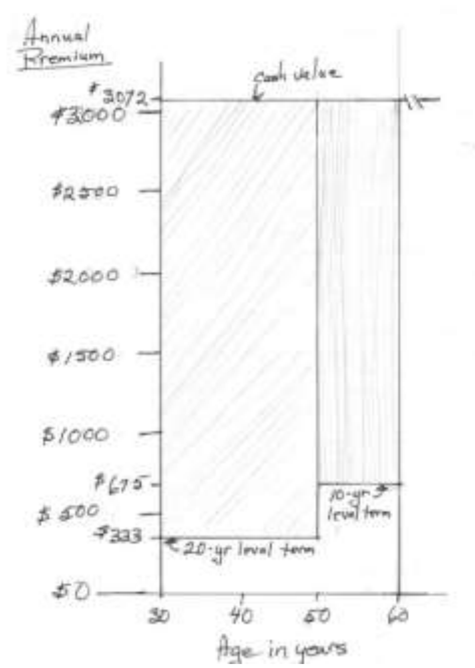
Term policy face value $450,000
plus
Accumulated savings $27, 390 + interest
Year 1 $2739 + 9 years interest
Year 2 $2739 + 8 years interest
Year 3 $2739 + 7 years interest

Year 4	$2739 + 6 years interest
Year 5	$2739 + 5 years interest
Year 6	$2739 + 4 years interest
Year 7	$2739 + 3 years interest
Year 8	$2739 + 2 years interest
Year 9	$2739 + 1 year interest
Year 10	$2739

There's another way to look at the logic of buying term insurance—**from the viewpoint of affordability**. Let's say Tom looks at his budget and determines that he can afford $333 a year for life insurance and no more. He really doesn't even have anything much left over for investing. But he knows he needs life insurance. How much can he buy with his $333? We already know the answer if he buys term—he will get a face value of $450,000. If he were to choose a cash value policy instead, the calculator shows that his $333 a year would buy him a face value of only $50,000. Given his insurance needs with a young family, that would leave him incredibly underinsured.

It's like going to the store to buy meat for your meals for the next week when you only have $10 left. If you buy a T-bone steak, you'll be able to afford only a small amount and will end up hungry for much of the week. However, if you buy ground beef and make a big pot of chili, you'll have enough to eat all week. Ground beef does the job better because it provides what you need at a price that is manageable. The same can be said of term insurance.

One of the strategies used to divert you from buying term insurance is to point out that the yearly premiums will go up at the end of the term. That is true—and it makes sense because you will be several years older. But here's what they don't tell you: Although premiums go up if you need to renew your policy at the end of the term, you started out *so* much lower that you are still far ahead. At the right is a graphic representation of the example we've been using.



As the graph illustrates, when Tom renews his policy at age 50, it will cost him $675[v] rather than $333. But even though his premium has doubled, it's still $2397 *less* than the cash value premium. So the fact that term premiums go up over time is really a false argument. The total he pays for the term policy is much less, and his beneficiaries will get $450,000 either way, whether his policy is term or cash value. Can a term policy be a bad thing?

It could be, if he bought a term policy that was non-renewable. **When you buy term insurance, be sure you are getting *renewable* term.** Here's why. As you get older, your health may deteriorate. If you have a non-renewable policy and don't pass the medical exam, the company may refuse to insure you for a new term.

However, if your policy is renewable, the company agrees to renew your insurance without requiring a medical exam. A renewable policy will cost a bit more than a non-renewable policy, but this is one place you do not want to save money. *Always* buy the renewable one.

Best advice: Keep your insurance and investments separate.

Buy term insurance to get the protection you need, and incorporate investments into your budget as a separate item. Why?

- You will get better rates on the investments that you make for yourself.
- Your beneficiaries will get *both* the face value of your insurance *and* whatever you have put into your own savings.
- It keeps the cost of insurance manageable so you can get the amount your family needs.

Another piece of good advice: It's generally advisable to get a second opinion. This is especially true when you're dealing with a subject that is complicated or subject to high-pressure sales. When looking for a second opinion, you want someone who has no vested interest in your decision (that is, will not benefit from what you decide to do) and is knowledgeable.

On the subject of life insurance, I suggest Suze Orman. She's a well-known and outspoken American financial writer and speaker who has dedicated her career to helping people get on track with their finances. She calls it as she sees it, and has a strong knowledge base to back up her position. Among other things, she is licensed to sell life insurance in all the continental United States. Suze Orman is a strong proponent of term insurance. To hear what she has to say, check out her YouTube segments on life insurance.[vi]

Don't argue with the seller…

You might have listened carefully to Suze Orman and taken to heart what I've said, but I wouldn't recommend engaging in a debate with an insurance seller even so. Remember that they are highly trained in selling techniques and have access to enough information to confuse and confound all your newly-gained perspective. If you encounter a salesperson intent on convincing you to buy a cash value policy, you will find yourself doubting your decision to buy term, and you won't have enough information to develop counter-arguments.

Before making an appointment with a seller, do your homework. First figure out how much life insurance you need.[vii] Then decide on the type—term or cash value. Finally, do an online rate comparison to get an idea about what you might expect to pay.[viii]

With this amount of information you are ready to go shopping. Life insurance is sold in four different ways. ***Brokers*** represent several different companies and will look for what suits you best among the products of those companies. ***Agents*** are representatives of one particular insurance company and sell their employer's products exclusively. Products of ***direct sellers*** are sold via telephone from a call centre rather than from a local agent. ***Group plans*** provide life insurance to members of a particular group—workplace or university alumni, for example—and you must be a member of that group to participate.

Pick what you think will work best for you, bearing in mind that brokers have access to a wider range of choices. Then prepare yourself to meet or speak with the seller. I have two recommendations—one is about *where* you meet and the other is about your *approach*.

First, location. This applies to those instances where there will be a face-to-face meeting. It has been traditional, particularly for company agents, to meet with potential clients in their own homes. They say it's so people can feel comfortable. I think they have two more-compelling reasons. First of all, coming into your home gives a seller many clues about who you are and what you value. They can then use these clues to tailor their approach and manoeuver you into buying what suits them. Remember the adage that insurance is sold, not bought. Secondly, you have invited them into your home and it isn't always easy to get them to leave. Do you recall the story of the salesman who made huge commissions? Enough said.

Given all this, it's usually better to meet at their office or a convenient coffee shop. This puts you in a position of strength because you can get up and walk away at any time. You are not a captive audience.

As for approach: I've already pointed out that this book hasn't provided enough information to equip you for debate. Therefore, an argumentative or ***aggressive*** stance will not do you much good. You'll probably get backed into a corner and end up either giving in and buying what is being sold, or saving face by refusing to buy anything at all even though you need insurance.

The other extreme is a ***passive*** approach, one in which you don't take an active role and just go along with whatever the seller suggests, not asking questions or otherwise engaging in the process. There is nothing reciprocal in such a meeting.

These are two opposite ends of a continuum that has limited effectiveness. A more useful approach is an ***assertive*** one, which combines confident statements with respectful listening. As shown in the diagram below, an assertive approach is a third way. It is an approach that affirms the speaker's right to a particular point of view without either giving in to or denying the other person's viewpoint.

Taking Another Way

An assertive approach is a constructive alternative to debating the merits of a term versus cash value policy. To use this approach, you would simply state what you need. Example: "I require $300,000 of term insurance. Could you please tell me how much that will cost?"

If the seller responds by trying to convince you that a whole life policy would be better than term, simply restate what you need, without arguing: "That may be true, but I've looked at my situation and what I need is $300,000 of term insurance. Could you please tell me how much that will cost?"

There may be another round of the seller giving you the reasons why term is a bad thing for you. Once again, restate what you need. By then the seller will realize that you will be buying term or nothing—or else you will realize that this seller is not someone you're interested in dealing with. In that case, if you are meeting in a location outside your home, you can politely excuse yourself and leave. Your next step, of course, would be to look for another salesperson who *will* help you get the term insurance you need.

i "How Much Life Insurance Do I Need?" This is a calculator I like; accessed October 4, 2012, http://www.calcxml.com/calculators/how-much-life-insurance-need

ii Online comparison site for *term* insurance: Canada Life Insurance Quotes, accessed August 26, 2012, https://www.life-insurance-quotes.ca/default.aspx?Section=Common&Page=Quote Online comparison site for *cash value* insurance: https://www.life-insurance-quotes.ca/default.aspx?Section=Common&Page=Quote&Whole=True

iii It is difficult to find a general example because the cash surrender value appears to be specific to each particular policy.

iv "What happens to the cash value of a life insurance policy when the insured dies?" (The Insurance Providers website), accessed October 4, 2012, http://www.insuranceproviders.com/cash-value-life-insurance-policy-insured-dies

v To check this out, I used the same comparison tool as before to find out what Tom's insurance would cost at age 50.

vi Suze Orman videos on life insurance, accessed October 4, 2012, http://www.youtube.com/watch?v=kkUkZFczj0A&feature=related AND http://www.youtube.com/watch?v=WzgtWfQngII&feature=related AND http://www.youtube.com/watch?v=6vnN9liFWaE AND http://www.youtube.com/watch?v=IPzems4fWE4

vii accessed October 4, 2012, http://www.calcxml.com/calculators/how-much-life-insurance-need

viii https://www.life-insurance-quotes.ca/default.aspx?Section=Common&Page=Quote and https://www.life-insurance-quotes.ca/default.aspx?Section=Common&Page=Quote&Whole=True