YNAB PRESENTS

Life Insurance, Really?

A primer on why you need it, what you need (and what you don't).

You Need A Budget.

The idea of life insurance is pretty disturbing. Honestly, I'd rather be talking about any other financial topic (except taxes). Think about it: You're basically saying, *"I'll pay you this money so if I die, you'll pay some money to my heirs."*

That's a morbid thought, no?

Like it or not, life insurance is the most critical component of your financial plan. It's more important than getting out of debt, investing for retirement, or even getting on a budget. (Yes, it's *that* important.)

Why? Because if you were to die, your dependents (perhaps your spouse, definitely your young children) would not only suffer an emotional loss, but also a financial loss: the loss of income you were earning.

The purpose of any insurance is to protect you and your loved ones from the effects of a significant financial loss. If you give it some thought, the concept of insurance really makes sense. You pay a small amount of money each year (along with thousands of other people) to the insurer for the promise that if an unfortunate day arrives and you suffer loss, you will be made whole. For pennies on the dollar you receive the benefit of protection from financial catastrophe.

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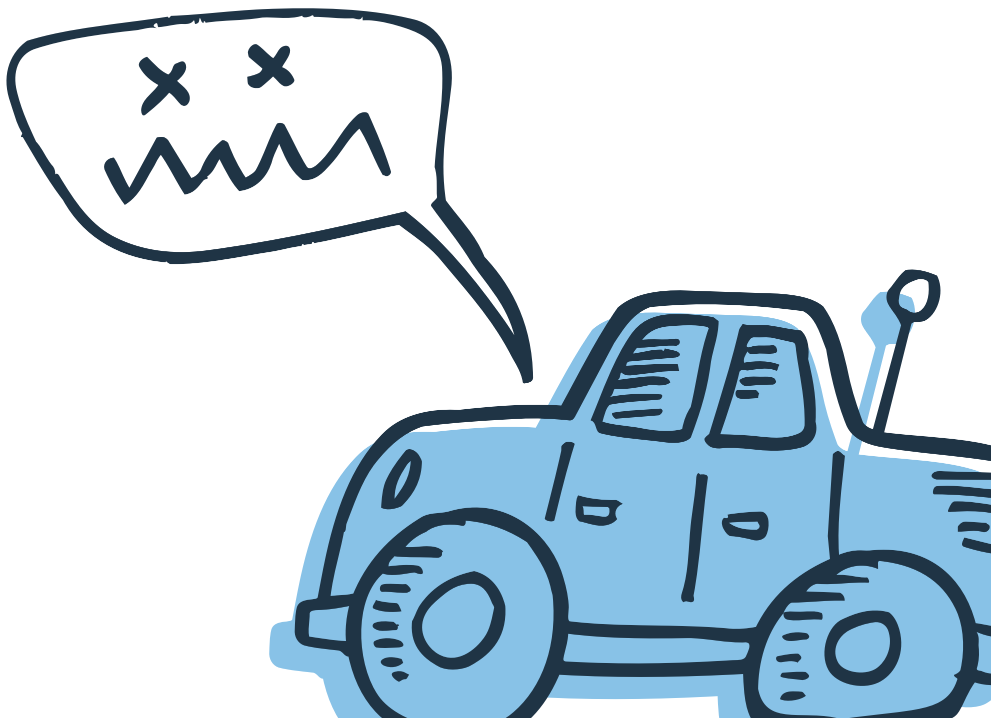
For instance, if you own a $40,000 car and wreck it, you would need to buy a new car. Coming up with the money to replace that car would be difficult for many, and would often require a loan—setting you back financially for years. An even worse scenario would be if you had owed money on the first car. You would not only need to purchase a new car, but would also still be stuck paying the original loan as well. That type of financial situation would be undesirable for anyone, and insurmountable for many.



As another example, if you own your home and it burns to the ground, you would suddenly need to provide new shelter for your family—either temporarily while you rebuild, or long-term. Providing for shelter and rebuilding your home would not only be undesirable, it would be an insurmountable financial obstacle for most. The problem would only be magnified if you were also still on the hook for a loan for the original home. Homeowner's insurance would protect from financial ruin by paying for temporary housing as well as the building of a new home on your property.

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The idea of insurance really makes sense. You wouldn't want to lose your home and have to figure out how to afford new shelter, and you wouldn't want to suffer the loss of a $40,000 car on which you still owe money and also be stuck needing to purchase another car.

The concept of insurance against financial catastrophe can make the most sense when it comes to life insurance. If something bad happens while you are still alive, you can work really hard and earn enough money to overcome the loss. On the other hand, if you die, there is no way for you to overcome the financial consequences of your death on your own. The financial obligations you have don't stop just because you're no longer around. Your spouse or children will still require food, shelter, and the basic needs of life, not to mention future needs like education. Your untimely passing would likely have a significant impact on the rest of their lives in many ways.

The reality is, if you have anyone who depends on your income, you need life insurance. It's critical to your financial plan, because it protects your dependents from catastrophic financial loss.

How Much Life Insurance is Required?

There are as many answers to this question as there are life insurance agents.

The calculation of how much insurance you need can become very complicated. However, you usually can keep it pretty simple. The most important thing is that you get life insurance in place, and then you can adjust the amount later as needed. The second most important thing is that you get insured for the amount that you feel will best fit your needs and your budget. Here are two good ways to make a quick, but fairly accurate estimate of the right amount of insurance for your needs:

OPTION **1** *Simple*

25x Your Income

This usually is the highest amount of life insurance suggested. The reason for the 25x multiple is to replace your income stream for at least 30 years. For example, let's say you earn $60,000 per year. If you bought life insurance equal to 25 times that amount, you would be purchasing a $1.5 million ($60,000 x 25) policy.

When you die, your dependents would receive the $1.5 million (tax-free), invest it, and then draw upon that investment in the years to come. Even if the money were invested fairly conservatively, it would likely last over thirty years (you'll want to check out our free investment course for more in-depth information on that).

OPTION **2** *Moderate*

Needs Analysis

Another option for determining your life insurance needs is to conduct a basic needs analysis. Let's walk through an example with Bill. We'll evaluate four important areas:

1. **Funeral expenses** (they run between $10,000 and $20,000 so use $15,000 as an estimate). In Bill's case, let's use $15,000.
2. **Outstanding debts.** Bill tallies his mortgage ($250,000), student loans (his and his wife's combined: $20,000), credit card ($8,000), and a car loan ($22,000). This gives Bill a total debt balance of $300,000. We'll want Bill's life insurance to leave his dependents debt free.

3. **Education expenses.** Most schools provide a calculator to figure out what will be required for each dependent. If you aren't planning on helping your dependents with education, you can skip this portion. In Bill's case, he has a 15-year old daughter, and plans on helping pay for her education, to the tune of $50,000.

4. **Income replacement.** With funeral expenses, all debts, and education paid, Bill can compute what portion of his income is still needed. Bill's gross income is $60,000. His income will no longer be needed to:

   a. Save for retirement. Bill was saving 10% of his gross income for retirement ($6,000 annually).

   b. Service $300,000 of debt ($21,600 annually).

   c. Save for his daughter's college education ($2,400 annually).

His income needing replacement drops from $60,000 to $30,000 ($60,000 - $6000 - $21,600 - $2,400). A quick way to get to a lump sum that would provide income replacement, is to multiply the required income by 25. With Bill's required gross income of $30,000, you multiply by 25, yielding life insurance needs for income replacement of $750,000.

To sum up, Bill will need:

- $15,000 for funeral expenses
- $300,000 for outstanding debts
- $50,000 for his daughter's higher education, and
- $750,000 for the remaining income replacement.

Bill's total life insurance needs are $1,115,000.

You can walk through the same exercise, and determine your own life insurance needs.

Many of the online life insurance "needs" calculators are sponsored or provided by life insurance agents, brokers, or agencies. They have a very strong economic interest in having your life insurance needs be much higher than necessary, because they stand to make a larger commission. Just keep this in mind when shopping around online for life insurance, and using a calculator as the basis for your needs.

SIDENOTE:

Many employees end up with group life insurance. This comes with several significant problems: 1) the amount of insurance is usually inadequate, 2) the price is too high, 3) the insurance doesn't go with you when you change jobs, and 4) the price usually increases each year. The best deals are found by shopping the private market.

What Kind of Life Insurance is Needed?

This is the *easiest part* of the whole process. You need term insurance. NOTHING ELSE. Do not fall for any other type of insurance. Agents will try and sell you all kinds of fancy insurance: whole life, variable, universal... if it isn't **term** insurance, and *only* that, then your agent is trying to maximize their commission at your expense, or they are making recommendations based on the training the insurance company has given them. Either way, neutrality is in question. Term insurance policies provide the smallest commission of any life insurance product out there.

What's term insurance? You agree to pay a fixed annual premium, for a given "term" (the length varies, expressed in years). If you pass away during that term, your heirs are paid the death benefit attached to the policy. Pretty simple, isn't it? With life insurance, we like simple.

For those of you that are big fans of permanent life insurance, like whole life, please understand that I am not just saying this because it's a popular thing to say. I've had a whole life insurance agent in my home for several hours, over multiple visits, and we hashed out all sorts of possibilities. I have an extremely high tax bracket, earn a good living, and am as good a candidate as any when it comes to these whole life policies...and the numbers were still very unimpressive.

You need term insurance.

THAT'S IT.

What Term is Needed for Term Insurance?

The simple answer to this question is that you should buy a term policy, with fixed premiums for a length of time that sufficiently covers the risk that you are insuring. If your financial situation, as well as your dependents' need for your income, makes the insurance unnecessary in X years, then only buy a policy that covers you for that many years.

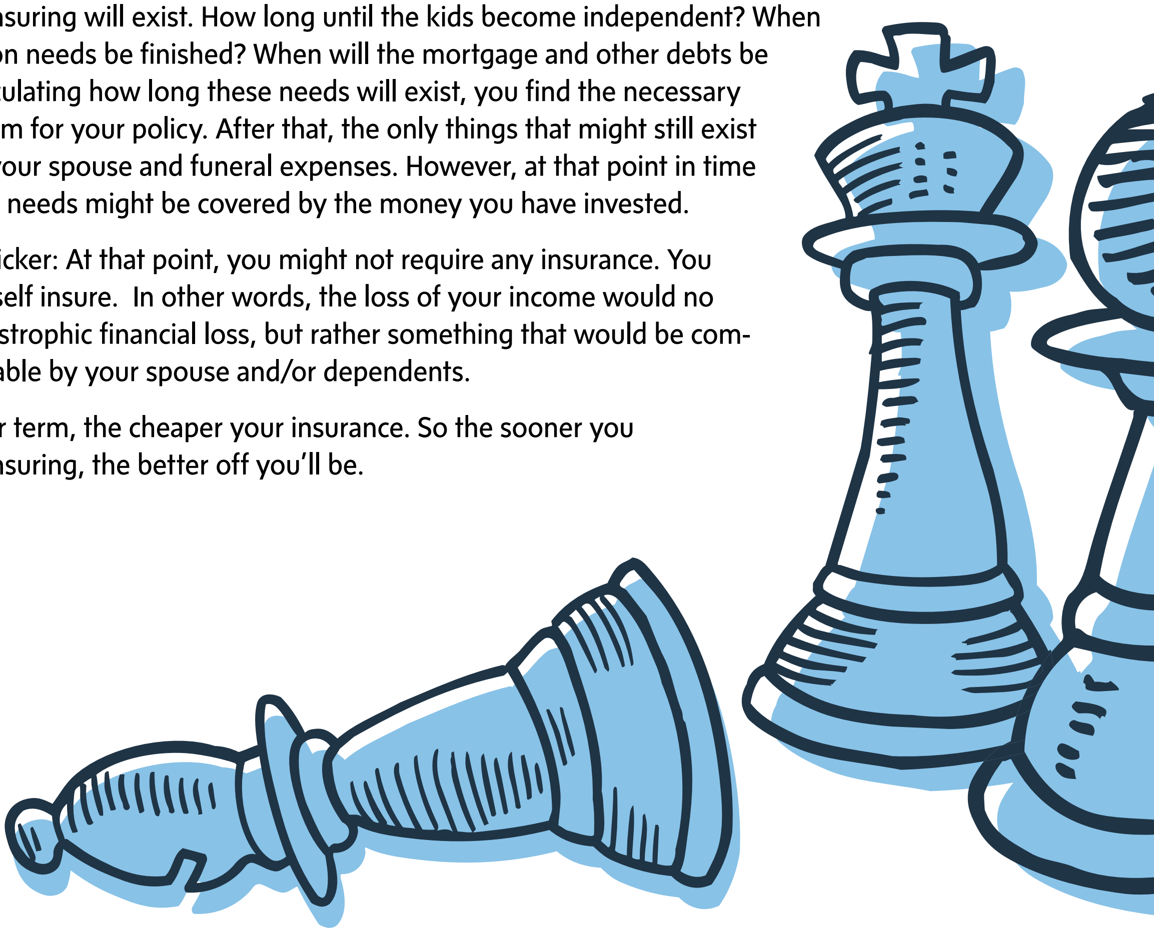
For example, I purchased my term insurance policy when I was 25, and its price is fixed until I'm 45. By the time I'm 45, two of my kids will be on their own, and the youngest will be three years from college. Barring absolute financial catastrophe between now and then, our primary residence will still be paid off, the rental homes will be mortgage-free, and we still won't be carrying any consumer debt. We will also have been saving for an additional 13 years, and our retirement nest egg should have grown substantially from continued contributions and compound growth...

What does all of that mean? *Sayonara* term life insurance premium, that I've been paying for 20 years. You are now useless to me. (And, if the point where I don't need insurance comes earlier than 20 years, I can end the policy even sooner.)

When you're evaluating how long the term should be on your policy, ask yourself how long the needs you are insuring will exist. How long until the kids become independent? When will the education needs be finished? When will the mortgage and other debts be paid off? By calculating how long these needs will exist, you find the necessary length of the term for your policy. After that, the only things that might still exist are income for your spouse and funeral expenses. However, at that point in time these remaining needs might be covered by the money you have invested.

And that's the kicker: At that point, you might not require any insurance. You may be able to self insure. In other words, the loss of your income would no longer be a catastrophic financial loss, but rather something that would be completely manageable by your spouse and/or dependents.

The shorter your term, the cheaper your insurance. So the sooner you can get to self-insuring, the better off you'll be.



Where to Buy Your Term Insurance

My initial plan in writing this primer was to link to a few insurance calculators, where you could fill out some basic information, have a random life insurance agent (who pays for those leads) contact you, and you'd get a term insurance policy. YNAB would make a small commission for sending leads their way.

Then I started feeling really uneasy about it. From my own experience, I recognized that many agents who might contact you would start out selling term insurance, and then persuade you to overpay by having you:

- Purchase something other than term insurance (whole, variable, universal life…)
- Purchase more insurance than you actually require
- Purchase a longer term than is actually needed
- Purchase from an insurance agency that didn't provide the best rate

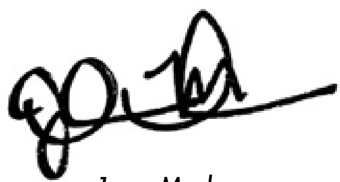
If you were to do any one of those things, or a combination thereof, you'd be paying too much. (Your agent would also be earning too much.)

I was reminded of the old adage, "If you want something done right, you do it yourself."

Well, I'm doing that. I formed YouNeedTermInsurance.com, where I send every single inquiry to my own trusted financial advisor, Casey Murdock. The goal is really simple: Provide the *optimal amount* of *term insurance* for the most *competitive price* available, from a highly-rated insurance company.

Casey will take your unique situation, and analyze all of the policies available at dozens of the nation's best insurance companies. He finds thrill in the deal, and will get you the best deal available.

With this primer as your guide, you are certainly very well informed, and could likely navigate the life insurance waters with a fair bit of savvy. However, if you'd like my advisor, Casey, to guide you through the process and shop the policies for you, check out YouNeedTermInsurance.com. It won't cost you a dime, and he'll take good care of you.



-Jesse Mecham