



Sound Financial Bites 005 - Life Insurance Basics, Part 1

Episode Transcription

"It is nearly impossible to get over insured."

Hello, and welcome to "Sound Financial Bites." I'm your host, Paul Adams, President and CEO of Sound Financial Group. I want to welcome you all to the call today. Today, we're going to talk about some life insurance basics. Now, hang in there. This is usually a very boring topic for most people, but given our last podcast on the highest stakes game going, about the ending of our income, this is something that will make a lot of sense to be able to dig in and listen to maybe multiple times, to make sure you get this part of your financial life exactly right, because we don't get the choice of whether or not we get to fix this one later. I'll talk more about that soon. If you've not had a chance to get much into our podcasts before, and engage us as a firm, I'd encourage you, if you've not had the chance to do so, have a 30 minute call with one of our advisors.

You can find out more about us at sfgwa.com, that's Sound Financial Group WA .com, because our mission is to help you design and build a good life, and we teach suitable clients who to keep money that they're currently forfeiting unnecessarily, either to the IRS, or to financial institutions, and we do that on an educational based model, rather than a sales based model as most firms do, so much like these podcasts, all we want to do is have you intellectually engage and learn. You can go to our website, you can email us at info@sfgwa.com, and you can see our upcoming events. We do about 12 events a year that are 1 hour, focused learning sessions for our clients, some that you can attend by web, as well, and we look forward to having you come and learn with us at one of those events. Why don't we get right down to our subject at hand today? Life insurance basics.

First, I would say there's two major things that we always need to think about as it relates to life insurance, that really simplifies how you might view this subject. First is, what's the appropriate amount of life insurance? What's the appropriate amount of life insurance, and what's the appropriate type of life insurance? The amount of life insurance is something that is often debated by financial people, everything from a financial advisor to CPA's to attorneys, and it often comes down to the use and purpose. What I want to refer all of this back to is actually one of the first books that were written, that was really a scholarly book in the area of life insurance, this idea of the economic value of a human life, and it goes to an author by the name of Solomon Huebner, that's the gentleman who founded the American college which does an incredible amount of education for most financial professionals here in the country.

In his book, "The Economics of Life Insurance," he said what we should look to do is insure someone's human life value the same way we would insure a property value. That is for full replacement, full economic replacement. Simply put, if I own a building that's worth 10 million dollars, and then I go to my insurance agent to insure that building, how much should I insure it for? Well, do I want to insure it for enough money to now put a 5 million dollar building in its place, or do I want to fully replace it? Well, I need to not only fully replace the building and rebuild it, but I need to be compensated for lost rent during that time. I need full economic or as close as I can get to full economic replacement of that asset.

If you're not a commercial real estate developer, you can think of it as your own personal home, that if something happened to your residence, how much of your residence would you want back? If you have a 4000 square foot home now, would you be okay putting a 1000 square foot home in its place? Of course not. You want full replacement. We somehow relate to that very easily when it comes to property values, but not so easily when it comes to our own value, economic value as a person that we bring to the world, that we bring to our companies, that we bring to our community, that we bring to our family. Why is that? Well, not long after Solomon



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“We need to replace most of our income; the bills don’t just drop when you drop dead.”

Huebner wrote that book early last century, another philosophy came out.

It was really a sales philosophy that was built to help people buy lots of life insurance. What they did is they did life insurance needs, which when you do a life insurance needs analysis, think about from the perspective you heard it in one of our earlier podcasts, this idea of needs that we're really pushing to the minimum. You don't want your retirement needs. It's like, what do I need? What can I get by with? The thought process was that if we got people to buy into their, quote unquote, "needs," that what that would do is put us in the position like if somebody's a sales person for life insurance, selling to us, it would put us in the position, we got to buy it, because they just went through like, "Worst case scenario, you need to have at least 1.2 million dollars."

We say, "Okay," and we sort of surrender. When I first got in the financial industry, they called it "backing up the hearse." "You have to really make them feel what it's like if they were to die." That sales technique became prevalent and it even got into other areas, because now everybody's talking about what's the minimum amount of life insurance you can get rather than the maximum. Let me share with you very simply what I think happens far, far too often when we go down the path of life insurance needs. We begin to say things about ourselves and even about our spouses that are totally inappropriate. Things like, "My wife is beautiful. She would get remarried. She doesn't need that much life insurance."

Now, only if I built a nice relationship with a client would I say at that point, "Help me understand your strategy. What you want to do is have your wife, because you don't have the appropriate amount of life insurance, you want to have her get remarried later, and part of her marriage that she's going to enter into needs to be financial, because that person needs to be able to take care of her and her children, so part of that decision needs to be financial." You can tell, at that point, if it's the husband, he knows he's getting set up a little bit, but incidentally by the way, I've done this with the bread winner that's the wife, also. It kind of sheepishly will go, "Well, yeah." I say, "Well, if she's going to go ahead and get remarried after your death for financial reasons, why don't we have her going out looking right now to get remarried for financial reasons?"

Now, in the instances where I've had that conversation with a client, I've got to tell you, nearly every situation, even a GoToMeeting, I can hear her hit him. In person, it's kind of like a slap on the shoulder. Why is that? Because it's silly, but if what we're going is to needs, what's the minimum, we start making up reasons why it's okay to not make sure that our family is okay. What's the maximum? If we know the minimum, I think everybody would agree, when you sit back with a scientific and thinking mind, it's like, "The minimum is probably not what I should be doing." What's the maximum? What's the most somebody could do? The most you can do, by most life insurance companies regulations, depends on your age. If you're in your 20s, you can usually get 30 times your assets. If you're in your 30s, you can get 20 times. If you're in your 40s, you can get about 15 times your income. If you're in your 50s, 10 times your income, and 60+, you can have 1 times assets.

1 times your actual assets. Like, net worth. You can usually get more if you're a business owner. There's business reasons to own life insurance, but as an individual income earner, whether you're a business owner, not for personal reasons, that's usually about the maximum you can get. Why is that? The insurance companies need to make sure that it's not ever an economic incentive that someone should die. That's why it's nearly impossible to actually get over insured. Nearly impossible to get over insured. Why? Because the insurance company will not issue enough life insurance on you to be in a position that you would get over insured, simply put. If you want to



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“Your advisor’s professional responsibility is to help you acquire the appropriate amount of life insurance.”

retire with an amount of money, and I like this conversation, because it touches on retirement, as well. If you're going to be retired one day, and you said, "Well, I need, in retirement, is \$200,000, because that's what I make, I'm in my 30s, I make 200,000 today, I need 200,000 in the future." That means you need 5 million of capital at work, taking 4% of every year, to produce that 200,000. Very simply equation.

If something happened to you and you got hit by the number 4 bus, and you want \$200,000 to come in for your family, then you've got to have 5 million dollars on your balance sheet to pull that off. The problem is, the life insurance company is only going to give you 20 times your income. That's 4 million dollars. Even if you have the maximum amount of life insurance, 4 million, and your family gets the 4 million and invests it, and draws off 4% a year, they've got \$160,000 a year. Here's the thing. I would bet you nobody listening to this podcast anywhere is sitting there right now with their monthly budget saying, "Oh, my gosh. I don't even know what to do with all the money I'm making. I've just got it stacked in cardboard boxes in the bottom of the closet."

All of you are utilizing all of your money, either currently, or you're reserving that capital for future utilization by putting it into bank accounts, saving accounts, investing, to one day be able to provide income when you're no longer working. It's either being utilized today, or reserved for future utilization. Either way, it's all getting utilized. We need to replace most all our income, because the bills don't drop the day we drop dead. In fact, in many circles, when I ask that question, they say, "There's probably some pretty good reasons bills could increase if I die." The right amount of life insurance to get, I would submit to you would be the most the insurance company will allow you to get. We can't end up over insured. The insurance company won't let it anymore than they would let me insure my car so that if it gets wrecked, I get a brand new Rolls Royce. That would be over insurance. My car would be in grave danger if it were to be hit, and I got a Rolls Royce instead.

They can't allow over insurance. It increases claims. Just do the math for you. If you need to replace 100% of your income, and for whatever reason, you and your spouse live in the lifestyle you're in right now, well, my wife in particular stays home. Because she stays home, we made that as a values based decision that she would stay home right now. Here's the thing. My family's values, I don't certainly want them to change because I'm not there. I don't want to say I want to live by one set of standards as long as I'm here to enjoy the situation, but man, the day I die, my wife needs to go back to school, get some additional skills and enter the workplace, because now they would have lost both parents, they might have lost me to the grave, and their mother to the workforce. I'm not okay with that. I don't think most people are really okay with that if they're really reflecting from the perspective of doing what they would want for their family.

There's a very real situation. This is going to branch us over into cost. There's a very real set of concerns around how much does it cost to get this insurance protection done. I think out of the wisdom of making these podcasts an appropriate length, what we're going to do is I'm going to get to types of life insurance in the next podcast. It'll be life insurance basics part two, but for now, let me just touch briefly on cost. See all too often, we come up with all the reasons in the world we want this, or we don't want that, amount of life insurance or disability insurance for that matter, or an appropriate amount of savings. We have all kinds of reasons, but almost all of those reasons fundamentally come down to cost.

You see, if let's just say, tomorrow, tomorrow the federal government passed a piece of legislation that for whatever reason, they decided everybody should have the maximum amount



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of life insurance. Your 20s, you get 30 times your income. If you're in your 30s, you get 20 times income. If you're in your 40s, you get 15 times. 50s, 10 times. 60s, 1 time net worth. If they did that tomorrow, passed at legislation, done, and the only thing that was required was you just needed to sign a piece of paper. There is no cost, they've decided it's better for society that everybody had life insurance and all you had to do was sign it. Or, if your employer made the same deal with everybody. Your health insurance provider said, "Here's the deal. We're going to get you the max amount of life insurance.

All I need you to do is sign this and tell us who you want the death benefit to go to." There is not a person listening that wouldn't say, "Of course I would do that. Of course." The reason that we would do it is because cost is no longer a factor, and nearly everything in our lives where we begin to compromise, especially the protection component of our world, it comes down to cost or perceived cost. This is where the role of your advisor enters in. Your advisors professional responsibility is to help you acquire the appropriate amount of life insurance, with the least amount or no out of pocket costs, meaning they were able to make other parts of your life more efficient so that you can acquire the appropriate amount of protection. With that, we're going to hold off on types of life insurance until our next episode. I want to just encourage everybody, as you're digging in, listening to these podcasts, you're actually spending time learning how to design and build a good life.

It's not easy. You're taking this time during your, you could be listening to a national news radio sure, and yet, you're tuning into these podcasts. I want to acknowledge you for taking the time to do this, for journeying along with us and helping us pour into your world to help you be more effective with your money, and I really look forward to either seeing you at one of our upcoming events, hearing that some of you reached out to our advisors, or just getting your comments. You can send them in at info@sfgwa.com, and any "a-ha's" you got from any of these episodes. I look forward to meeting you one day in person. Have a great day.

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