6 Reasons Not To Buy Life Insurance For Your Children

I would hope this would function more as a back to basics post, as I would hope that most long-term regular readers already know the answer to this question. But I’m seeing it enough that it is clearly worth addressing.

Q.

I am considering purchasing child life insurance for our little girl. We have been reading various articles and are seeing a lot of different opinions on this. Would you recommend it?

A.

Not no, but heck no. Child life insurance, like most permanent insurance, is a product made to be sold, not bought. Let’s consider the reasons why. And then we’ll try to find some articles advocating otherwise and debunk them.

# 1 Your Child Has No Income

The main purpose of life insurance is to replace the necessary
earned income of a breadwinner. If you are financially independent, you don’t need life insurance. If you depend on someone else for your income/lifestyle, then you don’t need life insurance. Now, a reasonable case can be made to carry some amount of life insurance if you contribute in an economic way to a household, even if that way isn’t a paycheck (think stay-at-home mom whose household duties might cost $30-100K per year to replace), but that doesn’t apply to a child. I have no doubt in my mind that if, heaven forbid, one of my children died, that my household expenses would go DOWN, not up.

Only one person in this picture carries life insurance. Guess who?

# 2 Burying Your Child Isn’t That Expensive

Others advocate that you should buy life insurance on your child to pay for their burial expenses. “It’s only pennies a day,” they say. Well, the reason it’s only pennies a day is that not only is it extremely unlikely that your child will die, but it isn’t that expensive either. A typical burial is < $10,000. If you can’t cover $10,000 out of either your current
earnings or your emergency fund, you have a lot bigger financial problems than whether or not to insure your children. But sure, if that would be a financial catastrophe for you, then buy your kid a $10K life insurance policy.

# 3 It Doesn’t Preserve Insurability

Some people buy life insurance on their kids thinking it will be great for them in case they develop diabetes at age 8 or something and can’t buy life insurance as an adult. However, their life insurance need as an adult is likely to be $500K-$5M, and that doesn’t even include the effects of inflation over the next 20-50 years (which at 3% turns that $500K-$5M into $900K-$9M at 20 years and $2.2M-$22M at 50 years.) You really think that $10K whole life policy is going to make any kind of significant dent into that kind of need? Not a chance. This isn’t a disability insurance policy that is sold with a “Future Purchase Option” rider. There’s no guarantee they can actually buy more life insurance at a reasonable price later. And nobody is going to buy a $2M whole life policy on their child. Give me a break. If you’re buying life insurance from the same company that sells you baby food, there’s an issue.

# 4 Life Insurance Is A Terrible Investment

In case you’ve never read through my series on The Myths of Whole Life Insurance (most of what is sold for children) it is important that I point out that the returns on a whole life insurance policy are terrible. Often negative for a decade or two, they are only guaranteed to be about 2% over a lifetime and projected to be perhaps 3-5%. The smaller the policy (like most child policies) the lower the return due to more of it being eaten up by administrative and insurance costs.
# 5 Nobody Knows What To Do With an Inherited Life Insurance Policy

I’m always seeing posts from people who were given a life insurance policy at 25 or 40 that their parents had been paying on for decades. The analysis of what to do with it is always complicated. In many ways, they’re inheriting your poor decision. Don’t do that to your kids.

# 6 If They Don’t Die, They Can Use the Cash Value In Their 20s

The worst part about giving the kids your bad decision (to buy whole life insurance on them) is that if you had only given them something with a higher return, they’d be getting a lot more money and with a lot fewer strings attached. The likely return on whole life after 20-30 years is probably 0-2%. If you had just given them shares of a good stock index fund, that return is likely to be more like 7-10%. That makes a big difference over decades, not to mention the better tax treatment on gains when they cash it out. It would be even better if you gave them the money in one of the three ways I’m giving my kids money:

- Roth IRA- The daddy match allows all their earned income to go into a Roth IRA, never to be taxed again, while
they spend the equivalent amount of my money

- 529- If used for college, a way better plan than anything else. Not only is there an upfront state tax break in many states, but all earnings are tax-free.
- An UGMA- For those non-college expenses, it’s better to have the money in their name, so it is only taxed at their lower tax bracket. In fact, unless it becomes a really big account or is invested very tax-inefficiently, chances are it won’t be taxed at all.

Okay, enough ranting about conniving insurance salesmen duping the financially illiterate into purchasing a product made to be sold at one of the more emotional times of life (and sometimes even while they’re still in the hospital after delivery.) Let’s look at some of those others articles out there.

Here’s one on NerdWallet, reportedly written by financial advisor Brian Frederick. If you are Brian’s client, you might want to rethink some of the other advice he has given you, by the way. He says this:

> The prudent, responsible thing is to always carry enough coverage for a child’s funeral expenses. Also, if you’re in a good place financially by not having consumer debt and being on track for your retirement, it also makes sense to at least consider using a policy as an accumulation vehicle.

No Brian, neither of those are a good reason for most people, much less high earners, to purchase life insurance on their children. In fact, there is no good reason. He goes through a bunch of the reasons I’ve listed above, and, of course is wrong about each of them. He also throws in a new reason- to have money that isn’t subject to the FAFSA when you apply for financial aid. That trick actually works for Joe Middle Class, but don’t count on it as a high-income professional who reads
financial blogs. Chances of your child qualifying for aid are very low, and what they’ll qualify for is mostly loans anyway. Nice gift to your kid. The issue is that Joe Middle Class doesn’t have the money (nor savings rate) to max out all their retirement accounts anyway so they almost surely have a better investment available to them than whole life insurance and they get much better tax treatment on that investment, even if it shows up on your FAFSA.

Trent Hamm at The Simple Dollar does a better job on this subject.

The obvious and easy answer to the child life insurance question is no. Life insurance is usually purchased as either a salary replacement (so that a spouse or children aren’t left with an inability to maintain their standard of living) and/or a tool to pay for funeral expenses.

He should have stopped there. He then starts hedging and waffling about preserving insurability and paying for college. No and no. Those are not valid reasons to buy life insurance on your child.

Donna Fuscaldo at Fox Business does a typical journalist article where she doesn’t give her opinion, she just found someone with opinions on both sides of this “argument” and presented their views. So she talked to someone who sells life insurance:

With a term policy, Bill White, vice president, life insurance and annuity product line leader at insurer USAA, says the insurance is added as a rider and once the child grows up, it can be converted to the child’s own $100,000 policy. He adds that type of coverage would ensure if the unthinkable happened, the funeral costs would be covered.
"You buy insurance strictly for risk protection," says Tony Steuer, creator of Insurance Literacy “Because it’s mixing in two different types of financial products it’s not taking the best of either one.” Buying life insurance as an investment made sense back in the 1940s when there were limited options, but today there are countless ways to grow money with relatively low risk taking, says Steur, pointing to an exchange-traded fund with low fees.

The article does point out the only valid reason for life insurance on a child that I could find- if your child supports you financially.

One instance where buying a life insurance policy on a child makes sense is situations where the parents are dependent on their child for their livelihood (think Miley Cyrus or other child stars).

I would point out that if you are reading this blog, it is highly unlikely you’re in that situation. Even if your child is a star, you’re probably not financially dependent on them.

Here’s one from the Insurance Information Institute (sounds unbiased, right?) It talked about the usual wrong reasons to buy insurance, then throws out this beauty:

Still another reason for buying life insurance on a child’s life is part of a program to teach the child financial responsibility. Typically the insurance is whole life insurance, ownership of which is transferred to the child when he or she turns 21.

Sounds like a good way to teach your child to be financially illiterate to me, or at least demonstrate to them your
financial literacy as soon as they realize what you’ve done.

US News got it right, when it wrote an article titled 4 Types of Life Insurance You Should Never Buy:

2. Life insurance for children. In general, life insurance for kids is a huge waste of money. That’s because (thankfully) most children are born healthy and live a very long time. And since children don’t have any income, you don’t really have any reason to insure their lives, as cold as that may seem. Just because you don’t buy insurance doesn’t mean you don’t love your children. It means you are smart enough to put that money to better use—like saving for a college education.

I love the line about how it doesn’t mean you don’t love your kids if you don’t insure them. Take that Gerber!

Jason Brooks is a financial planner who gets it, although I’m not sure Joe Heider does:

Most kids don’t need life insurance, since its chief purpose is to replace income...And while whole and variable life policies have a cash value that rises, high fees slow that growth. Breaking even on premiums can take decades....The only reason to buy is to guarantee insurability later in life, says Cleveland adviser Joe Heider. You can, he notes, lock in a policy—helpful if your child later has an illness, such as cancer or diabetes, that makes insurance expensive or unobtainable. But such misfortune is rare; only one in 400 children has diabetes before age 20, for example. And the size of most kiddie policies ($50,000 or less) is usually too small to be useful for adults. A better idea is to save for a more likely need: higher education.

Hope that survey of what pops up readily on the internet is useful. Do your kids a favor—Ensure financial independence
for yourself, then put something away in a higher-returning investment inside a tax-protected account that they can use in their 20s, when they can really benefit from your help.

What do you think? Did you purchase life insurance on your child? Why or why not? Do you regret it? Did your parents buy life insurance on you? Was it helpful? Comment below!