The Law Offices of KIDWELL & KENT NEWSLETTER

How Much Life Insurance Do You Need?

Your life insurance needs change as your life changes. When you are young, you may not have a need for life insurance. However, as you take on more responsibility and your family grows, your life insurance needs increase. Your needs may then decrease after your children are grown. You should periodically review your needs to ensure that your life insurance coverage adequately reflects your life situation.

Estimating your life insurance need

There are a couple of simple methods that you can use to estimate your life insurance need. These calculations are sometimes referred to as rules of thumb and can be used as a basis for your discussions with your insurance professional.

Income rule

The most basic rule of thumb is the income rule, which states that your insurance need would be equal to six or eight times your gross annual income. For example, a person earning a gross annual income of $60,000 should have between $360,000 (6 x $60,000) and $480,000 (8 x $60,000) in life insurance coverage.

Income plus expenses

This rule considers your insurance need to be equal to five times your gross annual income plus the total of any mortgage, personal debt, final expenses, and special funding needs (e.g., college). For example, assume that you earn a gross annual income of $60,000 and have expenses that total $160,000. Your insurance need would be equal to $460,000 ($60,000 x 5 + $160,000).

Several more comprehensive methods are used to calculate life insurance need. Overall, these methods are more detailed than the rules of thumb and provide a more complete view of your insurance needs.

Family needs approach

The family needs approach requires you to purchase enough life insurance to allow your family to meet its various expenses in the event of your death. Under the family needs approach, you divide your family's needs into three main categories:

- Immediate needs at death (cash needed for funeral and other expenses)
- Ongoing needs (income needed to maintain your family's lifestyle)
- Special funding needs (college funding, bequests to charity and children, etc.)

Once you determine the total amount of your family's needs, you purchase enough life insurance, taking into consideration the interest that the life insurance proceeds will earn over time, to cover that amount.

Income replacement calculation

The income replacement calculation is based on the theory that the family income earners should buy enough life insurance to replace the loss of income due to an untimely death. Under this approach, the amount of life insurance you should purchase is based on the value of the income that you can expect to earn during your lifetime, taking into account such factors as inflation and anticipated salary increases, as well as the interest that the lump-sum life insurance proceeds will generate.

Estate preservation and liquidity needs approach

The estate preservation and liquidity needs approach attempts to calculate the amount of life insurance needed upon your death to settle your estate. This includes estate taxes, and funeral, legal, and accounting expenses. The purpose is to preserve the value of your estate at the level prior to your death and to prevent an unwanted sale of assets to pay estate taxes. This method takes into consideration the amount of life insurance needed to maintain the current value of your estate for your family, while providing the cash needed to cover death expenses and taxes.

Sincerely,

John Kent Kidwell