HOW MUCH LIFE INSURANCE DO YOU NEED?

Keep in mind that there is no one “right” method, there are many method with sound rationale. Further information and resources can found on my website at www.lifeinsurancetoolbook.com in the “How Much Life Insurance” section. The accuracy of any calculation depends on the method chosen as well as on the information used. Your needs will need to be adjusted at certain milestones such as children graduating from college, retirement, moving, etc. Along with calculating future income and expenses, you will need to estimate your life expectancy.

The most commonly mentioned method of calculating life insurance needs is the simple rule of thumb of using a multiple of your income (anywhere from 6 to 15 times). While rules of thumb may be helpful, they do not take each individual's situation into consideration. Also, though a spouse may not have an earned income, it is important to recognize their value to the household budget.

If you know the amount of income that needs to be replaced (assuming that this a permanent level income), you can perform a reverse calculation by dividing the income stream needed by a conservative, reasonable rate of return if you were to invest the entire proceeds and leave the principal intact (such as a 5% annual rate of return). For example, if your need is for an annual before tax income stream of $50,000 then divide by 5% ($50,000/.05) resulting in a death benefit of $1,000,000.

WORKSHEET:

INCOME NEEDS:
1. Annual income your family would need if you die today (typically between 60%–80% of total income)
   Consider any lifestyle changes, and include any current expenses such as mortgage/rent, groceries, clothing, utility bills, entertainment, travel, transportation, child care, etc: $__________
2. Annual income available to your family from other sources - include all salaries, dividends, interest, current (or estimated) social security benefits along with all other sources of income: $__________
3. Annual income to be replaced (Subtract line 2 from line 1): $__________
4. Funds (Capital) needed to provide income for your required number of years? $__________
   Multiply line 3 by the appropriate factor* below:
   * 10 YEARS X 8.1; 15 YEARS X 11.1; 20 YEARS X 13.6; 25 YEARS X 15.6; 30 YEARS X 17.3; 35 YEARS X 18.7 and 40 YEARS X 20.0

EXPENSES:
5. Funeral expenses - average cost of an adult funeral is about $10,000: $__________
6. Administrative Expenses (also referred to as an Emergency Fund and/or Final Expenses (approximately six months - 50% of the higher wage earner’s salary); - can vary for cleaning up the affairs of the deceased, e.g., advisor fees, filing taxes: $__________
7. Mortgage and other outstanding debts (credit card debt, car loans, home equity loans, etc). It may make sense to pay off these debts, considered if the survivor will have a substantial income: $__________
8. College costs**: 2002-2003 cost of a four-year education: public college-$51,346; private college $109,412 multiply by number of children, costs are increasing more rapidly than inflation $__________
9. Capital needed for college - Multiply line 8 by the appropriate Years before college Factor:
   * 5 years X .82; 10 years X .68; 15 years X .56 and 20 years: X .46
   Total capital required Add lines 4, 5, 6 and 9 $__________

ASSETS: Keep in mind that current asset value may be considerably different at time of liquidation as well as the value may be significantly discounted due to forced sale such as real estate, family business or other investments:
11. Bank accounts, money market accounts, CDs, stocks, bonds, mutual funds, real estate: $__________
12. Retirement savings IRAs, 401(k)s, Keoghs, pension and profit sharing plans: $__________
13. Present amount of life insurance (including group life insurance assumes that it will continue): $__________
14. Total income producing assets - Add lines 11, 12 and 13 $__________
15. Life insurance needed - Subtract line 14 from line 10 $__________

* Factors: Inflation is assumed to be 3%. College costs indexed at 6%. The rate of return on investments is assumed to be 6% after tax.
** Source: The College Board, Trends in College Pricing 2002
Information and factors are based on information from the Life and Health Insurance Foundation for Education; a nonprofit organization

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