



CORNERSTONE FINANCIAL PLANNING

How Much Life Insurance Do You Need?

By Gary Case

During the past couple of months I have focused on common mistakes made with respect to life insurance. This column focuses on determining how much life insurance you need. There are numerous calculators available through insurance companies or via the internet, and this calculation has to do with income replacement rather than estate tax, or legacy planning. Also, if you are considering using a life insurance policy to accumulate funds to produce future income, there are additional considerations with respect to the amount of money you place into the policy. Those considerations are not covered in this column.

The first determinant is how much income the family needs at the death of a bread winner. Those who contribute to the household income also consume a portion of that income, so at their death the amount consumed by the deceased person should be deducted from the need. A major bread winner could consume 20% or more of a family budget.

Next, add the income available from other sources, such as dividends, Social Security, pensions, and other family income. Subtract this amount from the replacement income amount from the above paragraph. Then, figure out for how many years the income must be replaced. This is an interesting calculation because unless you factor in retirement income or savings toward that income in the replacement amount, you could experience a shortfall at retirement. Once you have determined how many years the income must last, determine the present value of the total (your financial calculator can do this function or you can have a financial professional make the calculation for you—the computer models often do this.)

Now it is time to determine what capital expenses may need to be met, in addition to the needed replacement income. Among the most common capital items are burial and funeral expenses, college costs, and mortgage and other debt elimination (be sure not to double count—if you plan to pay off your mortgage, don't include your mortgage payment in the replacement income calculation...please note that your property taxes and insurance costs don't go away when you pay off your mortgage).

Finally, subtract your current assets from the total. Current assets can include savings, retirement accounts, present life insurance, and future inheritance (if you are brave enough to want to estimate that!). You now have a net amount of life insurance needed.

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