

How Much Life Insurance Do You Need?

A simple guide to providing for your family – after you're gone

The amount of life insurance that is offered to us can be so large that the numbers become unreal: \$1 million? \$2 million? Is there any amount that could be considered enough?

Remember, the purpose of life insurance is to provide financially for your loved ones after you pass away. So if you're wondering how much life insurance you really need, the first question to ask is "Whose financial needs am I responsible for?"

For most people in their prime working years, the answer to that question is "my spouse and the children I'm supporting." If that's who your life insurance is slated to protect, there's an old rule of thumb that says you should maintain life insurance in the amount of 10 to 12 times your annual income. That replaces your salary for, obviously, 10 to 12 years.

But it actually amounts to a bit more than that. Because your dependents would get all that money upfront, it gives them some assets to invest, and the interest can provide additional income. On the other hand, that rule doesn't account for whatever growth in income you might expect over those 10 to 12 years.

Of course, it also matters what your current assets and debts are. For a more sophisticated answer to how much life insurance you need, your annual income times 10 to 12 years is just the beginning.

HERE'S A WAY TO FIGURE IT:

Starting with that 10- to 12-year figure, add the balance of your mortgage, expected educational expenses for your children, and any other significant debts. That gives you an idea of the amount of money you'll want your life insurance ►

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to replace. Then subtract savings, including any existing 529 plans or other educational funds, as well as other life insurance currently in place, including any employer-provided coverage. That will give you a good figure to shoot for.

The number can be adjusted based on the age of your dependents. If your kids are already in high school or college, the number of years that you would need to provide for them is lessened. If they're in diapers, you may want to insure for a bit more (and don't forget about their future educational expenses).

If the primary purpose of your life insurance is to safeguard the needs of your children, term life insurance (as opposed to permanent life) can make a lot of sense here. Term life insurance locks in a death benefit and premium amount for a specific amount of time. For many families with young children, if the level term period expires in 15 or 20 years, the kids are likely to be independent at that point – out of college and into their careers. And term is far less expensive in the short run than permanent insurance, which is typically designed to never expire.

Once your kids are on their own, your need for life insurance lessens considerably. But there are some situations where it remains useful. Those might include:

ACCESS TO LIQUID ASSETS

If most of your family's assets are tied up in a home, a business, or some other illiquid asset, your heirs may need cash to cover your debts or other expenses, like funeral costs and final medical expenses. Life insurance can cover those costs and keep them from selling off valuable property.

SPECIAL NEEDS PLANNING

Families who have children with special needs often use life insurance as a way to provide for them into the future. Designating the insurance proceeds to go into a special needs trust allows you to appoint a trustee who can oversee the child's assets after you're gone.

HOMEMAKER SERVICES

If you have a spouse who is accustomed to staying home and caring for children or other family members, a life insurance plan can allow them to stay home and continue to fulfill those duties.

SUCCESSION PLANNING

If you're a business owner who has children who aren't active in the business, it may not make sense to leave a piece of that business to them. A life insurance policy can help with estate equalization - providing an inheritance for those who would rather not be involved in the family business without having to liquidate it. For business owners, life insurance proceeds can also go towards key employees, to ensure they stay with the business, or towards funding a buy-sell agreement.

ESTATE SETTLEMENT

Even if your estate isn't large enough to bump up against the estate tax, settlement costs can be significant. Again, this is especially important if there are illiquid holdings in the estate, like a business or real estate. Life insurance can be used to offset those settlement costs.

PHILANTHROPIC CONCERNS

Life insurance can be a way to support your favorite charitable organization without taking anything away from your heirs; indeed, it can offer tax benefits to your estate and heirs.

When it comes to providing for your family's future, it may seem that there can never be enough. But what you pay for life insurance in the here and now is also a consideration. Balancing those two concerns is the best way to protect your family's assets.

If you're looking for help with planning for the unexpected, your Baird Financial Advisor can help you sort out how your insurance needs can safeguard your family – now and into the future.

Please reach out if you or anyone you know would benefit from discussing this topic further.