HOW MUCH LIFE INSURANCE DO I NEED?

Life insurance is essential to ensure your loved ones are protected in the worst of situations. From paying taxes, debts, and outstanding bills, to leaving a legacy, life insurance provides peace of mind and helps ease the financial burden left behind. Knowing the proper amount of life insurance coverage may be difficult depending on your goals. There are several methods to calculate the amount of life insurance that may fit your unique needs.

**THINGS TO CONSIDER**

There are many factors that can be taken into consideration to determine your coverage needs. Ensuring you have all relevant factors accounted for is the first step.

- How old are you?
- Are you employed? Is this your family’s primary source of income?
- Whom do you want to protect?
- Are you married? Do you have children?
- Are there special needs for any of your beneficiaries?
- How long would they require financial support?
- How much do you pay in taxes?
- How much do you earn before taxes?
- At what age are you planning to retire?
- What is the value per year of the home responsibilities you manage, such as mowing the lawn, chauffeuring kids, or whatever role that your survivors would have to pay someone else to do?
- How much do you receive in employee benefits, such as contributions to retirement savings?
- Do you own a business?
- Are you saving for a child’s education?
- How much will your family need for things like clothing, food, and transportation?
- Do you own a home? How much is the mortgage?

This list is nowhere near complete. As you can see, calculating your needs can be overwhelming. A financial professional can be very useful to help simplify this exercise.
CHOOSING A METHOD

Once you have outlined all the relevant factors, calculating a coverage amount is the next step. This is much more involved than it sounds on the surface. To complicate things, there is no single universally accepted method to calculate coverage levels. Below are three common life insurance needs analysis methodologies and how they differ.

MULTIPLE OF INCOME

What is it?
A calculation that multiplies your income by a set number of years

Pros
Simple and easy to calculate

Cons
May not take into consideration your actual needs arising from family, assets, debts, taxes, inflation, and other aspects unique to your situation and the economy

Example
$100,000 annual income X 10 years = $1,000,000 of required life insurance.
A variation of this method adds $100,000 for every child, primarily for education expenses.
$100,000 annual income X 10 years = $1,000,000 + $200,000 (2 children) = $1,200,000

HUMAN LIFE VALUE

What is it?
An income-based method that takes into consideration various personal factors and future earnings

Pros
Comprehensive, takes into consideration more factors than the multiple of income method

Cons
More complicated, takes multiple steps. May not account for funeral expenses, educational expenses, or actual future needs (debts and mortgage for example). Discounting for taxes and rate of return may be too aggressive. These items can be added as desired.

Example
$100,000 annual income, with 2% expected annual wage increase, anticipated 4% simple interest rate over the duration, and retirement in 15 years.

> Steps
1. Calculate the wages plus 2% annual increase for 15 years = $1,763,929
2. Subtract 30% from the $1,763,929 = $1,234,750
3. 4% simple interest X 15 years = 60%. $1,234,750 reduced by 60% = $493,900
4. Expected benefits over the 15 years are $50,000. $493,900 + $50,000 = $543,900
Life insurance should be considered as part of your greater financial plan. Viewing it in isolation may create mistakes.

**DIME**

**What is it?**
A simplified needs analysis method that takes basic information to arrive at a coverage amount.

- **Debt**
- **Income** Annual income x number of years
- **Mortgage** Outstanding balance
- **Expenses** Future costs, like education, wedding, etc.

Adding these items up can provide a simple guideline on a coverage amount.

**Capitalize Needs Analysis**

**What is it?**
The capital needs analysis method takes into consideration not just the lost income of the insured but also the capital needs of their beneficiaries, both immediate and future. The capital needs approach takes the following into consideration:

- Income – both of the insured and the surviving spouse
- Liquidity needed at death – this would include funeral expenses, mortgage and debt repayment
- Future expenses – including college, retirement, and care expenses of the spouse
- Other assets – value of assets available to help cover the above items

After everything is taken into consideration, there are then two ways to calculate insurance needs.

**Earnings-Only Approach**
The survivors will live off only the investment earnings of the policy without cashing in the principal value. To provide a sufficient income stream, the death benefit is usually larger than in the approach below.

**Liquidation Approach**
The surviving beneficiary utilizes a portion of the principal as well as the investment earnings. There is more risk with this approach, particularly if the investment earns less than originally predicted. Since principal is used, the proceeds may exhaust at some point.

**Words of Wisdom**

- **Don’t underestimate your needs.** Put some thought into it. Things change drastically over time. Income, assets, and your financial situation may improve over the years. Building in an appropriate cushion can ensure your insurance meets your ongoing needs.

- **Communicate.** Discuss this with your family and your financial professional. Planning for uncertainty may be uncomfortable, and if you are the only one who knows about the coverage, the ride may be bumpy.

- **Education and due diligence.** Be certain you understand exactly what type of insurance you are purchasing and why it is right for you. A financial professional can help.
Contact your Transamerica agent to learn more.

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