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Life Insurance—Analyzing Your Needs

You probably are aware it is important to have enough **life insurance** coverage to handle the financial contingencies that may affect your family in the event of your death. However, determining the necessary amount of life insurance can be complicated. One general rule of thumb is that you should have enough life insurance to equal five to seven times your annual salary. However, to be more specific, you may want to determine the “right” amount of life insurance coverage with a careful “**Needs Analysis**,” rather than using an arbitrary formula.

The Needs Analysis approach incorporates an evaluation of a family’s most important financial obligations and goals. This includes insurance coverage to help address mortgage debt, college expenses, and future family income, as well as liquidity for meeting future estate tax liabilities.

Mortgage Debt

The first point worthy of consideration is whether your life insurance proceeds will be sufficient to help pay the remaining mortgage on your home. If you are carrying a large mortgage, you may need a sizable amount. If you own a second home, the mortgage on that home should also be factored into the formula.

College Expenses

Many people want life insurance proceeds large enough to help cover their children’s college expenses and, possibly, graduate school. The amount needed can be roughly calculated by matching the ages of your children against projected college costs adjusted for inflation. This calculation should be revised periodically as your children get closer to college age, and it may be a good idea to be as conservative as possible when estimating long-term savings goals.

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Continuing Income for Your Family

The amount of income you will need to help provide for your surviving spouse and dependents will vary greatly according to your other assets, retirement plan benefits, Social Security benefits, age, health, and your spouse's earning power. Many surviving spouses may already be employed, or will find employment, but their income is based on education, training, and experience. Your spouse's income, alone, may be insufficient to cover the monthly expenses of your family's current lifestyle. Providing a supplemental income fund can help your family maintain its standard of living.

Estate Taxes

Life insurance has long been recognized as an effective method for establishing liquidity at death to both pay estate taxes and maximize asset transfers to future generations. However, this use of life insurance requires qualified legal expertise to help ensure the proper results.

Existing Resources

If your current assets and retirement plan death benefits are sufficient to cover your financial needs and obligations, you may not need additional life insurance for these purposes. However, if they are inadequate, the difference between your total assets and your total needs may be funded with life insurance.

There are many factors to consider when completing a Needs Analysis. In addition to the areas already mentioned, some other questions you might want to address are:

1. How much will Social Security provide and for how long?
2. How do you "inflation-proof" your family income, so the real purchasing power of those dollars does not decrease?
3. What is the earning potential of your surviving spouse?
4. How often should you review your Needs Analysis?
5. How can you use life insurance to help provide retirement income?
6. How do you structure your estate to reduce the impact of estate taxes?

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7. Which assets are liquid and which would not be reduced by a forced sale?
8. Which assets would you want your family to retain because of future growth possibilities or sentiment?

As you develop an insurance strategy, remember to analyze your existing policies. Calculate the additional coverage you may need based on your family's financial obligations and any other resources, such as retirement benefits and savings. Remember, having the proper life insurance coverage can play a major role in any family's financial protection.

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