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Assessing Life Insurance Needs

Needs and obligations minus liquid assets can help determine coverage targets

If your family relies on your income, it's critical to consider having enough life insurance to provide for them should you pass away. But too often, life insurance is an overlooked aspect of personal finances.

In fact, according to a 2021 study conducted by Life Happens and LIMRA, which closely follows life insurance trends, nearly half of Americans say that they have no life insurance coverage at all, even though 59% of people without life insurance recognize the need to obtain it.¹

ROLE OF LIFE INSURANCE

Realizing the role life insurance can play in your family's finances is an important first step. A critical second step is determining how much life insurance you may need.

Several factors will affect the cost and availability of life insurance, including age, health, and the type and amount of insurance purchased. Life insurance policies have expenses, including mortality and other charges. If a policy is surrendered prematurely, the policyholder may pay surrender charges and have income tax implications. Also, consider determining whether you are insurable before implementing a strategy involving life insurance. Any guarantees associated with a policy are dependent on the ability of the issuing insurance company to continue making claim payments.

RULE OF THUMB

A widely followed rule of thumb for estimating a person's insurance needs is based on income. One broad guide suggests a person may need a life insurance policy valued at five times their annual income. Others recommend up to 10 times.

If you are looking for a more accurate estimate, consider completing a DNA, or Detailed Needs Analysis, test, which takes into account a wide range of financial commitments to help better estimate insurance needs.

The first step is to add up needs and obligations.

SHORT-TERM NEEDS

Which funds will need to be available for final expenses? These may include funeral costs, final medical bills, and any outstanding debts, such as credit cards or personal loans. How much to make available for short-term needs will depend on your individual situation.

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LONG-TERM NEEDS

How much will it cost to maintain your family's standard of living? How much is spent on necessities, like housing, food, and clothing? Also, consider factoring in expenses such as travel and entertainment. Ask yourself, "What would it cost per year to maintain this current lifestyle?"

NEW OBLIGATIONS

What additional expenses may arise in the future? What family considerations will need to be addressed, especially if there are young children? Will aging parents need some kind of support? How about college costs? Factoring in potential new obligations allows for a more accurate picture of ongoing financial needs.

Next, subtract all current assets available.

LIQUID ASSETS

Any assets that can be redeemed quickly and for a predictable price are considered liquid. Generally, houses and cars are not considered liquid assets since time may be required to sell them. Also, selling a home may adjust a family's current standard of living.

Needs and obligations – minus liquid assets – can help you get a better idea of the amount of life insurance coverage you may need. While this exercise is a good start in understanding your insurance needs, a more detailed review with a trusted financial advisor may well be necessary to better assess your situation.

Citations.

1. LIMRA.com, 2021

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