How Much Life Insurance Do You Need?

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Whether you are married or single, a parent, or without children, life insurance can play a key role in your financial plans. However, millions of Americans have no life insurance coverage whatsoever, and of those who do, many may not have enough.

Appreciating the importance of having adequate life insurance is one step, while assessing your own unique needs is quite another.

Where to Start

Many people obtain life insurance when they first have children and then forget about it, except for when the premium bill comes due. But an effective financial plan includes reexamining your life insurance needs continually throughout your life to ensure the assets you've accumulated are protected and to provide additional opportunities to create wealth.

As a starting point, determine your net earnings after taxes as well as your routine living expenses. Other factors to include in your calculations include:

- Any outstanding debt that you owe, such as a mortgage or education loans.
- Future tuition bills for your children.
- Funeral and/or potential uninsured medical costs.
- How much your surviving spouse might need to adequately fund a retirement nest egg.

Generally, you'll want a benefit that will cover all of these expenses. Some planning specialists believe a good rule of thumb is to buy a policy that would provide the equivalent of five to seven times your annual salary. That standardized approach may work for some people, but in reality your decision may not be that simple.

While ensuring the financial security of loved ones is a critical use of life insurance, there are other ways it can be used to meet planning goals throughout your life. For instance, people in their peak earning years can use life insurance to protect their wealth while accumulating additional tax-deferred assets. Older people can use life insurance as an integral part of an estate planning strategy designed to pass more wealth to future generations.

What Type of Policy Is Right for You

Once you have an idea of the coverage you need, evaluate whether term life or permanent life insurance is more appropriate for you. Term life is the more basic and less expensive form of life insurance -- particularly for people under age 50. A term policy provides coverage for a predetermined period of time, typically one to 10 years, but policies are also available for longer terms. Premiums increase at the end of each term and can become prohibitively expensive for older individuals. Unlike many other policies, term insurance has no cash value and benefits are paid only if you die during the policy's term.

Permanent life insurance combines death benefit protection with a tax-deferred savings component. With permanent life insurance, as long as you continue to pay the premiums, you are able to lock in coverage at a level premium rate for the life of the contract. Part of that premium accrues as a tax-deferred cash value. As the policy's value increases, you may be able to borrow up to 90% tax free at attractive interest rates. If you do not repay the borrowed money, it will be taxable as income at then-current rates. And if you're younger than age 59 1/2, you may also be subject to an additional 10% IRS early withdrawal penalty.

Determining the right type and amount of life insurance coverage you need is easier said than done. Your financial professional can help you make an accurate assessment of your needs.

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