

LIFE INSURANCE SIMPLE RULES OF THUMB

Income Replacement Coverage

Working Family

- The capital preservation method is one commonly used method to conservatively determine how much insurance to buy if you want to protect your income for your family.
- This method answers the question: "How much do I need to have invested so I can only withdraw interest and never touch the principal?" While the result may seem to overestimate the needed amount of insurance, this method should yield an estimated coverage amount that will ensure your family will be able to survive comfortably.
- This coverage is likely to be term coverage for the number of years until retirement.

CAPITAL PRESERVATION METHOD: INCOME NEED / 5%	
LIFE INSURANCE NEED CALCULATION	INSURANCE NEED
\$150,000 / 5% =	\$3 MILLION
\$200,000 / 5% =	\$4 MILLION
\$300,000 / 5% =	\$6 MILLION

- While younger people generally have a longer time period to cover, and thus typically a larger need, they also have a longer time horizon to be able to invest the proceeds slightly more aggressively. This is why we generally use a 5% rate of return on the proceeds in determining how to provide a sustainable income stream.

Additional Coverage for Goals

- To ensure your other goals are covered in case of a premature death, you may consider obtaining additional life insurance coverage. Many families obtain additional coverage to pay off the mortgage or pay for college. Insuring these goals with additional coverage should ensure your family has enough resources to maintain their daily living costs, as well as accomplish your other goals.

Income Replacement

Couple Close to Retirement

- As you approach retirement, your life insurance need generally decreases because you are typically only replacing a few years of income assuming you have already accumulated savings for your retirement.
- For couples that are nearing retirement, the most common rule of thumb to calculate the insurance need is to multiply the number of working years by the amount of income earned annually. This method should allow your survivors to replace your income to cover both your expenses and your savings. This rule of thumb works best when your savings are on track for retirement but may underestimate needs if your death would cause your survivors to lose other sources of income i.e., pensions, or an interest in an inheritance.

INCOME REPLACEMENT METHOD		
YEARS UNTIL RETIREMENT	X ANNUAL INCOME	= NEEDED DEATH BENEFIT
10	\$250,000	\$2,500,000
5	\$350,000	\$1,750,000

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Other Uses for Life Insurance

Life Insurance During Life

- The primary reason for buying life insurance should always be for the death benefit it provides for survivors. However, in addition to the tax-free death benefit, life insurance has other benefits that you could enjoy during life.
- Qualified life insurance policies* allow for the tax-deferred growth of assets inside the policy, and income tax-favored distributions. As long as your policy meets certain IRS requirements, any assets held inside your policy are treated similarly to other tax-favored vehicles for income tax purposes in that cash surrender values grow tax-deferred. However, utilizing life insurance could offer more flexibility. There is no minimum age requirement to be able to access the policy's cash surrender value like there is for retirement plans, and no requirement that you use the distributions for any specific reason as with a college savings plan. In addition to the preferential tax treatment, cash surrender value inside life insurance policies is not included as an asset for Federal Student Aid purposes. Be sure to consult your licensed life insurance broker for more information.

**If the policy becomes a Modified Endowment Contract, the policy will not qualify for preferential tax treatment. Review IRC Section 7702 to find the definition of life insurance and how it is taxed.*

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