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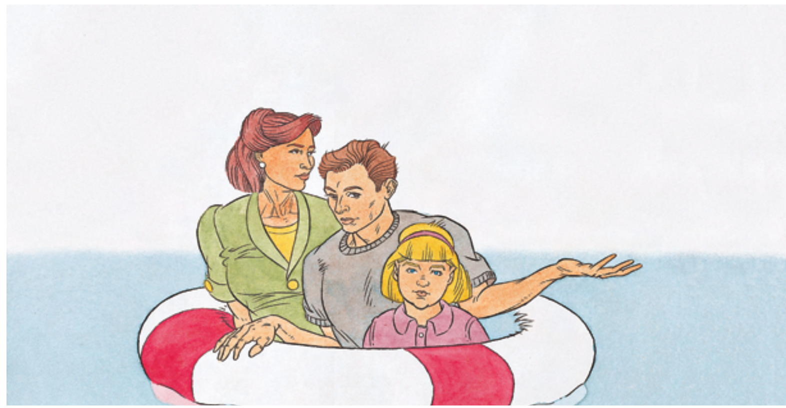
Life Insurance

Evaluating your life insurance needs is a key part of financial preparedness.

The simple answer to how much life insurance you need is enough money to cover your dependents' immediate cash needs and living expenses.



If you support a family, keep a household running, have a mortgage, or expect the kids to go to college, life insurance can fill the financial gap left by your death or disability. But if you don't have dependents, or they don't need your money to live on, your life insurance needs may be very different.

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In general, older people need less life insurance because their financial obligations have been met—mortgages and college tuition are paid—and their investments are producing income.

Experts disagree on how much coverage is enough. An old rule of thumb says that you need five to seven times (or even ten times) your annual salary. But a lot depends on your life style, number of dependents and other sources of income.

ROUGHING OUT YOUR LIFE INSURANCE NEEDS

To estimate the amount of coverage you need to replace 75% of your take-home pay for the years you would have been working, multiply your salary by the factor at the intersection of your salary and your current age. In this example, it's $720,000.*

Annual pay (before taxes)	Current age of person insured: 25	30	35	40	45	50	55
$30,000	14	13	12	10	9	7	5
$40,000	13	12	11	10	9	7	5
$60,000	12	12	11	9	8	6	5
$80,000	12	11	10	9	8	6	4
$100,000	11	10	9	8	7	5	4
$150,000	10	10	9	8	7	5	4
$200,000	9	9	8	7	6	5	5

*Doesn't take into account any income survivors can expect from Social Security, investments, or other sources. More or less coverage may be needed, depending on individual family circumstances.

Source: Principal Financial Group

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WHAT TO COVER

When you buy life insurance, you anticipate short-term and long-term needs. The most immediate expenses are those such as funeral costs, any outstanding debts that have to be paid, and immediate living expenses.

Long-term expenses vary, depending on the goals you have for your family. How much you allot for each of these goals depends on how important you think they are and what you think your contribution to them would have been if you'd lived. Some people choose to replace all the income they would have contributed. Others calculate insurance needs based on the time they think it would take their survivors to become self-sufficient.

LIFE INSURANCE WORKCHART

You need enough life insurance to cover your dependents' living expenses. You can use this workchart to estimate that amount, as the illustration below shows:

1	Dependents' annual living costs (including mortgage payments and other loans)	$ 65,000
2	Dependents' sources of income Salary $35,500 Investment income $3,500 Social Security, pensions and other $5,000	– $ 44,000
3	Additional income needed (subtract 2 from 1)	= $ 21,000
4	Divide line 3 by the prevailing interest rate	÷ 7%
5	Face value of the policy you need	= $300,000

To provide money for educational expenses, you can increase your coverage.

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PAYING BILLS

The cost of buying life insurance varies enormously, depending on the type you buy, the company you buy it from, and how long the company thinks you are likely to live.

Estimating the total cost can be tricky, since the **premium**, or amount you pay for some types of insurance, may increase over time. Further, two companies may charge very different amounts for the same coverage.

RISK vs. COST

The cost of insurance is largely determined by the risk you pose to the insurance company, as shown on an **actuarial table**. These tables project your life expectancy based on age, gender, health and life style.

UNDERWRITING is the process insurance companies use to assess you as a risk and decide if they will sell you insurance. It's based on the information you provide in the application. If you don't tell the truth, your insurance may be cancelled, or the company may refuse to pay a claim.

If you're considered a high risk—for example, if you smoke, are overweight, or have a dangerous occupation or hobby—the company may charge you a higher premium than other people of the same age or gender, or may refuse to insure you at all.

However, if you are a preferred risk—generally a nonsmoker whose health and life style make you likely to live longer—you may qualify for lower rates that significantly reduce your premium and save you money.