



How Much Life Insurance Do You Really Need?

Don't make the mistake of thinking a simple rule of thumb is enough to keep your family protected.

By Maryalene LaPonsie | Sept. 22, 2016

Kyle Winkfield knows a thing or two about how [life insurance](#) has the power to change lives. The managing partner at financial firm O'Dell, Winkfield, Roseman and Shipp in the District of Columbia has seen how life insurance payouts have impacted many of his clients, but one particular case sticks out in his memory.

After one of his clients passed away, the surviving spouse was surprised with a [multi-million dollar check](#) from a life insurance policy purchased nearly 40 years earlier. Winkfield's client had been a person of modest means and the initial death benefit was much smaller, but it grew as money was reinvested into the plan over the years. Along with the check was a letter from Winkfield's client explaining the money was meant as a legacy for the family to compensate for opportunities he didn't have as an African-American growing up in the mid-20th century. "It's a financial love letter," Winkfield says of life insurance. "[It says] I love you so much that I don't want you to struggle when I'm gone."

For those looking to create their own financial love letter to their family, here's how finance experts say people should go about picking the perfect policy.

The biggest mistake is underestimating needs. Financial experts say most people underestimate the amount of life insurance they should buy. "People undervalue themselves all the time," says Thomas O'Connell, president of International Financial Advisory Group in Parsippany, New Jersey. "If [your employer] paid you \$5 million upfront, you'd look at the money differently. You would protect that money differently."

O'Connell says high earners could conceivably make \$5 million over the course of their career, but they don't think in those terms when buying life insurance. "They've got \$500,000 in life insurance, but I explain that if it were put into investments, it generates only a \$20,000 income," says Scott Moffitt, president and CEO of Summit Financial Group in Loveland, Ohio. To avoid a situation in which a family is left with

too little money on which to live, Moffitt says people should skip using general rules of thumbs and instead take a more comprehensive review of their family's needs.

How to choose the right life insurance death benefit. Traditionally, people have been advised to buy life insurance with a death benefit that is seven to 10 times their annual income. However, Moffitt says this rule of thumb could leave many people underinsured. He suggests that lost income, future expenses such as college and the ability of the spouse to earn an income should also be taken into consideration when calculating life insurance needs.

Moffitt also cautions against assuming a stay-at-home spouse will immediately be able to jump back into the workforce. "We typically add in a few years' worth of additional income [into the life insurance benefit] as a buffer," he says. That gives a spouse a cushion to either stay at home longer with the kids or take the time needed to update work skills. "You need to think, God forbid, something happens to me today," says Rick Rivera, partner at Safeguard Investment Advisory Group in Corona, California. "What position is my family in today, and where do I want them to be?"

Instead of buying life insurance solely to replace income, people should consider whether they want their policy to allow their family to [pay off the mortgage](#) or other debt, cover the cost of college or offset potential [estate taxes](#). Unlike many other assets, the death benefit from life insurance is not taxable, meaning it can be a simple and versatile way to provide money to loved ones left behind.

Other factors to consider. While the death benefit is usually the most important consideration when it comes to buying life insurance, there are other factors to review as well. "Traditional long-term care insurance is becoming a financial nightmare for many people," O'Connell says. However, some of today's life insurance policies bundle [long-term care coverage](#), making them a more affordable option.

Other people may use permanent life insurance as part of a retirement income strategy. Loans against the cash value are tax-free, which can make them an attractive option to supplement income when [funds in IRAs](#) or 401(k)s may be affected by a down market.

However, in the end, the most important aspect of deciding how much life insurance to buy is how it will allow family members to live after a person's death. As Winkfield says, "If you plan correctly, you might be physically and emotionally gone, but you'll financially always be present."