Life insurance is a good safety net, but not for everyone

The old adage is true that life insurance is not so much about life as about death. The only time that you or your family benefit from life insurance is at your death. The trouble with life insurance is that it is often confusing to general consumers about both basic questions such as when to buy it and when to skip it or more complicated questions about how much coverage and which is the best policy for you.

The first question is when do you need life insurance? You need life insurance under the following conditions (if you don't fall into one of the categories below, you probably don't need life insurance at this time, but remember to review your situation again from time to time when circumstances may change).

• You have dependent children. The loss of your income will most definitely affect your spouse's ability to remain in the family home with the children or provide the level of education that you would have provided for your children if you were still alive and working.

• You are married to a nonworking spouse. In this situation, your death will affect your spouse's ability to continue in the same life style, as going to work for the first time or going back to work after being out of the workplace will result in a lower paying job with a much diminished standard of living.

• You have a working spouse with an income substantially less that your income. Life insurance is appropriate here as your higher income has given you a lifestyle that your spouse could not afford alone.

• You have parents or special need siblings to care for and support.

• You still have a large mortgage remaining on your home. Having life insurance in this circumstance will allow your spouse to use the life insurance proceeds to pay off the mortgage, easing your spouse's financial burden after your death.

• You are using life insurance as an estate planning tool and wish to provide your family with the proceeds of life insurance that will restore to them the amount of your estate that was diminished by death taxes.

Another question to ask is how much insurance is enough? The proper amount of life insurance would allow your beneficiaries and their dependents to invest the proceeds of life insurance and draw down the earnings thereon and some capital over time to live on to make up for the loss of earnings that the deceased spouse would have provided. There are several basic methods to determine the amount of the insurance that you may need:

• The standard rule of thumb to estimate the amount of your life insurance needs is to estimate that you will need life insurance between five and ten times your annual salary net of taxes. If your net salary is $50,000 per year, you would have a minimum life insurance need of $250,000 and a maximum amount of $500,000. This method is fairly simplistic and does not take into account the specific needs you may have, such as the price of your children's education or the amount necessary for a special needs child.

• The second method seeks to replace the amount of your income over a number of years. For instance, if you earned $50,000 per year and you wanted to make sure that income was available to your spouse for the next fifteen years, you would need $750,000 of life insurance. This method is fine, as long as there are no special needs to address and you have little in the way of financial assets already.

• The third and most detailed method is to review the financial need. In this approach, you would take into account the various expenses that your income would otherwise pay, such as the family's annual living expenses, tuition for college and graduate education, mortgage or debt payoff and future retirement needs, as well as any special needs. This approach will require a little more thought and effort on your part to determine what expenses will be covered and what expenses are already covered by financial assets, such as college expenses that you have already taken care of through Section 529 plans and the like.

Life insurance is not for everyone, but there are many times that it is a necessary part of your financial planning for your family's future.

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