Figuring Out How Much Life Insurance You Need

When it comes to figuring out how much life insurance you need, it's important to determine how much you're financially worth to your family. Otherwise, you'll probably end up buying too much or too little coverage.

Many consumers use what's called the "multiple of earnings" method to figure out how much life insurance coverage they need. With this method, you look at your annual salary and decide how many years your family would need to replace income if you died.

So, if you earn $75,000 and you want your family to be covered for five years, you would need $375,000 in life policy coverage.

However, many experts believe this method is ineffective. It doesn't take wage increases into account and it can be difficult to determine how many years your family will need to be covered.

Plus, the technique does not measure your non-wage value. Non-wage contributions include essential duties such as cleaning the house or taking care of your children вЂ” tasks your family might have to pay someone to do if you were no longer living.

The Human Life Value calculation

Many financial experts believe that Human Life Value calculations are more effective in gauging the appropriate amount of life insurance coverage that one needs.

Courts often use this method to determine the amounts to be awarded in wrongful death lawsuits. Although this technique is much more complicated than the multiple of earnings method, it can offer a more precise estimate of your value.

Step one вЂ” The first step in calculating your Human Life Value is to add the current value of all future income you expect to earn plus any other value you plan to contribute to your family until your projected retirement date.

You then subtract your taxes and personal expenses from now through your retirement date.

Step two вЂ” Next, adjust this yearly amount for inflation over the number of years until your planned retirement.

*Step three*вЂ” Finally, you apply what is called a "discount rate" to each year's projected total value. This accounts for what's known as the "time value" of money.

For example, let's say Tom, 30, plans to retire at age 60. His annual salary is $65,000, and 20% of that goes into his personal living expenses while the remaining 80% of his income goes to his family in the form of living expenses, home and vehicle costs, etc.

Tom provides additional value for his family by doing the yard work, handling all the house and car repairs and making a few other non-wage contributions. When all this is added together, he contributes about $14,000 of non-wage value to his family each year. (This is the estimated cost of a skilled worker to perform these same tasks.)

Therefore, Tom's total current annual value to his family comes out to $52,000 (80% of his $65,000 salary) + his non-wage value ($14,000) = $66,000.

Next, Tom needs to adjust his value for annual inflation. At a 3% rate of annual growth, his value will increase to $121,363 by the time he reaches his projected retirement age of 60.

Finally, Tom applies the discount rate to each year's projected value to represent the time value of his money. At a discount rate of 4%, the total present value of his projected value through age 60 is a little more than $1 million.

Based on these calculations, Tom needs $1 million of life insurance coverage to adequately protect his family if he were to die.

Obviously, calculating your Human Life Value can be a complex process. You may want to meet with us to determine how much life insurance coverage you need. We can help you calculate your value and ensure that your family is adequately protected.

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