WELLS FARGO Advisors

# How much life insurance is enough?

## Guidelines for determining what your family needs

**Our worksheet can help**

Deciding how much life insurance you should have can be a sobering issue, but it may lead you to some valuable discoveries. Since no two families have the same needs, quick formulas and "rule of thumb" multiples often lead to incorrect assumptions and answers.

The Life Insurance Calculation Worksheet on page 3 of this guide will help provide you with a detailed overview of your current financial situation to help you determine whether your dependents would have enough income if something were to happen to you.

Because your family's financial situation continually evolves through various life stages — birth of children, need to fund education, career advancement, and salary increases — you should regularly review your life insurance needs. This guide is specifically designed to help you determine whether you have enough life insurance coverage based on your immediate expenses, debts, available assets, existing coverage, and other key considerations.

## What you need to consider

As you complete the worksheet we've provided, several areas require careful consideration. You'll need to compare your immediate cash needs with those funds available from investments and life insurance. Use the following guidelines to help fill in the worksheet.

### Immediate expenses

**Final expenses.** The amount needed to cover all final expenses upon your death. This includes funeral costs, medical expenses, probate fees, etc. The national median cost of a funeral is over $7,640.*

**Mortgage.** Would your family want to keep your current home or possibly move to a smaller, more manageable home or rental property?

If your family will keep the home and you intend to have your mortgage paid in full upon your death, enter your mortgage balance on line 2 of the worksheet.

If you think your family will sell your home, estimate the new mortgage or rent. Keep in mind the tax consequences often involved in selling a home may trigger capital gains taxes. It's important to consult your tax advisor regarding your circumstances.

*2019 Statistics — National Funeral Directors Association, nfda.org/news/statistics
National Funeral Directors Association General Price List Survey

**Other debts.** Estimate the amount needed to pay off your debts. Include credit card balances, car loans, education loans, and other outstanding liabilities.

**Emergency fund.** The amount you would like to reserve for unforeseen financial needs, such as income lost due to work absence, medical expenses, and home/auto repairs.

**Education fund.** The total cost of sending your children to college. The current annual average cost of public and private colleges including room and board is approximately $23,420 and $52,010, respectively.*

**Income replacement**

Think of your life insurance in terms of the income it can provide. After all, your goal is to ensure that your paycheck continues for those who are dependent on that income.

**Available assets**

**Savings and investments.** The current value of savings and investments that may be liquidated to provide your family cash flow upon your death. Include stocks, bonds savings accounts, etc.

**Retirement savings.** The current value of retirement savings that may be liquidated to provide your family cash flow upon your death. Include IRA, 401(k), annuities, and other retirement accounts.

If your retirement plan allows, your survivor may receive a single payment of the entire account balance (lump sum distribution). This distribution is fully taxable to the survivor. For example, if your survivor receives a $100,000 lump sum and pays taxes on it at the 35% rate, only $65,000 will remain to generate income.

The surviving spouse can, instead, roll over the entire balance into a traditional IRA. These assets would then have the potential to accumulate without current taxes until the time they are withdrawn. In our example, the entire $100,000 could be rolled over to the surviving spouse's IRA. Please keep in mind that rolling over assets to an IRA is just one of multiple options for your retirement plan. Each option has advantages and disadvantages, including investment options and fees and expenses, which should be understood and carefully considered.

You should remember that these assets will be subject to IRA withdrawal rules, including a 10% IRS penalty in addition to ordinary income taxes if the surviving spouse withdraws IRA money before the age of 59½.

If your current retirement plan is a traditional IRA, a second option for a spouse who is younger than 59½ is to leave the funds in the existing account while he or she maintains "beneficial control." An account like this may be registered as "John J. Smith Deceased IRA FBO Mary M. Smith." Because the deceased's name remains on the account, withdrawals your surviving spouse takes, although still subject to income taxes, will not be subject to the 10% penalty because they will be taken as a result of the original IRA owner's death.

A Roth IRA passes directly to beneficiaries on an income-tax-free basis.

*Source: Trends in College Pricing and Student Aid. collegeboard.org. Total yearly costs for in-state tuition, fees, books, and room and board (transportation and miscellaneous expenses not included). Base is 2020–2021 school year.

### How to use the money factor chart

This chart provides the multiplier needed in line 8 to determine the present value of your dependents' income needs. It considers how long that income will be needed and an assumed real rate of return.

- Estimate the annual growth rate you expect on your savings and investments. This is generally in the 4% to 8% range.
- Next, subtract the estimated annual future rate of inflation. Usually 1% to 5% is appropriate.
- Now you have determined the real rate of return.
- Using your real rate of return and years your dependents will need the income, find your money factor in the table for line 8.
- For example, if your estimated annual growth rate and inflation rate are 8% and 3%, respectively, your real growth rate is 5%. If you assume your dependents will need the income for 20 years, your money factor from the table is 13.1.

# Life insurance calculation worksheet

**Immediate expenses**

| | | | |
|---|---|---|---|
| 1. | Final expenses: | $ ____________ | (1) |
| 2. | Mortgage: | ____________ | (2) |
| 3. | Other debts: | ____________ | (3) |
| 4. | Emergency fund: | ____________ | (4) |
| 5. | Education fund: | ____________ | (5) |
| 6. | Total cash for immediate expenses: *Sum of lines 1 through 5* | 0 ____________ | (6) |

**Income replacement**

| | | | |
|---|---|---|---|
| 7. | Survivor's income replacement (see page 2): | $ ____________ | (7) |
| 8. | Money factor from the money factor Table below: | ____________ | (8) |
| 9. | Present value of future income need: *Line 7 multiplied by line 8* | 0 ____________ | (9) |

**Available assets**

| | | | |
|---|---|---|---|
| 10. | Savings and investments: | $ ____________ | (10) |
| 11. | Retirement savings: | ____________ | (11) |
| 12. | Other assets: | ____________ | (12) |
| 13. | Current life insurance: | ____________ | (13) |
| 14. | Total available funds: *Sum of lines 10 through 13* | 0 ____________ | (14) |

Summary

| | | | |
|---|---|---|---|
| 15. | Total expenses at death: *Line 6 plus line 9* | $ 0 ____________ | (15) |
| 16. | Total investments and life insurance from line 14: | ____________ | (16) |
| 17. | Estimate of life insurance deficit: *Line 15 minus line 16* | $ 0 ____________ | (17) |

# Money factor table

| How long income is needed | Real rate of return | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1% | 2% | 3% | 4% | 5% | 6% | 7% | 8% | 9% |
| 5 years | 4.9 | 4.8 | 4.7 | 4.6 | 4.5 | 4.5 | 4.4 | 4.3 | 4.2 |
| 10 years | 9.6 | 9.2 | 8.8 | 8.4 | 8.1 | 7.8 | 7.5 | 7.2 | 7.0 |
| 15 years | 14.0 | 13.1 | 12.3 | 11.6 | 10.9 | 10.3 | 9.7 | 9.2 | 8.8 |
| 20 years | 18.2 | 16.7 | 15.3 | 14.1 | 13.1 | 12.2 | 11.3 | 10.6 | 10.0 |
| 25 years | 22.2 | 19.9 | 17.9 | 16.2 | 14.8 | 13.6 | 12.5 | 11.5 | 10.7 |
| 30 years | 26.1 | 22.8 | 20.2 | 18.0 | 16.1 | 14.6 | 13.3 | 12.2 | 11.2 |
| 35 years | 29.7 | 25.5 | 22.1 | 19.4 | 17.2 | 15.4 | 13.9 | 12.6 | 11.5 |
| 40 years | 33.2 | 27.9 | 23.8 | 20.6 | 18.0 | 15.9 | 14.3 | 12.9 | 11.7 |

**Getting started**

Talk to your financial advisor today for assistance in determining how much life insurance is necessary to protect your family's future income needs, as well as what policy options might be right for you.

**Other assets.** All other assets that may provide income for your family (inheritances, commodities, rental properties, etc.).

If you own a weekend house or rental property, decide whether your family will want to keep this property or sell it. If it is kept, you'll need to record expenditures for mortgage payments, insurance, taxes, and maintenance in the "Immediate Expenses" section. If it is sold, you'll also need to account for selling expenses and taxes due on the sale amount.

For most families, Social Security provides only temporary benefits. Determine how long your family may qualify for benefits. This period may be so short and the benefits so small that you may want to exclude them from your calculation. Nonetheless, if you know the amounts of these payments, record these benefits as "Other Assets."

After totaling all sources of income, compare this amount with the income you would want your family to have. If a gap exists, additional insurance coverage is one of the best solutions.

**Current life insurance.** Include all life insurance policies, including coverage through your employer.

## Other considerations

These calculations can provide a helpful starting point for estimating your family's needs, but you should also consider that:

- Trust planning may be necessary in today's environment, especially in certain situations, such as:
  - – Special needs for a mentally or physically handicapped child
  - – Additional funds for care of an elderly parent
  - – Estate tax consequences of owning a life insurance policy
- The survivor income analysis on each spouse should be completed.
- If inflation averages 4%, the purchasing power of $1 will be cut in half in 18 years. At 6%, the purchasing power will be cut in half in only 12 years.