

FINANCIAL COACHING

by Fran Peirson, Financial Advisor, Quantum

What Is The "Right" Amount of Life Insurance?

In my business, most of the people I meet feel life insurance is a necessary evil and they tend to avoid the subject like the plague.

The truth is we almost all need some form of life insurance to protect our loved ones in the event of our untimely demise. The death benefit is often used to replace the income of the deceased and this is an area where people get it wrong. So in this installment of Financial Coaching, I'd like to talk about "how much insurance is enough."

It's difficult to get your income replacement insurance right - life insurance needs vary as your family and financial situations change. While it is pointless to pay premiums for life insurance you don't need, the fact is most Canadians are underinsured. Scrimping on insurance could have serious consequences for you and your family.

To get an accurate reading of your life insurance needs, it is important to use assumptions that are valid today, not a decade ago. That includes taking into account low interest rates that will affect earnings on policy payouts. For example, if the proceeds of a \$500,000 policy are invested in GICs they could generate less than \$20,000 of income a year, and that income is taxable (policy proceeds are not).

Calculating the right amount of life insurance also requires making a few realistic assumptions about your future, which your financial planner can help you with.

Step 1 - Why are you buying life insurance? Most families have a life insurance program for one primary reason - to replace income should an income earner die. Whether you're a one or two income family, you likely rely on virtually all income flowing into the household; so replacing any that's lost is key to your family's

security.

Step 2 - What expenses must be covered?

If you routinely prepare a family budget, you should know the expenses to be covered should one of you die. If you don't budget, it's time to start. Most people underestimate their daily expenses. When you draw up a budget and compare it to the actual results over say, a three-month period, you will get a realistic handle on your expenses.

Step 3 - What big-ticket items should be taken into account?

The three most common are paying off the mortgage, education funding for your children, and retirement funding. Providing for these with life insurance is inexpensive, and if they are funded in advance, your month-to-month expenses will drop. Also consider expenses such as burial costs, retiring other debts, etc.

Step 4 - Calculate how much life insurance you need.

Your goal is to have the proceeds of your life insurance policy provide adequate income and fund a savings program for big-ticket items. Unfortunately, these proceeds usually don't stretch as far as you might think.

Let's look at a family of five, whose prime income earner is 35 years old. The accompanying box shows their expected expenses and income requirements should that provider die.

Much to the family's surprise,

Expected Family Income Needs*	Annual income to be replaced	\$50,000
Death Expenses (funeral, estate costs etc.)		\$20,000
Mortgage		\$100,000
Education (current value)		\$100,000
Retirement (current value)		\$200,000
*Tax is figured into all calculations. Note that income on retirement savings will not be tax sheltered.		

they really should be carrying more than \$600,000 in life insurance just to replace the lost income of \$50,000 per year (it's assumed the insurance proceeds earn about 8% per cent annually; much more life insurance would be needed if the proceeds earned only 5 per cent). If this income is to keep up with increases in the cost of living, considerably more life insurance is needed. They also need another \$420,000 to cover expected lump sum expenses. That's over \$1,000,000 for an average Canadian family, not a wealthy one.

What type of life insurance should you buy?

It depends on your current needs and specific income. The most important factor, though, is to get sufficient coverage quickly. Term insurance is the least expensive way to upgrade your life insurance program.

Will you need \$1 million in life insurance coverage?

It all depends on your family situation and where you stand now financially. If you have a well-established savings program, have two "good" incomes, and your expenses are under control, probably not. But you may need more than you think.

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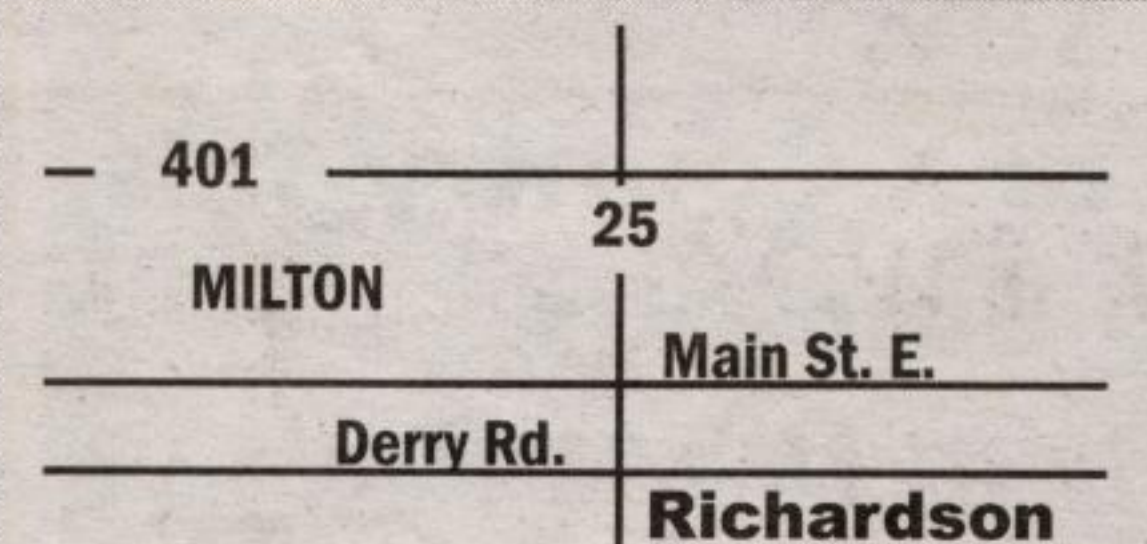
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