How much life insurance do I need?

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This article looks at the question “how much life insurance should I have?” Like all financial issues, there is no single answer. This is because there are many unknowns and a person’s circumstances constantly change. Also, some people have preferences to have more or less than what might be theoretically appropriate. It is a good idea to weigh up the different issues and come up with your own answer for what is right for you.

Why have it?

Life insurance is about managing risk. It is a tool to help you manage the financial risks your family face, should you die. It is particularly useful when the financial consequences of death are significant and adverse, and the capital or ongoing income needs of the survivors is greater than the amount you could save while you were alive, or they can earn. Remember that you can die at anytime and so you have those potential capital/income needs tomorrow.

If I die tomorrow, would someone be financially embarrassed?

Do I need it?

If you have a family, or if there is someone that’s dependent on your income, you probably need life insurance. Exactly how much will depend on the level of the dependence (“how much do they need?”), your goals for your dependants, their expectations and your level of debts.

Check out the calculator on page 4.

Most people should have enough life insurance to make sure that their surviving family can continue to live a ”reasonable” lifestyle relative to their current lifestyle until their death.

When thinking about how much life insurance you need, you should ask yourself the question **“If I die tomorrow, would someone be financially embarrassed?”** The embarrassment will arise because they were dependent on your income - for example, to pay a mortgage, or to buy food, or to provide for a child’s education.

If the answer is “yes”, then having insurance makes sense. If the answer is “no”, you should think twice about buying it. You probably don’t need it and you might be better to save the premiums otherwise payable.

“Will someone be financially embarrassed?” is a question you should ask yourself each year. You should then review your insurance level accordingly.

If you do not ask the question each year, you should think about it when your circumstances change, for example on marriage, or the birth of a child, or buying a new house, or a child leaving home, etc.

How much?

How much life insurance you should have depends on your financial responsibilities. You can group the financial responsibilities you have at the time of your death into three main areas: debts, final expenses and income loss.

You should look at the amount you need in each of these areas:

1. How much do you owe (mortgage, hire purchase, credit cards etc.)? Most people would want their debts paid off if they were to die and not leave the problem for family members to resolve.

2. What are the one off costs that you would have if you were to die? For example funeral costs, medical costs, solicitor's costs, etc?

3. How much ongoing regular income do you think your family needs to maintain their lifestyle and to provide for your children's education? How many years is the income needed for? This is a hard one, as you need to take into account:

    - whether or not your spouse/partner currently works, or will be able to work and their likely income level (taking into account child responsibilities and other family commitments).

    - whether or not your spouse will remarry.

    - whether or not your children will go to university or need additional support.

You also have to think about how dependent your spouse's/partner's ultimate retirement security is on your future income and future savings.

In thinking about each of the above, you should look at your position today (i.e. should you die tomorrow) and how it might change should you die in a year's time or in, say, 5 years. This will give you some idea of whether your insurance need is increasing or reducing.

You also need to make assumptions about the level of investment returns that might be earned on the capital (i.e. the investment of the insurance proceeds) after your death and the likely level of inflation. The lower the returns or the higher the inflation, the higher the required life insurance and vice versa.

Can I have too much?

Many of us have too much or too little life insurance – thanks to the fear of the unknown, or because we have not reviewed the level and our circumstances have changed.

It is always tempting to take out too much (e.g. to be generous to your dependants) - you must remember that every dollar you spend on insuring the consequences of dying, is a dollar less that is available to be saved for your retirement, i.e. the consequences of not dying. As most of us make it to retirement without dying, it is important to have enough life insurance, but not too much.

Other questions

What about my spouse/partner?

When working out how much your family needs if you die, you should also work out how much you and your family will need, if your spouse/partner dies. How much do you rely on your spouse/partner's income contribution to the family's well being? What additional costs will you incur (e.g. childcare, house keeper etc)? Will you be able to continue working?

What about disablement?

It is relatively easy to think about the consequences of death, but you should also think about the consequences of disability or disablement. In both cases, because you survive, your need for capital or income may be higher. There is another mouth to feed (yours) and perhaps other expenses to provide for your wellbeing.

What about future health risks?

One of the many arguments put forward to buy insurance is that by buying it while you are young and healthy, the premiums are lower and there are fewer risk of loadings for future health reasons. It is up to each individual to decide whether the risk of this is worth paying the premiums while you do not need the cover.

Insurance level calculator

Complete the boxes to work out how much insurance you might need.

Debts						
- Mortgage		$				
- Credit cards	+	$				
- Hire purchase	+	$				
- Other	+	$		=	$	(a)
Immediate costs						
- Funeral		$				
- Legal	+	$				
- Medical	+	$				
- Other	+	$		=	$	(b)
Family income needs						
- Education		$	p.a.			
- Child support	+	$	p.a.			
- Spouse support	+	$	p.a.			
- Retirement savings	+	$	p.a.			
- Other	+	$	p.a.			
Sub total	=	$	p.a.			
x number of years required	x			=	$	(c)
Total (a + b +c)					$	(d)
Deduct						
Current investments	+	$				
KiwiSaver	+	$				
Current insurance	+	$		=	$	(e)
Your insurance “gap” (d - e)					$	