The New York Times

BUSINESS DAY

How Much Is Enough in Insuring a Life?

Your Money

By HILLARY CHURA SEPT. 23, 2006

If you died today, would your family be destitute in a few years, comfortable, or toasting your good planning as they vacationed on the Riviera?

It largely depends, of course, on your investments and how much life insurance you've bought.

Figuring out how much life insurance you need can be difficult, and the appropriate amount varies by situation: marital status, number of dependents, earning potential of each spouse and whether both work. Many financial advisers, nonetheless, maintain that correct coverage is crucial to a successful financial plan.

Overinsure, and good money is wasted on the unlikely event of a premature death. Underinsure, and a family may have to lower its lifestyle at an already traumatic time, a newly single stay-at-home parent might have to return to work, a house might have to be sold in a bad market or children attending college might have to drop out.

Gina Belsanti Cleary, 35, started thinking hard about the subject in 2004, when her second child was born and she was starting a residential mortgage company in LaGrange, Ill. Because she is the family's primary earner, she took out $900,000 in life insurance on herself and $600,000 on her husband, Matthew, 44, a construction worker.

"I thought, What would happen if I died today?" Mrs. Cleary said. "I took myself out of the picture, and what I saw was not very good. I saw my family suffering emotionally and financially. If I can prevent the financial part, hopefully the emotional part won't be so heavy."

She said she wanted enough coverage so her husband could stay home with their two children until they were in school, pay off the mortgage, clear debts, invest money for college and finance the daughter's wedding. She said their $1.5 million term insurance policies cost about $100 a month.

"This is one trip to Walgreen's and one dinner out to eat for the four of us," she said.

The life insurance industry's rule of thumb is 10 times annual salary for an individual. But consultants and various online life insurance calculators try to provide more specific estimates. The Life and Health Insurance Foundation for Education, a nonprofit group financed by the insurance industry, has a calculator at www.life-line.org.

Insurance aggregators, like insweb.com and insure.com, offer calculators to figure life insurance needs as do insurance companies, banks and investment companies.

The goal is for people to withdraw less annually than their investment portfolio returns. This allows for inflation if the money is to support them for long periods. Many advisers recommend an annual withdrawal of 5 percent or less, which would be $50,000 in annual taxable income on $1 million.

"And 5 percent may even be on the high side if you have to pay someone to manage your finances," said David Barkhausen, a fee-only life insurance consultant in Lake Bluff, Ill., and president of Life Insurance Advisors Inc.

Robert Hunter, director of insurance for the Consumer Federation of America, said 10-times-earnings is a good rule of thumb.

"You want to make sure a child is protected," he said. "That's a considerable amount of money when you consider education, food, housing, vacations. The nice part of it is that once your child begins to grow up and graduates from college, you can buy less life insurance."

There are two basic varieties of life insurance. Term insurance, which covers a set period of time, is cheaper. Permanent insurance, which includes whole life and universal life, does not expire and is often used by wealthier individuals to pay estate taxes.

Young people in excellent health should not automatically buy extra life insurance through their employers, specialists say, because it can be more expensive than what they could obtain on their own unless they get it at a group discount rate. Conversely, older people, those in poor health or those looking for a convenient way to buy life insurance could benefit from employer plans, they say.

Dr. Alexander Sudarshan, an eye surgeon from Los Fresnos, Tex., has $4.8 million in life insurance — $1.6 million in whole life and the rest in term. The idea is that his wife and three adolescent sons would live off the interest were he to die unexpectedly. To calculate his needs, he hired Peter Katt, a national fee-only life insurance consultant from Mattawan, Wis., who charges $325 an hour.

"There is no room for error," said Dr. Sudarshan, 47. "Life insurance calculators are sufficiently complicated. I was a math major at Yale. They are complicated enough that you really need somebody who really understands."

Many advisers recommend term insurance over permanent. Term insurance costs a fraction of permanent insurance like whole life (with a locked-in premium) or universal life (where the premium may vary based on projected interest rates). Term rates tend to be constant for the life of the policy — 5 to 30 years — but coverage is like a lease: it expires when the policy does. When their term insurance expires, people who are in ill health or are otherwise considered a bad risk may finds themselves uninsurable or facing prohibitively higher premiums.

One compromise is converting term insurance to a permanent policy at preset points, allowing coverage to continue but at higher rates. Permanent insurance should not expire and it sometimes is used as a savings tool because it accumulates cash value. If policies are surrendered within a short period of time, however, policyholders may receive little of their investment.

Harold Evensky, an independent financial planner with Evensky & Katz in Coral Gables, Fla., does not sell insurance but views it as a risk management tool. He said correct insurance coverage was one of the most important aspects of financial planning.

“Once you have the right coverage, then you can talk about investing somewhere else,” he said.

The American Council of Life Insurers, a trade group, said 35 percent of households had no life insurance. One was the Diss family of Tampa.

Laura Diss was attending Florida State University when her father, Mark Diss, died of an aneurysm last year. A freelance writer, 52, he was paying for his daughter’s education but had no insurance. When he died, Ms. Diss had to drop out of college and get a job. Now 20 and a junior at Wellesley College, she receives financial aid and scholarships, works about 20 hours a week and has summer jobs.

“His philosophy tended to be that if he could spend the money on doing something with us right now, he’d rather do that than something long term,” she said. “Insurance is something that you don’t ever want to have to use, but it’s really not about you. It’s for those people who are going to be there if something happens to you.”

Kirsten Izatt, an estate planner in Wheaton, Ill., says women are more motivated than their husbands to do estate planning because they better understand day-to-day costs that would become their responsibility if their husbands died. Men, she said, often believe they could support their families without a wife.

Neal Rhoney, an Atlanta-based financial adviser with Ameriprise Financial Services, said many clients presumed a surviving stay-at-home parent would work if the breadwinner were to die.

“It’s like ‘Oh, you’re a single parent, and now you’re going back to work full time?’ You have to pay someone to care for your kids,” he said. He recommends that stay-at-home parents have 30 percent to 50 percent of the insurance carried by the working parent. “If the working parent is not able to focus on their income and instead they have to constantly take time off to chauffeur kids around, there is a big drain on that parent’s ability to earn an income.”

When Jennifer and Stephen Goldstein first heard estimates that they needed life insurance worth 8 to 10 times annual salary, they thought it was excessive. She works in Pfizer’s licensing and development department. He is a business development and marketing executive.

But after running the numbers, and having their first child in May, the Manhattan couple realized the estimate was on target.

“When you factor in everything — like you might send your kid to a $14,000 private school and a $25,000 nanny and the mortgage and what you’ll pay for college — we did end up back with that,” Mrs. Goldstein said.

A version of this article appears in print on , on page C6 of the New York edition with the headline: How Much Is Enough In Insuring A Life?.