LIFE INSURANCE BUYERS GUIDE

Have you ever wanted to get advice on life insurance and understand what is going through your agent's mind?

Inside you will find a guide that walks you through the basics of life insurance and what you need to know to determine if your agent is working with you or selling to you.

At The Gaines Group we work with our clients.

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Life Insurance Buyers Guide

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Life Insurance Buyers Guide

Life insurance is a type of insurance that provides financial protection for your loved ones in the event of your death. It is designed to help cover expenses such as funeral costs, outstanding debts, and ongoing living expenses for your family.

Many types of life insurance policies are available, each with its own features and benefits. In this blog post, we will cover the basics of life insurance and help you understand the different types of policies available, how they work, and which one is right for you.

1. ***Types of Life Insurance***

There are two main types of life insurance: term life insurance and permanent life insurance.

A. Term life insurance provides coverage for a specific period, typically one to thirty years. If the policyholder dies during the term, the beneficiaries will receive a death benefit payout. If the policyholder outlives the term, the policy will expire, and no payout will be made.
   Term life insurance is generally less expensive than permanent life insurance because it provides coverage for a limited time period. Therefore, it is a good option for individuals who need coverage for a specific period of time, such as to pay off a mortgage or other debts or to provide for children until they are grown and financially independent.

B. Permanent life insurance provides coverage for the entire life of the policyholder. It is more expensive than term life insurance because it provides coverage for a more extended period of time and typically includes a savings or investment component.
   There are several types of permanent life insurance, including:
   - Whole life insurance provides a death benefit and a savings component that grows over time.
   - Universal life insurance offers more flexibility than whole life insurance by allowing the policyholder to adjust the death benefit and premium payments.
   - Variable life insurance allows the policyholder to invest the savings component in various investment options.

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2. ***How Life Insurance Works***

When you purchase a life insurance policy, you pay a premium in exchange for coverage. The premium is typically paid monthly, quarterly, or annually, and the amount is based on several factors, including your age, health, and the type of policy you choose.

The beneficiaries will receive a death benefit payout if the policyholder dies during the policy term. The payout amount is based on the face value of the policy, which is the amount of coverage you purchase when you buy the policy.

If the policyholder outlives the policy term, the policy will expire, and no payout will be made. However, with permanent life insurance, the policy will remain in force as long as you continue to pay the premiums.

3. ***Choosing the Right Life Insurance Policy***

Choosing the right life insurance policy depends on your individual needs and goals. Here are some factors to consider when selecting a policy:

Coverage amount: How much coverage do you need to provide for your loved ones in the event of your death? Consider factors such as funeral costs, outstanding debts, and ongoing living expenses for your family.

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Premiums: How much can you afford to pay in premiums? Remember that the cost of the policy will depend on several factors, including your age, health, and the type of policy you choose.

Term length: How long do you need coverage? If you only need coverage for a specific period of time, such as to pay off a mortgage, a term life insurance policy may be the best option. If you need coverage for the rest of your life, a permanent life insurance policy may be a better choice.

Investment options: If you are interested in using your life insurance policy as an investment vehicle, a permanent life insurance policy with a savings component may be a good option. However, remember that these policies are typically more expensive than term life insurance and may not provide the same level of investment returns as other investment options.

Health and lifestyle: Your health and lifestyle can impact the cost and availability of life insurance coverage. If you have pre-existing medical conditions or engage in high-risk activities such as skydiving or scuba diving, you may need to pay higher premiums and/or may be ineligible for certain types of coverage.

Working with a licensed insurance agent or financial advisor is important when choosing a life insurance policy. They can help you evaluate your options and choose the policy that best meets your needs and goals.

4. ***Benefits of Life Insurance***

Life insurance provides several significant benefits for you and your loved ones:

Peace of mind: Knowing that your loved ones will be taken care of in the event of your death can provide peace of mind and reduce stress.

Financial protection: Life insurance can help cover expenses such as funeral costs, outstanding debts, and ongoing living expenses for your family.

Estate planning: Life insurance can be part of your estate planning strategy to help ensure your assets are distributed according to your wishes.

Tax benefits: The death benefit payout from a life insurance policy is typically tax-free, which can provide a significant financial benefit to your beneficiaries.

5. ***Determining how much life insurance you need.***

Below we will outline for you several different methods for determining how much life insurance you need. This is by no means an exhaustive list, but it will show you the many different factors that go into determining how much life insurance you need.

5.1 The Multiple of Income Method

The multiple of income method is a simple way to estimate an individual's life insurance needs based on their current income. Here are the steps for calculating life insurance needs using the multiple of income method:

A. Determine the individual's annual income: The first step is to determine the individual's annual income.
B. Choose a multiplier: Next, a multiplier is chosen based on the individual's specific situation. A common rule of thumb is to purchase a policy with a death benefit equal to 10 to 15 times the individual's annual income.
C. Calculate the appropriate coverage amount: Once the multiplier has been chosen, the appropriate coverage amount can be calculated by multiplying the individual's annual income by the chosen multiplier.

   For example, if an individual earns $50,000 per year and a multiplier of 10 is chosen, the appropriate coverage amount would be $500,000.

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In summary, the multiple of income method of calculating life insurance need is a simple way to estimate coverage amount based on the individual's annual income. A multiplier is chosen based on the individual's specific situation, and the appropriate coverage amount is calculated by multiplying the individual's annual income by the chosen multiplier.

5.2 The Income Earning Potential Method

The incoming earning potential method is a way to estimate how much life insurance coverage an individual needs based on their future income potential. This method is particularly useful for individuals who are just starting their careers or who have a significant earning potential that is not reflected in their current income.

Here are the steps for calculating life insurance needs using the incoming earning potential method:

A. Estimate future income: The first step is to estimate the individual's future income potential. This can be done by considering factors such as education, experience, industry trends, and other factors that could impact future earnings. It's important to be realistic when estimating future income, and to consider both best-case and worst-case scenarios.

B. Calculate future income needs: Once future income has been estimated, it's important to consider the individual's future income needs. This includes expenses such as mortgage payments, college tuition, retirement savings, and other living expenses that the individual or their family may incur in the future.
C. Determine the coverage amount: The next step is to determine the appropriate life insurance coverage amount based on the estimated future income and future income needs. A general rule of thumb is to purchase a policy with a death benefit equal to 10 to 20 times the individual's annual income.
D. Consider other factors: While the incoming earning potential method can be a useful way to estimate life insurance needs, it's important to consider other factors that may impact the individual's specific situation. This could include factors such as outstanding debts, medical expenses, and other financial obligations that may impact the amount of life insurance coverage needed.

In summary, the incoming earning potential method is a way to estimate life insurance needs based on an individual's future income potential and future income needs. While this method can be useful, it's important to consider other factors and to consult with a financial advisor or insurance agent to determine the appropriate coverage for your specific needs.

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5.3 The Debt Repayment Method

The debt repayment method is a simple way to estimate how much life insurance coverage an individual needs based on their outstanding debts. Here are the steps for calculating life insurance needs using the debt repayment method:

A. Identify all outstanding debts: The first step is to identify all outstanding debts, including credit card balances, car loans, student loans, and other debts.
B. Calculate the total outstanding debt: Once all outstanding debts have been identified, calculate the total amount of debt that needs to be repaid.
C. Determine the coverage amount: The next step is to determine the appropriate life insurance coverage amount based on the total outstanding debt. This ensures that if the individual were to pass away, the death benefit from the life insurance policy would be sufficient to pay off all outstanding debts and prevent them from becoming a burden for surviving family members.
D. Consider other factors: While the debt repayment method can be a useful way to estimate life insurance needs, it's important to consider other factors that may impact the individual's specific situation. This could include factors such as income, living expenses, and other financial obligations that may impact the amount of life insurance coverage needed.

In summary, the debt repayment method is a simple way to estimate life insurance needs based on outstanding debts. While this method can be useful, it's important to consider other factors

and to consult with a financial advisor or insurance agent to determine the appropriate coverage for your specific needs.

5.4 The Dime Method

The DIME method is a simple and effective way to estimate how much life insurance someone needs. DIME stands for Debt, Income, Mortgage, and Education, which are the four main factors that should be considered when determining life insurance coverage.

Here is a breakdown of each factor:

A. **Debt:** This includes all outstanding debts, such as credit card balances, car loans, and student loans. It's important to factor in all debts when calculating life insurance needs, as they could become a burden for surviving family members if the insured were to pass away.
B. **Income:** This refers to the income that the insured currently earns. A general rule of thumb is to multiply the insured's annual income by 10 to determine the amount of life insurance coverage needed. For example, if the insured earns $50,000 per year, they should consider purchasing a policy with a death benefit of $500,000.
C. **Mortgage:** If the insured owns a home, it's important to factor in the outstanding mortgage balance when calculating life insurance needs. The death benefit from a life insurance policy can be used to pay off the mortgage, which can provide financial security for surviving family members.
D. **Education:** If the insured has children who plan to attend college, it's important to factor in the cost of tuition and other education expenses when calculating life insurance needs. This can help ensure that the insured's children will be able to attend college even if the insured were to pass away.

By taking these four factors into consideration, the DIME method can help individuals determine a ballpark estimate of how much life insurance coverage they should consider purchasing. It's important to note that individual circumstances may vary, and it's always best to consult with a financial advisor or insurance agent to determine the appropriate coverage for your specific needs.

5.5 The Needs Based Method

The Needs based method is a way to estimate an individual's life insurance needs based on a comprehensive analysis of their financial situation and obligations. Here are the steps for calculating life insurance needs using the Needs based method:

A. Calculate final expenses: The first step is to calculate the costs associated with final expenses, such as funeral and burial costs.

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B. Determine outstanding debts: Next, outstanding debts such as mortgages, car loans, credit card balances, and other liabilities are identified.
C. Estimate future education expenses: If the individual has children, future education expenses such as college tuition may need to be factored in.
D. Determine ongoing living expenses: The individual's ongoing living expenses are identified, including items such as housing costs, food, utilities, transportation, and other regular expenses.
E. Factor in any additional needs: Depending on the individual's specific situation, there may be additional needs that need to be factored in, such as the need to provide for a spouse or elderly family member.

F. Calculate the appropriate coverage amount: Based on the calculations above, the appropriate life insurance coverage amount can be determined.

In summary, the Needs based method of calculating life insurance needs considers a comprehensive analysis of the individual's financial situation and obligations. Final expenses, outstanding debts, future education expenses, ongoing living expenses, and any additional needs are factored in to determine the appropriate coverage amount.

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5.6 The Budget Based Method

The Budget method is a way to estimate an individual's life insurance needs based on their current budget and expenses. Here are the steps for calculating life insurance needs using the Budget method:

A. Determine the individual's monthly budget: The first step is to determine the individual's monthly budget. This includes all income and expenses, such as housing costs, food, utilities, transportation, and other regular expenses.
B. Estimate future expenses: If the individual has dependents or other future obligations, future expenses such as education costs, weddings, or other significant expenses may need to be factored in.
C. Determine the appropriate time frame: Based on the individual's specific situation, the appropriate time frame for coverage needs to be determined. This may be until dependents are self-sufficient, a specific age is reached, or other factors that impact the individual's financial situation.
D. Calculate the appropriate coverage amount: Based on the budget and expenses identified above, the appropriate life insurance coverage amount can be determined.

In summary, the Budget method of calculating life insurance need considers the individual's current budget and expenses, future expenses, and the appropriate time frame for coverage needs. Based on this information, the appropriate coverage amount can be calculated.

5.7 The Human-Life Value Method

The Human Life Value method is a way to estimate an individual's life insurance needs based on their potential future earnings over the course of their working years. Here are the steps for calculating life insurance needs using the Human Life Value method:

A. Determine the individual's potential future earnings: The first step is to estimate the individual's potential future earnings over the course of their working years. This can be based on factors such as current income, expected salary increases, and the number of years until retirement.
B. Calculate the present value of future earnings: Once the potential future earnings have been estimated, the present value of those earnings must be calculated. This considers the time value of money, which means that future earnings are worth less in today's dollars.
C. Subtract living expenses: The next step is to subtract the individual's living expenses from the present value of future earnings. This will provide an estimate of the amount of money that would be needed to replace the individual's income if they were to pass away.
D. Factor in any additional needs: Depending on the individual's specific situation, there may be additional needs that need to be factored in, such as outstanding debts, future educational expenses for children, or other financial obligations.
E. Determine the appropriate coverage amount: Based on the calculations above, the appropriate life insurance coverage amount can be determined.

In summary, the Human Life Value method of calculating life insurance need considers an individual's potential future earnings over the course of their working years and subtracts living expenses to determine the amount of money that would be needed to replace their income if they were to pass away. Additional factors may also be considered to determine the appropriate coverage amount.

5.8 The Estate Planning Method

The Estate Planning method is a way to estimate an individual's life insurance needs based on their estate planning goals and obligations. Here are the steps for calculating life insurance needs using the Estate Planning method:

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A. Identify estate planning goals: The first step is to identify the individual's estate planning goals. This may include passing on assets to heirs, funding trusts, or covering estate taxes. These goals are important to consider when determining the appropriate life insurance coverage amount, as the death benefit from a life insurance policy can be used to accomplish these goals. If structured properly, the death benefit of life insurance is non-taxable and can lower the estates' tax burdens.
B. Determine estate planning obligations: Next, estate planning obligations such as outstanding debts, mortgages, and other liabilities are identified.
C. Calculate the appropriate coverage amount: Once the estate planning goals and obligations have been identified, the appropriate life insurance coverage amount can be calculated. This may involve working with an estate planning attorney or financial planner to ensure that the coverage amount aligns with the individual's estate planning goals and obligations.

In summary, the Estate Planning method considers the individual's estate planning goals and obligations to determine the appropriate life insurance coverage amount. This method is typically used by individuals with significant assets and high net worth and can provide peace of mind for both the individual and their loved ones.

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5.9 The Contribution Margin Method

The Contribution Margin method is a calculation used primarily by business owners to determine the amount of life insurance coverage needed to protect their business in the event of their death. It is based on the concept of contribution margin, which is the amount of revenue remaining after variable costs are deducted.

A. To calculate the appropriate coverage amount using the Contribution Margin method, the business owner first determines the contribution margin of their business. This can be calculated by subtracting the variable costs of producing a product or providing a service from the revenue generated by the business.
B. The business owner must estimate the number of years the business would need to operate without their leadership and input. This time period is typically based on the amount of time it would take to find and train a replacement.
C. The appropriate coverage amount is calculated by multiplying the annual contribution margin of the business by the number of years it would need to operate without the owner.

It's important to note that the Contribution Margin method may not be suitable for all types of businesses and may not consider other factors such as outstanding debts or obligations. As with any method for calculating life insurance need, it's important to consult with a financial planner or insurance professional to determine the most appropriate method for an individual's specific situation and needs.

5.10 The Business Value Method

The Business Value method is a calculation used primarily by business owners to determine the amount of life insurance coverage needed to protect their business in the event of their death. It is based on the value of the business, considering any outstanding debts or liabilities.

A. To calculate the appropriate coverage amount using the Business Value method, the business owner first determines the total value of their business. This can be done by assessing the value of any assets, such as property, equipment, and inventory, as well as any goodwill associated with the business.
B. Any outstanding debts or liabilities are subtracted from the total value of the business. The resulting amount is the net value of the business.
C. The appropriate coverage amount is calculated by multiplying the net value of the business by a factor that considers the estimated time it would take to find and train a replacement for the business owner.

It's important to note that the Business Value method may not consider other factors that could affect the financial health of the business, such as changes in the market or competition. As with any method for calculating life insurance need, it's important to consult with a financial planner or insurance professional to determine the most appropriate method for an individual's specific situation and needs.

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6 The Gaines Group Life Insurance Philosophy

If there are two things to take away from the prior section on determining how much life insurance you need, it is that there is no one size fits all and there are several factors to take into consideration. In order to simplify things, we like to think of life insurance as a multiple layer protection plan that should work with your financial plan not against it. We have created these general objectives to guide us on the development of your specialized protection plan.

Objectives:

A. End of Life Expenses
    i. Calculate the present value of funeral expenses for you. We do this by taking the current average cost of a funeral, average inflation rate, and mortality tables to determine how much a funeral will cost when that time comes in the future. This becomes the desired death benefit for your whole life insurance policy.

    We use whole life insurance for this policy because this is the one event we can guarantee will happen and we do not want to have to make sure there is a reserve amount in our retirement accounts to cover this expense. For the vast majority of our clients this is the only whole life product we recommend.

B. Debt Repayment
    i. For this objective we use the Debt Repayment Method from section 5.3 above.
    ii. We use term insurance that matches the terms of the debt obligations here. See the example below for more details.

C. Income Replacement
    i. For this objective we use the 5.1 Multiple of Income Method and 5.2 Income Earning Potential Method, depending on the client's age and future career goals.
    ii. We use term insurance here to line up with retirement age and/or childcare needs.

D. Legacy
    i. This objective becomes our reassessment objective because at this point your family and loved ones will not have a financial burden if something happens to you, so now we are looking at the opportunity to leave a legacy and/or protect the legacy you have already created. For this objective we use a series of different methods depending on your specific needs.

Example 1

A. John Doe is a 45-year-old Male that is on pace to retire at 65 years old and makes $40,000/year. His wife Jane Doe is 42 years old and is also on pace to retire at 65 years old

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and makes $50,000/year. John and Jane have 2 kids that are 10 and 15 years old respectively. They live in a home they own with 20 years and $200,000 left on their mortgage.

a. Objective 1 – End of Life Expenses
    i. As of writing this woman were expected to live on average to 79 and men to 73. Assuming a 3.5% average inflation that would mean.
        1. John needs $26,000 Whole Life Insurance
        2. Jane would need $36,000 Whole Life Insurance
b. Objective 2 – Debt Repayment
    i. In this example there is $200k for a mortgage with 20 years left, so that would mean.
        1. John needs $200k 20-year Term
        2. Jane needs $200k 20 yr. Term
c. Objective 3 – Income Replacement
    i. It is important to consider that the kids won't be old enough to take care of themselves for another 5-10 years, and there are also 18-20 years left in Jane and John's working careers, respectively. So, with that being taken into consideration.
        1. John needs $750,000 in total coverage. My recommendation would be to layer the policies to save on costs and better line up the coverage, so we would do a $500,000 20-year term and a $250,000 10-year term.
        2. Jane needs $1,000,000 in total coverage due to her higher income and additional years until retirement. My recommendation again would be to layer the policies for the same reasons. $500,000 20-year Term and $500,000 10-year term.
        3. To get a deeper dive into why we layer and also how we determine what amounts to use for each layer text or call our office at 518-244-8000 or visit us online at www.gainesgroup.net to get a personalized meeting for you.
d. Objective 4 – Legacy
    i. Once we have a plan for the first 3 objectives and we know the client can afford it, we will continue to have conversations about other life insurance needs. For this example, that might be setting up a college insurance fund for the two kids, creating a policy that will donate money to their favorite charity, estate planning if needed, ways to use life insurance to lower taxes on investment gains, the list goes on and on.

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The objective approach we use allows us to work through your insurance needs on a checklist type basis with what we have found to be the most important first and scaling up the insurance need as we continue to have conversations and as you continue down your financial path.

If you would like to have any specific questions answered or would like to setup an appointment to have your objectives checked off call or text us at 518-244-8000 or visit us online at www.gainesgroup.net.

7 Disclaimer

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