Life Insurance is a type of insurance that provides money that is paid upon death of the insured to a person identified in the policy. The beneficiary is that person who receives payment of the life insurance. You can get life insurance for a relatively low amount (several thousand dollars) to very high amounts (in the millions of dollars). You can also establish multiple beneficiaries, each receiving a designated percentage of the overall amount of the policy. For example, someone with a spouse and two children may designate the spouse to get 50% of the payout, and each child gets 25% of the policy.

Purpose of Life Insurance

Life insurance is normally used to provide family members the money they would need to live lifestyle you desire them to have in case of the untimely death of insured. Life insurance is also sometimes used to provide business partners with the money needed to cover potential losses due to the loss of partner.

Determining Life Insurance Needs

Step 1: Determining What You Intend the Life Insurance Payout to be Able to Do

When deciding how much you need in a life insurance policy, you need to determine what you want the beneficiary to be able to do. This will vary person-to-person, since everyone has their own unique financial situation, and they all have different desires on what they would like the life insurance to do.

One obvious use for life insurance is to cover funeral costs. Funerals can be expensive, possibly $10,000 or more.

You may also want to give the beneficiary the opportunity to pay off debt you might owe. You may want to give the beneficiary the ability to pay off any mortgages, car loans, credit cards, or other debt. Those debts would need to be paid off before your family could inherit any of your property, so giving them the ability to clear that debt can take a lot of financial pressure off of them, and they won't need to worry about having to sell the house, car, and other assets in order to pay off the debt.

You may also want to include the ability to replace earnings that the deceased would have earned if still alive. You might decide to make up for a specific amount per year for a specific number of years. For example, let's say you made $50,000 per year. You may want to include in your policy an amount that would replace five years of that income ($250,000) so that your beneficiary won't have to struggle to make up that lost income due to your untimely death.

You may also want to include an amount that would be sufficient to pay for college or other higher education for your children. Since you would not be providing the earnings to be saved or invested for their higher education, you may want to include an amount you think would be adequate to pay for that schooling.

There are many other possibilities of what you might want to get life insurance to be able to do. Perhaps you want it to be used to pay for a vacation. Perhaps you want to make a large charitable donation to a specific charity. Perhaps you want to leave it to your pets so they can be taken care of for the rest of their natural life.

If you die unexpectedly, you may want to ensure your family members do not suffer financial hardship during an already emotionally traumatic time. They may need money for funeral expenses, replacement of lost income, payoff of loans, money for college, or other financial needs you may identify. Life insurance can help relieve this financial stress. *Image courtesy Stuart Miles @ freedigitalphotos.net*

Step 2: Determine What the Beneficiary Will Already Have Available

Once you determine the overall amount you would like to have available for the beneficiary, you should determine what that beneficiary will already have available. For example, he/she may already have some current income he/she makes that you do not want to make up for. There may already be some money in savings or other investments that can either be used or provide an additional source of income to that beneficiary. You may already have an existing life insurance policy, and you are now considering getting additional life insurance to ensure your beneficiary's financial needs will be met.

Step 3: Determine the Net Amount Needed by the Beneficiary

Now that you have determined the overall needs of your beneficiary, and what he/she will already have available (or continue to have available), determine what amount of life insurance you need to get to cover what already won't be available. Subtract the amount available from the overall needs of the beneficiary to determine how much life insurance (or additional life insurance) you need to get.

Example of Calculating Life Insurance Needs

Financial Needs You Want Taken Care Of:	
Funeral Expenses	**$10,000**
Pay off Mortgage Balance	**$200,000**
Pay off Car Loans	**$30,000**
Pay off Credit Cards	**$15,000**
Replace 5 years of lost income @ $60,000/year	**$300,000**
Pay for child's college	**$150,000**
Provide inheritance for child	**$100,000**
Total Financial Needs	**$805,000**
Financial Assets Currently Available	
Current Life Insurance Policy	**$100,000**
Income from Investments @ $5,000/year	**$25,000**
Total Assets Available	**$125,000**
Additional Life Insurance Needed	**$680,000**

Types of Life Insurance

There are two main types of life insurance you can get: term life insurance, and whole life insurance.

Term Life Insurance

Term life insurance is insurance protection that is provided for a specified period of time. You may set the term to be 15 years, 20 years, 30 years, or other terms.

With term life insurance, payment is made to your beneficiary only if your death occurs during the time the policy is in effect. For example, if you have a 20-year term life policy and you die a week after the policy concludes, your beneficiary gets nothing. If you pay on the policy for the entire 20 years and do not die, you get nothing back.

Term life insurance is not an investment; it is just protection against risk. However, life insurance companies are starting to offer return of premium policies, which will return you a portion of the premiums you pay in should you reach the end of the policy term without dying. These return of premium policies are, however, more expensive than a regular term life policy in terms of your monthly premium.

Whole Life Insurance

Whole life insurance provides insurance coverage during the entire life of the insured, as long as the premiums are being paid. Where a term life policy only pays out if you die during the term, and the insurance company knows their obligation is over when the policy expires, insurance companies know they will have to pay out on a whole life policy; it is just a matter of when they will have to pay out. Since insurance companies know they will have to pay out, the premium on a whole life policy is much higher than a term life policy, since the policyholder is effectively pre-paying much of his/her death benefit.

There are two main forms of whole life policies. One is called **straight life**. With a straight life policy, the policyholder pays during his/her entire life. If you have a straight life policy, you keep paying the insurance company until they have to pay you.

Another form of whole life policy is called **limited-pay life**. With a limited-pay life policy, the policyholder pays up to a specified age, like 75 years old. At that point, the policyholder no longer pays any premium; however, the insured is still covered by the policy until his/her death with no additional premiums paid.

One of the characteristics of a whole life policy is that it builds up a *cash value* as you continue to pay the premiums. This cash value is very predictable, and the insurance company can tell you exactly what the cash value will be each year the policy is in effect. The insured gets the cash value if the policy is terminated early. If you want to cancel the policy, for whatever reason, you will receive the current cash value of the policy as a lump sum payment.

Getting a Life Insurance Policy

To get a life insurance policy, you will need to contact an agent with a life insurance company. You can find many life insurance companies locally. You can also shop for policies online.

All the named insured on the policy will have to get a physical exam prior to the premium being set and the policy being issued. Your premium will be based on the risk that the insurance company will have to pay out, and when they think they are likely to have to pay out. Insured individuals with a high risk of dying in the near future will pay more for life insurance than those with a low risk of dying, since the life insurance company will try to collect as much of the payout as it can before it is likely to have to pay out on a policy.

If you have health issues such as being overweight, being a smoker, or having a condition like diabetes, you will pay higher premiums for your life insurance, since the likelihood of you dying while the policy is in effect is higher. If you have a poor family health history, with serious diseases or illnesses like cancer or diabetes, will result in higher premiums. Older age individuals will have in higher premiums, since they are statistically closer to death than a younger person.

Risk Management for Life Insurance

Risk Reduction	Risk Transfer	Risk Retention
Take actions to reduce chances of untimely death Maintain healthy lifestyle Minimize risk associated with potentially deadly activities	Obtain life insurance to pay beneficiary desired amount with one of the following types of policies: • Term Life • Whole Life	Any expenses beyond the desired amount Death beyond end date of policy (term life only)