CASE STUDY #6

Based on the facts presented in this case, what is the impact of premature death on this family? What are the family's life insurance needs? What amount and what type of policies, if any, should be purchased?

Kevin, age forty-three and Patricia, age forty-one, are a married couple with two children, ages eight and eleven. Kevin earns $120,000 annually as a marketing and sales manager for a local firm. Patricia earns $32,000 annually as an administrative assistant with the local school district. She works only during the school term so she can be home with the children when they are on summer break.

Kevin and Patricia purchased their home ten years ago. It is currently valued at $309,000, with an outstanding mortgage of $142,500. They have one family car, valued at $27,500, which has an outstanding loan amount of $2,600. Kevin's employer supplies him with a company car for which all expenses are paid.

Kevin is contributing to a retirement plan (called a "401(k)") sponsored by his employer, who matches his contributions up to 5 percent. The current value of his tax-deferred contributions, employer contributions, and investment earnings is $232,000. Kevin also has a group universal life (GUL) policy through his employer in an amount equal to his salary ($120,000) and has purchased additional coverage up to two times his salary for a total of $240,000.

Patricia has a retirement plan with the school district that pays a specified benefit. Based on a retirement age of sixty-five, she would receive $392 monthly. If Patricia predeceases Kevin, he would be entitled to 50 percent of her monthly benefits starting at age sixty-five. The school district provides $15,000 in group insurance coverage to Patricia, and she has no other life insurance coverage. Kevin and Patricia are also both eligible to receive Social Security benefits in retirement.

The needs approach or the human life value approach can be used to determine whether Kevin and Patricia have sufficient life insurance in the event of their premature death. The agent has decided to use the needs approach for Kevin and Patricia. To accomplish this, the agent evaluates the family's current financial situation, economic needs, and available resources, such as existing life insurance and retirement plans. If additional coverage is needed, types and sources of life insurance would be discussed.

Needs Analysis Steps Calculating Kevin and Patricia's life-insurance needs entails several steps of analysis to determine cash needs in the event of Kevin's premature death as well as the assets the couple has available to meet those needs.

Expense Needs
Although both Kevin and Patricia are employed, the first step in determining life insurance needs would focus on Kevin as the primary wage earner in the family. This process entails review of the family's cash needs, such as ongoing living expenses, outstanding debt, and funding for the children's education, as well as final expenses that would arise in the event of Kevin's premature death. The same process would then be used to determine the family's cash needs in the event of Patricia's premature death.

The goal of this review is to determine how much money will be required to maintain the family's current standard of living should Kevin die prematurely. In this case, it is assumed that Patricia would continue to work in her current job with the same retirement benefits and that she would also receive Social Security benefits at retirement age. If Patricia planned to change jobs in the event of Kevin's premature death, the expense need projections would be adjusted. Patricia's current employment allows the family to avoid child-care expenses because her hours match those of the children's school hours and she is home during summer vacation. If she were to change to a job that had longer hours and required her to work during the summer, the needs calculation would have to reflect additional child care expenses.

Final Expenses Needs	
Funeral costs	$ 9,500
Estate settlement	7,500

Federal taxes	0
State taxes	0
Total Final Expenses	$17,000

Debt Elimination Needs	
Satisfy outstanding mortgage(s)	$142,500
Fund children's education	175,000
Eliminate outstanding credit card debt	3,750
Eliminate outstanding car loan	2,600
Total Debt Elimination Needs	$323,850

Family's Living Expenses Needs	
Household maintenance expenses	$150,000
Other living expenses	$200,000
Child care expenses	$ 0
Total Family Living Expenses Needs	$350,000

Special Needs
The next step would involve considering whether the family has any expenses related to special needs in addition to maintaining its current standard of living. Such expenses could include gifts to charitable institutions or establishment of a trust. Kevin and Patricia's only special need is establishing an emergency fund that would cover any unanticipated expenses following Kevin's premature death. This amount is determined to be $25,000.

Retirement Income Needs
After the family's living expense needs are calculated, it is necessary to consider how much income Patricia would need in retirement. This calculation is based on her age at Kevin's death and other sources of retirement income, including her defined benefit pension plan and Social Security benefits. Much of Kevin and Patricia's current funding for retirement is based on Kevin's 401(k) proceeds. In the event of his premature death, Patricia would need to supplement her retirement income to cover all of her living expenses. This amount is determined to be $350,000.

Total Needs
The final step of the needs approach is adding all of the calculated expense needs to determine the total dollar amount required to meet monthly, ongoing, special, and retirement income needs. This amount will form the basis for determining whether Kevin is carrying a sufficient amount of life insurance or whether additional life insurance should be purchased.

Total Needs	
Final expense needs	$ 17,000
Debt elimination needs	$ 323,850
Family living expenses needs	$ 350,000
Special needs	$ 25,000
Retirement income needs	$ 350,000
Total Needs	$1,065,850

Assets Available
After all of Kevin and Patricia's needs have been reviewed and calculated, the next step is to determine the dollar amount of assets that are available to meet these needs. These available assets include Kevin's group life coverage, his retirement account, and benefits that would be paid by Social Security. Patricia would not receive survivor's benefits under Kevin's Social Security until she reaches retirement age. Social Security will, however, pay monthly survivors benefits to the children until they turn eighteen (in most cases).

Available Assets	
Group life insurance	$ 240,000
Checking and savings accounts	$ 11,000
Social Security survivors benefits	$ 335,000
Retirement account	$ 232,000
Total Assets	$ 818,000

Total Life Insurance Needs

After all of the family's expense needs have been identified and compared to the available assets, the insurance professional would be ready to advise Kevin and Patricia regarding the adequacy of their current life insurance program. Based on the total needs of $1,065,000 and available assets to meet those needs of $818,000, there is a shortfall of $247,000.

Total Life Insurance Needs	
Total needs	$1,065,000
Minus total assets	$ 818,000
Additional Life Insurance Needed	$ 247,000

Recommendations

Based on this review, it is suggested that Kevin should purchase at least an additional $247,000 of life insurance. The insurance professional would give advice and explain several options available to the family but the customer makes the final decision.

Types and Sources of Life Insurance

One option would be for the family to purchase an individual term life policy for $250,000 from a private life insurer. This would be a cost-effective method to close the current gap in assets required to meet the family's needs in the event of Kevin's premature death.

Another option may be a combination of group universal life and individual term life. If his employer-sponsored group life plan allows it, Kevin could purchase an additional $120,000 increment under that plan and purchase the remaining amount from a life insurer under an individual term policy. The advantage of purchasing additional universal life insurance is that it provides permanent coverage (as long as Kevin is employed) and builds cash value. Term coverage is temporary but generally less costly than a universal policy. A $250,000 ten-year term policy would also cover the majority of the family's temporary needs, such as the children's future education and the mortgage elimination needs. Because these needs will change over time, it is important to periodically conduct a needs approach review as the family's situation changes. This review would also include an evaluation of the family's needs in the event of Patricia's premature death.