Insuring the Spend – Rethinking Life Insurance Needs

Why lifestyle spending, not debt, should drive coverage decisions.

Most Americans are significantly underinsured when it comes to life insurance, and the reason is simple: they focus on debt repayment at death rather than the cost of maintaining the family's lifestyle.

Research from LIMRA shows that many consumers frame life insurance purchases around specific liabilities rather than the broader need to replace the income that supports the family's standard of living. When surveyed, only 34% of respondents cited replacing lost income as a reason for purchasing life insurance. Other commonly cited motivations included paying off a mortgage, funding education costs, and covering final expenses so families are not left with financial burdens.

Most clients are seeking perspective on how much coverage they should have but are too often left to make that decision on their own. They begin mentally adding up their debts and end up somewhere between $500,000 and $1,000,000 and assume they are adequately protecting their loved ones. Or worse, they are provided with several quotes with varying coverage amounts and ultimately make a decision based upon price alone.

The role of the trusted advisor is to provide guidance and perspective to ensure the family is adequately protected. A thoughtful needs analysis is essential. *Even experienced advisors can sometimes focus more on the premium's impact on current spending than on the premium's role in protecting future spending and the family's lifestyle*. This imbalance understates financial risk in exchange for relatively negligible savings.

The insurance industry's reputation has also contributed to this problem. Advisors are understandably cautious about clients being "oversold," but that caution often leads to an overcorrection where underinsurance becomes common—even with low-cost term life insurance.

Nearly everything in life is funded by the client's income, including the repayment of debt. Every time a debit or credit card comes out of a wallet, income is paying the bill. Every meal, every trip to the grocery store, every gift, every online purchase, every subscription. Nearly everything that supports the family's lifestyle ultimately comes from income.

While eliminating debt is valuable, paying off debt alone is rarely enough for a family to sustain their current standard of living. The most valuable asset most families have—regardless of income level—is the present value of the future income stream of the primary breadwinner. That income stream is what supports the family's lifestyle.

For context, the chart below shows the average spending percentages across various income levels. Even households with seven-figure incomes maintain significant spending levels that represent substantial annual lifestyle needs.

Estimated % of Income Spent by Higher Income Levels

(Spending estimates derived from Consumer Expenditure Survey spending ratios and extended to higher incomes using Federal Reserve and academic research of saving behavior.)

Gross Income	Est. Effective Tax Rate[5]	Net Income	Avg Annual Spending[234]	Spend % of Gross	Spend % of Net
$100,000	22%	$78,000	$70,000	70%	90%
$250,000	30%	$175,000	$140,000	56%	80%
$500,000	35%	$325,000	$220,000	44%	68%
$1,000,000	40%	$600,000	$400,000	40%	67%
$5,000,000	42%	$2,900,000	$1,000,000	20%	34%

Let's consider a 45-year-old client who is 20 years from retirement and earns $250,000 annually. Suppose the client carries relatively little debt and, as a result, his advisor recommends a $500,000 life insurance policy to pay off the mortgage and fund the children's college should he pass away.

By focusing only on current and anticipated debts, the family's most significant financial need is being overlooked—the nearly $140,000 of annual spending that supports their lifestyle, representing 80% of the client's net income.

Is the family currently saving money, building investments, and paying down debt? Without a doubt. But will the family's lifestyle change if that income disappears due to death or disability? Without question. Raiding brokerage accounts and retirement assets to keep the family afloat during a period of tragedy would permanently alter the family's financial trajectory.

So how much coverage is needed to maintain the current level of spending?

Likely somewhere in the neighborhood of $2,125,458. In other words, the family's largest liability is not the mortgage or college tuition, it is the spending that their income supports.

That $2,125,458 assumes the death benefit is invested and earns a 6% portfolio return with 3% assumed inflation. Under those assumptions, the proceeds could support approximately $140,000 of annual spending for the next 20 years, protecting the family's lifestyle until retirement without forcing the liquidation of long-term investment assets.

By comparison, the advisor's original $500,000 recommendation, under the same assumptions, would generate only about $30,000 of annual income. Today, even a quick analysis using widely available tools or a simple AI prompt would highlight how far that falls short of supporting a $250,000 gross income and $140,000 spending lifestyle.

Death Benefit Needed to Sustain Lifestyle Until Retirement

(Assumes age 45, retirement at 65, 6% portfolio return, 3% inflation)

Gross Income	Annual Spending	Years to Retirement	Death Benefit Needed
$100,000	$70,000	20	$1,062,729
$250,000	$140,000	20	$2,125,458
$500,000	$220,000	20	$3,400,005
$1,000,000	$400,000	20	$6,072,736
$5,000,000	$1,000,000	20	$15,181,841

How Advisors Can Apply This Concept

Focusing solely on debt or using a standard multiple of income is unlikely to properly address the time horizon and spending needs of the family. While these approaches can be helpful starting points, a more practical method to evaluate the financial exposure of the family is a thoughtful income replacement needs calculation:

1. **Determine the household's current income.**
   Use earned income figures for the spouse(s) who support the family's lifestyle.
2. **Determine how much of that income is being used to maintain lifestyle.**
   An important question. Even high-income earners can spend the majority (if not all) of their income on lifestyle that supports their family. While some expenses may decline following the death of an income earner, it is often prudent to evaluate the household's total spending need more conservatively. The loss of a spouse during the income-earning years frequently introduces new and unexpected costs such as reduced

work capacity for the surviving spouse, childcare support, and counseling or therapy, which can offset any anticipated reductions in expenses

3. **Estimate the time horizon that spending must be supported.**
   For most families, this is the number of years until retirement.
4. **Calculate the capital needed to support that spending.**
   Using conservative return and inflation assumptions, determine the present value of the future income stream that is needed to maintain the current level of spending during the remaining working years.

Debts such as college funding, student loans, car notes, and other liabilities can still be layered on top of the calculation but beginning with spending ensures that the biggest asset of most families – the present value of the future income stream of the breadwinner(s) – is being addressed.

Conclusion:

For many families, the amount of life insurance needed to protect their lifestyle may be significantly higher than commonly assumed. Even households with modest debt may require several million dollars of coverage once the spending supported by their income is properly considered.

Research from Kitces Research surveying independent financial advisors found that the median household income of ongoing financial planning clients is approximately $200,000, with many firms serving households earning between $150,000 and $400,000 annually[6].

At those income levels, the annual spending required to maintain a family's lifestyle can be substantial and protecting that spending during the income-earning years is critical.

Fortunately, even for larger face amounts, term life insurance remains relatively inexpensive and can provide meaningful protection during the years when families are most dependent on income. For clients who are sensitive to premium costs, advisors can also consider laddering coverage using multiple term policies with different durations (for example, 10-, 15-, and 20-year level term policies). This approach can help reduce costs while still maintaining adequate protection over time.

Ultimately, the conversation around life insurance should extend beyond debt repayment. While eliminating liabilities is important, the larger financial exposure for most families is the loss of the income that supports their lifestyle. Ensuring that income (and the spending it supports) is properly protected is one of the most important roles a trusted advisor can play.

Footnotes

[1] Federal Reserve Bank of Chicago. *What Explains the Decline in Life Insurance Ownership?* Economic Perspectives, 2017 (citing LIMRA consumer survey data).

[2] United States Bureau of Labor Statistics. *Consumer Expenditure Survey, 2023 Annual Report.* U.S. Department of Labor, 2024. https://www.bls.gov/cex/

[3] Board of Governors of the Federal Reserve System. *Survey of Consumer Finances (SCF).* Federal Reserve Board, 2023. https://www.federalreserve.gov/econres/scfindex.htm

[4] Dynan, Karen E., Jonathan Skinner, and Stephen P. Zeldes. "Do the Rich Save More?" *Journal of Political Economy*, vol. 112, no. 2, 2004, pp. 397–444.

[5] Internal Revenue Service. *Statistics of Income: Individual Income Tax Returns Complete Report.* IRS, U.S. Department of the Treasury, 2023. https://www.irs.gov/statistics/soi-tax-stats-individual-income-tax-returns-publication-1304

[6] Kitces Research. *How Financial Planners Actually Do Financial Planning (2022 Advisor Productivity Study).* Kitces.com, 2022. https://www.kitces.com.