WEALTH CARE KIT℠

Insurance

SmartAboutMoney.org

A website built by the National Endowment for Financial Education dedicated to your financial well-being.

Insurance is the safety net for many aspects of our financial lives

Without the proper coverage, a catastrophic event can wipe out all you've worked hard to earn and save. But making decisions about insurance forces us to grapple with several complex, expensive, and sometimes uncomfortable issues:
• What types of insurance do you really need?
• How much coverage should you have and at what price?
• Have your needs changed?

RISK MANAGEMENT

Buying insurance is actually part of a broader concept with the fancy name of "risk management." In brief, risk management involves identifying what risks you and your family are exposed to and determining how to best manage those risks. Risks include sickness, injury, disability, loss of life, loss of or damage to property, and personal liability. What financial impact would these risks have on your estate, your personal life, and your family?

Once you've identified these risks, you try to eliminate or reduce them or their financial impact. You might install a burglar alarm in your new car. You might quit smoking and exercise to reduce your health risks—and minimize your life and medical insurance premiums. As discussed in the "Wealth Care Kit" section, you can build up a cash-reserve emergency fund to cover smaller losses yourself, such as the theft of a car stereo. This allows you to raise your insurance deductible and lower your premiums. An emergency fund lets you "retain" some of the smaller financial risks. This is sometimes called "self insurance." It is an important part of risk management.

Most of the financial risks that you can't avoid, control, or minimize can be transferred to a third party by purchasing insurance.

LIFE INSURANCE

If your spouse, children, or loved ones would be harmed financially by your death, or if you want to make gifts to charitable or educational institutions, then you probably need life insurance.

Life insurance comes in two basic forms. Term insurance provides "pure protection." You buy only the death benefit (face value of the policy say, $100,000). This provides temporary coverage (say, for the next 5, 10, or 20 years). Employer-provided life insurance typically is term coverage.

Cash-value life insurance, which includes whole life, universal, and variable, provides not only a death benefit but a savings component, as well. Part of your premium goes to cover the death benefit and part goes toward the savings component (called the cash value), where the earnings accumulate tax deferred. Some companies will pay dividends into your cash value. You can borrow against the cash value, withdraw it, use it to help pay your premiums, or let it accumulate for long-term goals, such as retirement.

The type of life insurance you purchase will depend on your needs. Term insurance initially offers the greatest death benefit for the dollar. If you need substantial amounts of protection for a temporary period (say, to get your children through school), term might be the most appropriate and affordable. But the cost for term rises significantly as you age. Cash value insurance offers lifetime coverage, usually with level premium payments, and a way to invest some of your money tax deferred. Sometimes a combination of types is the best option.

How much coverage should you have? As a rule of thumb, people in their 20s and 30s should buy a policy that has a face value of 8 to 14 times their annual earnings when added to other liquid assets. For people over the age of 40, multiply your earnings 4 to10 times. The younger you are—and, ironically, the lower your income—the higher the multiple. Factors to consider include the number of dependents, funding for college education, mortgage payments, and lifetime income needs of the surviving spouse.

People often don't own enough life insurance, especially as their needs change. As people grow older, their income rises, their estate grows, and they may have children. Also, inflation erodes the buying power of a policy. At an average annual inflation rate of four percent, a $200,000 policy will buy only $135,113 of goods 10 years from now.

DISABILITY INCOME INSURANCE

For more people, the ability to earn a living is their most valuable asset. During your working years, you are 2-3 times more likely to be disabled for at least 90 days than you are to die before age 65. Half of all mortgage foreclosures occur because a worker in the family becomes disabled. Still, over 80% of working Americans don't have adequate disability income insurance to cover them against the loss of income.

To review your disability needs, consider the following points:
• Generally, disability coverage is limited to 60 to 70 percent of your gross income. Get as much coverage as possible.
• Look for "own occupation" on loss of income coverage. This coverage means the company will pay benefits for as long as you cannot work in your own occupation or you have a loss of income due to injury or illness.
Some policies will pay only if you are not able to find work in any occupation, including low-paying/ unskilled labor.
• Consider coverage for partial or residual disability—you are able to work, but not at full capacity.
• Look for noncancelable coverage or at least a policy that is guaranteed renewable, with a cost-of-living adjustment.
• Disability insurance can be expensive. One way to cut premium costs is to select a longer elimination period—the time you have to wait before you can start earning benefits. Set aside money in an emergency fund to tide you over until coverage kicks in.

When determining your need to buy individual disability coverage and how much, consider alternative coverage.
• Group disability coverage usually is less expensive than individual coverage, but group plans typically are inadequate. Review the group plan with a knowledgeable professional to be sure the benefits match your needs. Group policies may be cancelled by the employer or insurance company, and they may not pay full benefits if you are receiving other benefits, such as workers' compensation aid group disability benefits generally are taxable; individual policy benefits are not.
• Don't depend just on workers' compensation and Social Security. Workers' comp will cover you only for job-related disabilities, and to collect Social Security benefits, you must be totally disabled.

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HEALTH CARE COVERAGE

In general, if you can obtain a health care plan through your employer, take it. Most of the time, it is better coverage at a more reasonable price than you can obtain on your own. Don't take it automatically, however. Review your group plan in light of your family's health history, type of employment, and recreational activities to be sure the benefits are adequate for your needs. Know exactly which expenses and prescriptions are and are not covered, what restrictions are included (such as the deductible amount and the maximum amount you may be asked to pay), what procedures you must follow, and how much the plan will cover in the event of a catastrophic situation. You may need to purchase additional individual coverage to cover any "gaps."

Some insurance company plans have a provision that is called the "stop-loss" or "breakpoint." This is the most you will be required to spend per person each year for covered expenses. Managed care plans that require a small payment each time you visit a doctor usually have no limit on how much you might spend in a year.

Though rare, you may find it is better to take the group plan for yourself, and perhaps your spouse, but cover your children separately.

If you and your spouse work and both receive health care benefits, consider reducing or eliminating one of the coverage to save money. You might obtain one set of benefits, such as dental and eye care, through one employer, and take the medical care through another. Be aware that duplicate coverage will not result in duplicate payment of benefits.

And don't overlook COBRA. It stands for Consolidated Omnibus Budget Reconciliation Act of 1985. Under COBRA, most employers with more than 20 employees covered by a group health insurance plan must provide the option for the employee or the employee's dependents to continue coverage if the employee leaves or dies, or there is a divorce or certain other changes in circumstances.

COBRA gives you time to find new coverage, usually up to 18 months. If you must obtain a health care plan on your own, check out professional groups and associations (which may offer more attractive group-rate plans), as well as individual plans.

LONG-TERM CARE INSURANCE

The average cost of nursing home care in America is over $70,000 a year. Long-term-care (LTC) insurance, designed to cover these steep bills, is offered by some employers. Medicare covers only about one percent of nursing home costs, and Medicaid will pay the bills only if you become nearly destitute. In fact, a congressional subcommittee on aging found that 70 to 80 percent of the people who enter nursing homes exhaust their savings in one year and are forced onto Medicaid, the government's health care program for low income and impoverished individuals. LTC policies have improved substantially in recent years, but many still have significant limitations, so it's best to work with a knowledgeable financial planner or insurance agent. A few things to keep in mind:

• Consider LTC insurance if your estate has enough assets worth protecting, but the estate is not large enough for you to be able to pay for care yourself.

• Benefits from qualified LTC policies generally are income tax free, and premiums may be fully or partially deductible.

• In many cases, it may make sense for the children to pay for their parents' LTC coverage to protect their own assets or inheritances.

• You may have heard of people giving their assets to relatives or using other loopholes to qualify for Medicaid without "spending down" their savings. Congress has closed most of these loopholes, and there are penalties for improperly transferring assets. Consult a qualified financial advisor if you are considering giving assets to others.

• Single women are far more likely to enter a nursing home than married men (the most frequent target of LTC sales).

• Choose a policy that covers all levels of care. Some older policies require hospitalization before you can collect for less intensive care.

• Read carefully for exclusions. For instance, excluding "organic brain disease" would mean you could not collect for Alzheimer's disease.

• There are differences of opinion about the value of home healthcare riders, the best elimination period, maximum benefit years, and other LTC issues. Read widely and talk to several experts before settling on specific benefits.

HOMEOWNERS INSURANCE

If you are financing a home, you'll be required to purchase homeowners insurance. But don't assume that's all you have to do. Make sure the policy automatically adjusts to cover the increased value of your home over time, and that it will cover replacement costs for lost or destroyed items, not at a lower prorated value. Buy a "floater" to ensure full coverage for such items as jewelry, art, silver, antiques, and collectibles.

Take photographs or make a videotape of your possessions to ensure that if they are destroyed or stolen, you will remember all lost items and can prove ownership. Store the photographs or video and a list of the objects and their value in a safe deposit box. Update the list.

Remember, you only need to have enough insurance to cover replacement of the home, not the land it is on.

If you rent, don't take the "it's not-going-to-happen-to-me" attitude. Renter's insurance is inexpensive, yet many don't have it. The insurance will cover your personal property and protect you from liability claims.

Condominium or cooperative owners should be careful about potential association liabilities and the adequacy of the association's master policy .

Selecting an Insurance Agent

Although some agents sell all types of insurance, try to choose agents who concentrate on the areas for which you want coverage, such as life/health or property/casualty/liability. They should be most familiar with those products. Generally, it's better to choose agents who represent several companies. That gives you a better selection of policies. Ask friends and other financial services professionals for recommendations. Talk to at least three agents. Check their professional education, work experience, and membership in professional organizations.

CAR INSURANCE

Most states require insurance if you own a car, but minimum coverage amounts, particularly for bodily injury and property liability, may be inadequate. Don't skimp on coverage just to save a few dollars. For example, dropping coverage against being hit by an uninsured or underinsured motorist is penny wise but pound foolish. Weigh the savings against the potential loss. However, you can reduce premiums several ways:

- Auto insurance is competitive, so shop around, and do so periodically.
- Drive safely.
- Insure all your cars with the same company.
- Decrease or eliminate collision insurance as your car gets older.
- Install anti-theft/safety devices and buy a conservative car.
- Raise your deductible.

UMBRELLA LIABILITY INSURANCE

Like disability, liability insurance is an overlooked form of insurance. Yet, everyone—no matter what their net worth may be—is vulnerable to lawsuits for reasons ranging from dog bites to reckless driving to slander. Even if you do not work in an occupation susceptible to malpractice lawsuits, you need sufficient personal liability coverage (umbrella policies do not cover professional liability and malpractice). If you work in a volunteer capacity, sit on the board of a charitable organization, or provide day care at your home, you could be sued. And the amount of awards is growing.

Most homeowner and automobile policies provide some personal liability coverage, with a maximum of around $1 million. If you think you might need coverage beyond that, consider an umbrella liability policy.

An umbrella policy is surprisingly affordable: $100 to $200 per year for $1 million. The company that provides your homeowner or auto policies is a good place to start looking, since many companies require you to buy their "base" coverage before issuing additional coverage. Note that an umbrella policy not only increases the amount of protection, it also expands the protection to cover more areas of liability, and it usually covers the costs of your defense.

REVIEW YOUR POLICIES AND YOUR INSURANCE NEEDS

Reading insurance policies may not be your idea of fun, but it is important to familiarize yourself with your coverage. If you don't understand something, call your insurance agent or financial planner.

Review your insurance needs every year. The addition of dependents, a change in jobs or income, divorce or marriage, and a host of other contingencies may require new types or amounts of coverage. Changing government regulations may also affect your insurance strategies.

One last note: When buying insurance, it's easy to buy too much of the wrong kind, or not enough of the right kind because you're shopping solely on price. The key to buying insurance is to balance costs against your specific needs.

Selecting an Insurance Company

First, be sure the company is licensed in your state. Check with the state insurance commissioner for any complaints about the company (or the agent). Is the claims service prompt and reliable? Most insurance companies are financially secure. Still, it is wise to evaluate any company whose policies you are considering. Check the carrier's ratings by independent rating services such as Standard & Poor's, Moody's, and A.M. Best. A wide difference in ratings, or consistently low ratings, should be a red flag. Write to The Insurance Forum, P.O. Box 245, Ellettsville, IN 47429, call (888) 876-9590, or visit the "Insurance Links" section of their Web site at www.theinsuranceforum.com.

INSURANCE SUMMARY WORKSHEETS

These worksheets are provided to help you organize your insurance coverage information, assess the extent of your coverage, and identify possible gaps. You will need to gather your insurance policy information from your files, employer's benefits specialist, or your insurance professional. When you are finished, you'll have a complete record of your insurance information for your own use or to provide to a financial planner.

LIFE INSURANCE

Insured's Name	Death Benefit	Premium	Insurance Co.	Policy Number	Policy Type

DISABILITY INCOME INSURANCE

Insured's Name	Monthly Benefit Upon Disability	Party Paying Premium (group or individual)	Insurance Co.	Benefit Period (upon disability, how long benefits last)	Waiting Period (how long until benefits start)

HEALTH CARE PLAN

Insured's Name	Plan Provider	Type (health, dental, vision)	ID or Policy No.	Maximum Benefit	Coinsurance (if any)	Deductible (if any)

LONG-TERM-CARE INSURANCE

Insured's Name	Daily Benefit	Type (facility or in-home care)	Benefit Qualification (hospitalization, doctor's orders)	Insurance Co.	Policy Number

AUTOMOBILE INSURANCE

Insurance Company:	Policy Number:	Premium:

Benefit	Coverage
Liability	$
Medical Payments	$
Underinsured Motorist	$
Uninsured Motorist	$
Personal Injury Protection	$
Collision Loss	$
Other than Collision (Comprehensive)	$
Towing and Labor	$
Other:	$

HOMEOWNERS INSURANCE

Insurance Company:	Policy Number:	Premium:

Replacement Cost: ❏ Yes ❏ No

Type: ❏ Basic ❏ Broad Form ❏ Open Perils

Benefit	Coverage
Dwelling	$
Other Structures	$
Personal Property	$
Loss of Use	$
Personal Liability	$
Medical Payments to Others	$
Other	$

Floaters

Property	Value	Coverage