

PROJECT: GET IT DONE [TOGETHER]

Reading: Insurance 101

5 Insurance Policies Everyone Should Have

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Protecting your most important assets is an important step in creating a solid personal financial plan. The right insurance policies will go a long way toward helping you safeguard your earning power and your possessions. In this article, we'll show you five policies that you shouldn't do without.

Long-Term Disability Insurance

The prospect of long-term disability is so frightening that some people simply choose to ignore it. While we all hope that "nothing will happen to me," relying on hope to protect your future earning power is simply not a good idea. Instead, choose a disability policy that provides enough coverage to enable you to continue your current lifestyle, even if you can no longer continue working.

Life Insurance

Life insurance protects the people that are financially dependent on you. If your parents, spouse, children or other loved ones would face financial hardship if you died, life insurance should be high on your list of required insurance policies. Think about how much you earn each year (and the number of years you plan to remain employed) and purchase a policy that will replace that income in the event of your untimely demise. Factor in the cost of burial too, as the unexpected cost is a burden for many families.

Health Insurance

The soaring cost of medical care is reason enough to make health insurance a necessity. Even a simple visit to the family doctor can result in a hefty bill. More serious injuries, that result in a hospital stay, can generate a bill that tops the price of a one-week stay at a luxury resort. Injuries that require surgery can quickly rack up five-figure costs. Although the cost of health insurance is

a financial burden for just about everyone, the potential cost of not having coverage is much higher.

Homeowners Insurance

Replacing your home is an expensive proposition. Having the right home-owners insurance can make the process less difficult. When shopping for a policy, look for one that covers replacement of the structure and the contents, in addition to the cost of living somewhere else while your home is repaired.

Keep in mind that the cost of rebuilding doesn't need to include the cost of the land, since you already own it. Depending on the age of your home, and the amenities that it contains, the cost to replace it could be more or less than the price you paid for it. To get an accurate estimate, find out how much local builders charge per square foot and multiply that number by the amount of space you will need to replace. Don't forget to factor in the cost of upgrades and special features. Also, be sure the policy covers the cost of any liability for injuries that might occur on your property.

Automobile Insurance

Some level of automobile insurance is required by law in most places. Even if you are not required to have it, and you are driving an old clunker that has been paid off for years, automobile insurance is something you shouldn't skip. If you are involved in an accident, and someone is injured or their property is damaged, you could be subject to a lawsuit that could possibly cost you everything you own. Accidents happen quickly and the results are often tragic. Having no automobile insurance or purchasing only the minimum required coverage saves you only a tiny amount of money and puts everything else that you own at risk.

In Case of Emergency - Insurance Can Keep a Bad Day From Getting Worse



Insurance gets no respect. While just about every other aspect of personal finance centers on accumulating wealth, insurance is all about spending money for a product that, if you need it, you know you've had a bad day. You've either been robbed, you've wrecked your car, your

house has been damaged in a disaster, you've seriously injured yourself, you have an illness that has flared up, or, in the worst of all possible bad days, you have died.

For that reason, people typically hate shelling out for an insurance policy, often grumbling about spending money year in and year out for something they rarely, maybe even never, use.

That's understandable. But how often do you call on the police department because of an emergency? How often do you call on the fire department to save your burning home? You may not need either for decades, but when you do, you're relieved they're around.

Insurance is exactly the same. Without it, all the personal wealth you manage to amass is at risk when bad things happen to you or your property, or to others injured by you or your property. In those situations, all the money you've paid to own insurance through the years— the premiums — pays off, allowing you to replace your property, pay for expensive medical care, or cover the damages you inflicted on someone else.

Protecting One Another

All insurance is fairly similar in the way it works. When you buy an insurance policy, the insurer groups you with people similar to you in age, health status, sex, lifestyle, home location, and a variety of other factors. Then actuaries—vital statisticians who compute risk—calculate how many deaths, car accidents, heart transplants, hurricanes or whatever are likely to occur over a period of time to your particular group of people.

Insurers use that risk assessment to determine the premiums you must pay to insure whatever risk it is you're trying to protect against—whether it's your premature death or the risk that an uninsured motorist will total your car. With life insurance, for instance, if you're young and healthy, your premiums are low because, statistically, the chances are low that you will die soon and force the insurer to pay a benefit. On the other hand, if you're old and ailing, your premiums will be very high because the risk that you will die soon is substantially greater.

This pool of similar consumers essentially shares the risk of protecting one another from financial hardship in the event of death or some other insured event. This shared risk works because of the law of large numbers, a scientific principle which holds that the actions of one will not have a tremendous effect on the group as a whole at any given moment. Thus, a relatively small number of events each year that require an insurer to pay claims will not hurt the overall pool much.

Insurance companies don't just sit on the premiums you pay; they invest them. Since statistically you're not likely to claim the money for years, if ever, the insurer can generate an investment return on those dollars to increase the asset base available to pay claims with. Because of the investment return, and because only a small portion of the insured population will file a claim in any given year, insurers have the ability to pay your claim for, say, \$40,000 even though you might have paid the insurance company only \$7,000 in premiums through the years.

Three Main Figures

For the insurance carrier, there are hundreds of statistics that are taken into account in setting rates and assigning policyholders to risk pools. From the point of view of you, the average insurance buyer, there are just three key figures to keep track of: coverage, premium, and deductible.

Coverage is how much money the policy will pay out for whatever event you are insuring, whether it's your life or the cost of rebuilding a beachfront home after a hurricane blows through. With life insurance, for instance, the coverage might be \$100,000, meaning that when you die your beneficiary will receive a check for that amount.

Premium represents the cost of the coverage, or how much you have to pay to own the insurance policy. Though the coverage might be \$100,000, your premium will be just a sliver of that because of the way insurance companies spread your individual risk across millions of customers. Insurance companies place people in one of four risk groups: preferred, standard, substandard and uninsurable. Preferred customers are charged the lowest premiums; the uninsurable are, well, uninsurable for whatever reason.

But remember this: A customer whom one insurer labels "preferred" might be labeled standard by another insurer, which would adjust the customer's rates accordingly. Insurers routinely tighten and loosen their underwriting standards—the standards they use to determine who falls into what category—depending on a variety of business factors. Those standards can and do change regularly. The message is to shop around to find a less-expensive premium for the same coverage.

Deductible is how much money you have to come up with to help cover the cost of an insurable event. If you have a \$250 deductible on your auto insurance and you wreck your car, causing \$1,000 in damages to the car, you're responsible for the first \$250; the insurance company covers the rest.

Many consumers often want the lowest deductible because they loathe the notion of digging up a big chunk of money in the event something happens that causes them to file a claim. It is better, they feel, to pay as small an amount as possible and let the insurer do the heavy lifting.

That is a more expensive proposition in the long run. Here's why: If you double a \$500 deductible to \$1,000, you might save \$150 a year on your premiums. Sure, you're on the hook now for an extra \$500, but you'll come out ahead financially because every 3.3 years you will have saved \$500 in premiums ($500 \div 150 = 3.3$) you'd otherwise have to pay with a lower deductible.

That makes it a pretty simple equation: If you're not filing claims very often, why pay the higher premiums for no reason? And if you are filing claims often, then it's a moot point: Your insurance company is going to jack up your premiums anyway or cancel your coverage because you obviously present a greater risk to the company.