LESSON 6

BUYING INSURANCE

If anyone does not provide for his relatives,
and especially for his immediate family,
he has denied the faith and is worse than an unbeliever.
I Timothy 5:8

Financial independence—that's our ultimate goal, or is it? Is there really any such thing as "financial independence"? In *Financial Peace,* Ramsey suggests that we should not put our faith in such a concept:

> Independent of what? Can you gain enough money that you never have to worry or be cautious again? Can you gain enough money that you can protect your family from injury or sickness? Can you accumulate enough money to be guaranteed you won't lose everything due to war, famine, or the collapse of financial markets? I have never read about or met anyone who could hoard this much money.[29]

I have seen a grievous evil under the sun:
wealth hoarded to the harm of its owner,
or wealth lost through some misfortune,
so that when he has a son there is nothing left for him.
Ecclesiastes 5:13-14

Although we can't look into the future and foretell what will happen, we should make provision for our families with appropriate life and health insurance and protect some of our assets, such as houses and automobiles, with other types of insurance. Keep in mind, however, that there is no way you can possibly insure every financial risk you will ever experience. Insurance is protection from loss of assets. Your most important asset is your earning power.

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[29]Ramsey, David L. *Financial Peace,* Viking Penquin, 1997.

Risk is uncertainty of outcome. Businesses and individuals have the same problems with risks. There are assets you must protect because you want to be able to replace them should you lose them. For example, your earning power is an asset; it is your most important asset. There are two different ways to protect risk: (1) have enough liquidity (cash or cash-type investments) that you could replace the asset or (2) purchase insurance to cover the replacement of the asset should you lose it.

Perhaps we avoid learning about insurance because it sounds confusing, and it's not exactly great bedtime reading! When we stay in the financial dark about insurance, there will be a price to pay. Some people are *under-insured* because they refuse to purchase the insurance they need, which is a foolish mistake. However, many people are *over-insured* and waste money that could be put to better use.

Many years ago my husband and I purchased a life insurance policy from an agent who was a representative of one of the largest life insurance companies in America. Our agent was a certified life underwriter (CLU), and we trusted him to give us good advice on what type of policy to purchase. At the time we were living on a limited income and were planning to start a family. After I quit work and had a child, it was imperative that we have adequate life insurance to make provision for the possibility of the loss of the breadwinner.

Our agent sold us a life insurance policy which was expensive and provided very little actual coverage. We really were not adequately covered—and he told us so—but we could not afford to purchase any more insurance. Never once did our agent offer to sell us an insurance policy that we could afford, one that would provide much greater coverage with smaller premiums. Why? The type of policy he sold us paid him a large commission, and the type of insurance we needed would pay him a low commission. Ignorance is expensive! What happened to us happens to people all the time—they trust others to advise them who have a stake in what they are selling—and they fail to do their homework.

Representatives from the insurance industry use very strong sales tactics to get us to purchase coverage for every conceivable risk and sometimes make us feel that we are irresponsible if we let any risk go uninsured. There is a dichotomy of thought between those within the insurance industry and those who represent consumers. My personal belief—and there are those who will strongly disagree with me—is that consumer advocates present a more balanced approach.

The best known consumer advocate in this country, Ralph Nader, has stated that "less is more" when it comes to insurance. In many cases, it is more affordable and makes more financial sense to "self insure" some of our risks, which means using our own cash reserves to replace the loss of assets.

Lesson 6 will include a discussion of five major types of insurance: life, long term care (LTC), disability, renter's/homeowner's, and automobile. Because of the sweeping changes in our health care system in the U.S., there is no discussion provided here on health insurance. Lesson 6 also includes types of insurance to avoid purchasing.

Before beginning a discussion of types of insurance, it should be noted that you must select a good insurance agent and a top-quality insurance company. Ask your agent if he/she carries E&O

insurance (errors and omissions). When selecting an insurance company, check A. M. Best's web site, ambest.com. They publish financial strength ratings of insurance companies for free on their website. Also, many employers offer life and disability policies with options to insure spouses and children in smaller increments. These policies are usually good value for your insurance dollars.

WHO NEEDS LIFE INSURANCE?

My Uncle Dick, a financial planning adviser in the family, told me a heartbreaking story about a friend of his who sold his house and used the equity to start a business. He and his wife then moved into a very nice apartment and were enjoying a lifestyle of plenty. Uncle Dick advised him to buy a life insurance policy that would take care of his family's needs. Although he could afford the insurance, Uncle Dick's friend turned it down. Two months later, Dick's friend died. When Uncle Dick visited the man's wife a few months later, she was living in a third-floor apartment that overlooked a carwash and, because of her lack of skills, worked as a cleaning woman in a hospital.

Uncle Dick contrasted that story with another of a man who had gone into business with two nephews. His advice to the man was to have a buy-sell agreement drawn up between them in case of the death of one of the partners. Unfortunately, this man was killed one Sunday in a car wreck; but because of the partnership agreement he had, the business was sold. The man's family enjoyed a comfortable lifestyle after his death.

A good man leaves an inheritance for his children's children,
but a sinner's wealth is stored up for the righteous.
Proverbs 13:22

These stories demonstrate the importance of life insurance. Life insurance provides cash, called a death benefit, to your family when you die. If someone will suffer financially when you die, then you probably need life insurance. It is designed to replace part or all of your income so that your family will be able to pay your funeral bills, meet daily living expenses, and educate your children. Life insurance is designed to take care of those you care about after you are gone. The proceeds from life insurance are usually income tax free and are payable immediately upon your death.

The following list will help you decide if you need life insurance.

Married Without Children. Ask yourself if you or your spouse would be able to pay for the other's funeral expenses, pay off debts (credit card balances, auto loans, etc.), and cover monthly living expenses if one of you dies. If you are planning to have children, consider buying life insurance right away. It will be less expensive and easier to obtain now than during a woman's pregnancy.

Married With Children. If you or your spouse died suddenly, could your family maintain its standard of living on the other spouse's income alone? Probably not. Even without an income, homemakers should also be insured because the cost of domestic chores and child care can be substantial. For a family with small children, the death benefit must be substantial.

Single Adults. There are only a few reasons why single adults should have life insurance: to pay for their own funeral costs, if they financially support another person, or if someone will inherit their home with a substantial mortgage.

Single Parents. A single parent is the breadwinner, caregiver, cook, and chauffeur. It is critical, therefore, that single parents have adequate life insurance.

Retired and Elderly. Life insurance for this age group is expensive, especially if the policyholder is in poor health. As long as others are not depending on your income for support, life insurance is not necessary unless you want to use it to pay for your funeral expenses.

Children. Children do not need life insurance because no one depends on income from them. Consider it only if you don't have enough money for funeral expenses should your child die.

Small Business Owners. Besides taking care of your family, life insurance can also protect your business. A life insurance policy can be written to fund a "buy-sell" agreement, which would ensure that the remaining business owners have the money to buy the company when one of the owners dies. This will allow the owners to get the business and the family to get the insurance proceeds. Key-person insurance is also a valuable option for a business.

TYPES OF LIFE INSURANCE

There are two major types of life insurance, *term* and *whole life.* **Term Insurance** is plain vanilla insurance that is available for a term, or period of time, such as 10, 15, or 20 years. It provides a lot of coverage for a small monthly premium. You will have to re-apply for insurance when the term expires, and you can expect the premiums to increase since the costs increase with age. There are five types of term insurance.

Renewable Term provides a death benefit that stays the same, but the premiums go up in increments, such as every five or ten years. As the policyholder ages, the insurance will become too expensive. This type of policy can be renewed without evidence of good health. **Level Term** policies have premiums that stay the same for a period of time. A 5-year term may start out being less expensive than a 20-year term policy, but it may cost you more because you will have to qualify every five years. **Decreasing Term** provides a fixed premium, but the face value of the insurance decreases over the term of the policy, which makes the life insurance more affordable. Some people use this as mortgage insurance because it is cheaper than getting mortgage insurance through the mortgage company. **Convertible Term** allows you to convert to a permanent type of life insurance without a medical exam. **Return of Premium** is a type of policy that returns the premiums to you if you have not filed a claim by the time the policy expires, but the premiums are higher than for policies without it.

Whole Life Insurance is permanent insurance available for the whole life of the policyholder as long as the premiums are paid; and whole life pays its face value at death. In short, a whole life policy is an investment product that works on the premise that you are buying life insurance and accumulating savings called "cash value," so it is much more expensive than term insurance. Whole life includes traditional whole life, *Universal Life*, and *Variable Life*.

Regardless of how much savings is built into a whole life policy, it pays only the face value of the policy at death. For example, if you purchase a whole life policy with a death benefit of $200,000 and pay premiums long enough to accumulate $100,000 in the investment account, you would expect your beneficiaries to get $300,000. However, your beneficiaries will only get $200,000; and the life insurance company keeps your $100,000 investment. So, you are paying an additional premium to build cash value, which you don't get to keep unless you withdraw the cash value and lose the insurance.

There are advantages of whole life policies: (1) you know exactly what the premiums will be, (2) cash values grow tax deferred, (3) the death benefit is paid income-tax free, (4) you can borrow your cash values tax-free (with interest), and (5) your insurance remains in force as long as you continue to pay the premiums. However, the surrender values on whole life policies don't equal the premiums for the first 12 to 15 years because of the high fees and administrative costs. The expected returns on a whole life policy are only estimates. Insurance companies generally calculate their estimates without subtracting the fees and commissions. The actual returns on whole life policies can be as little as 2 or 3 percent.

Universal Life allows the policyholder to retain ownership of the cash values, but the premiums are not fixed. At some point, you may have accumulated enough cash value to cover the premiums. Universal Life is designed to let the policyholder benefit from higher rates of return, but the interest return fluctuates with the economy.
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Variable Life also builds cash values. Where whole life and Universal Life invest in fixed accounts, a Variable Life policy provides growth similar to mutual funds. You may experience years with good performance or just the opposite depending on the funds' performance. Like traditional whole life and Universal Life, this type of policy is also heavily loaded with fees. Premiums vary from zero to a maximum amount.

Many financial advisers recommend term insurance rather than any other life insurance because the accumulated savings (cash values) on whole life policies have much lower rates of return than other types of investments, even with the tax savings factored in. It may be better to purchase pure insurance (term) and put your savings into a separate investment account. The cost of whole life insurance can be ten times the cost of basic term insurance, so few people can purchase as much insurance as they need.

How much life insurance do you need? Your calculations should include enough for (1) funeral expenses, (2) mortgage and other debts, (3) education expenses for dependent children, and (4) income replacement. For most families, the total amount may be as much as $1 million or more. With term insurance, you can increase your death benefit by hundreds of thousands of dollars for just a few hundred dollars a year. Kiplinger's addresses the critical question of how much insurance is enough:

> Standard formulas, such as buying coverage equal to eight to ten times your annual income, are inadequate shortcuts. Online calculators are apt to tell you to raise your coverage by $1 million even if you already have insurance. The truth is that life insurance is a personal affair. Two couples may earn equal salaries, but it's silly to say that someone with four young children should have the same coverage as empty nesters with no mortgage and a substantial retirement fund.[30]

Whole life is the type of insurance my husband and I purchased early in our marriage. A number of years after we took out the policy, during the mid 1970s, the media began exposing the low rate of returns in the insurance industry, which spawned the growth of Universal Life and Variable Life insurance. These newer types of life insurance pay higher rates of return than traditional whole life, but they also take on more risk. There are some good reasons to purchase whole life insurance; however, most families would be far better off keeping insurance and investments in separate accounts.

LONG-TERM CARE INSURANCE

Long-term care insurance (LTC) is not just medical care and nursing home care. It includes all the assistance you could need if you have a chronic illness or disability that leaves you unable to care for yourself for an extended length of time. Your long-term care may be in a nursing home, assisted living facility, or your own home. Most long-term care services are provided to the elderly, but a young or middle-aged person who has a serious illness or has been in an accident could benefit from long-term care.[31]

Approximately 19 percent of Americans aged 65 and older need long-term care. Among people age 85 or over, that figure increases to 55 percent. Most people are cared for at home by family members or friends, but more and more people are entering nursing homes. A study conducted by the U.S. Department of Health and Human Services found that 40 percent of 65-year-olds will enter a nursing home, and about 10 percent will stay there five years or more.[32]

Long-term care is expensive. One year in a nursing facility can easily top $50,000 depending on where you live. However, bringing an aide into the home 24/7 is expensive, too. If you don't have coverage, you will pay out of pocket until your money runs out and you qualify for Medicaid. As with all types of insurance, rates rise dramatically with age.

DISABILITY INSURANCE

Americans have a one in five chance of becoming disabled. Therefore, disability insurance is critical when your earning power is your greatest asset. In fact, it is probably just as valuable as life insurance. Disability insurance pays a monthly benefit if you cannot work because of sickness or accident. Benefits are usually limited to 50 to 70 percent of your salary, depending upon your policy.

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[30] kiplinger.com, July 21, 2011.
[31] Ibid.
[32] Ibid.

There are two types of disability insurance. *Short-term disability* usually begins when sick leave runs out. *Long-term disability* pays where short-term disability leaves off and varies in the length of payment. If being out of work would create a serious financial crisis for you, then you need disability insurance.

RENTER'S AND HOMEOWNER'S INSURANCE

Renters and homeowners both face the same risk when disaster strikes. If you are a renter, your landlord or condo association may carry insurance, but it only protects the building's structure and not the personal items inside the building. Renter's insurance protects your home's personal effects in case of disaster, and it is available at very low rates.

People frequently try to save money on their homeowner's insurance by under-insuring their homes for less than 100 percent. Your home should be insured for the cost to replace it—the construction costs with today's dollars—and not for its market value. This amount should not include the value of your land, but it should include the contents of your home. Insurance companies usually consider 90 percent of the replacement cost as the full value of your home.

Consider adding additional coverage for catastrophes (hurricanes, earthquakes, flooding, etc.) and valuables (jewelry, art, computer equipment, etc.). Check with your agent to make sure you have adequate coverage. You can also save some on your premiums by having protection devices, such as smoke detectors and deadlock bolts. Another way to save on homeowner's insurance is to purchase your policy from the same insurance company you use for auto insurance.

Don't make the mistake of assuming that your coverage will cover a loss up to that amount if your house is underinsured. If your house is valued at $300,000 but your policy's coverage is only $180,000, then your insurance company will only pay 60 percent of your loss. Therefore, if you suffer a fire resulting in a $40,000 loss, you will only receive $24,000 (60 percent of your loss).

AUTOMOBILE INSURANCE

Automobile insurance is not optional in most states and should never be considered optional by a driver since a lawsuit could cost you your entire life savings. If you live in a no-fault state, such as Florida, your insurance company will have to pay even if an accident is not your fault. Most automobile insurance contracts cover the following areas:

Collision. This covers any damages to your personal vehicle when it is in a collision with another vehicle. Your car is considered totaled if the damages exceed a percentage of the car's value; however, there is no set percentage since different companies use different rates.

Comprehensive. This covers any damages to your vehicle caused by theft, fire, hail, vandalism, flood, etc., not caused by a typical accident.

Liability. This covers any property damages you do to others (such as damaged property and vehicles) and any bodily injury you do to others (such as medical expenses, pain and suffering, and lost wages). It also covers liability which occurs when a passenger in your vehicle is injured from an accident for which you are responsible. All states except New Hampshire require drivers to purchase liability insurance.

Liability is quoted in two or three amounts. For example, **100/300/50** would mean that your policy pays claims on liability from injuries in one accident up to $100,000 *per person* or up to $300,000 *per accident* and property you damage or destroy up to $50,000. If you cause more damage than you have insurance for, then you are financially responsibility for those damages and can be sued for the amount not covered by your insurance. The Insurance Information Institute recommends carrying a minimum of $100,000 in bodily injury protection per person and $300,000 per accident.[33] Experts in the insurance industry agree with this recommendation and also advise carrying a minimum of $50,000 for property damages.

Medical Coverage. This covers medical expenses, regardless of fault, when the medical expenses are caused from an auto accident.

Personal Injury Protection (PIP). This covers medical expenses for the insured driver and passengers, regardless of fault, caused from an auto accident. Fewer than half the states require PIP coverage, but it is required in Florida. If you have good health and disability insurance, you may not need PIP coverage.

Uninsured/Underinsured Motorist. This covers your car's damages in an auto accident that is caused by a driver who does not have liability insurance or who is underinsured.

Neither collision nor comprehensive insurance is required by any state, but your lender may require you to carry coverage until the car is paid in full. After your vehicle is paid off, you have the option of dropping the collision and comprehensive insurance.

Extras you can purchase are rental reimbursement, roadside assistance, and gap coverage. Rental reimbursement covers the cost of a rental vehicle after your car has been damaged in an auto accident. Roadside assistance covers expenses due to roadside breakdowns. Gap coverage pays the difference between the actual value of a vehicle and the amount left on your auto loan when your vehicle is totaled.

WAYS TO SAVE ON AUTO INSURANCE

There are ways to save on auto insurance without reducing your liability. One way you can dramatically decrease your premiums is by increasing your deductible. A *premium* is the amount paid for insurance, and a *deductible* is the out-of-pocket expense we would pay if we had an accident. When my teenage son began driving to school occasionally, our premiums increased from about $1,000 per year to about $3,000 per year. We changed our deductible from $250 to $1,000, which decreased our premium by about $1,000 per year. Of course, if you do this, you must have emergency funds set aside for this purpose.

[33]insure.com, July 21, 2011.

Keep in mind that a teenage driver can endanger your assets! It's not just the cost of coverage. Automobile insurance for teenagers is extremely expensive, especially for males. Should your teen become involved in an accident, you can be named in any legal action. One way to protect your assets is to put your teenager's car in his or her name.

Prices vary from company to company, so comparison shop. Get quotes from at least three insurers, and make sure you are comparing the same coverage in each quote. Don't shop on price alone, however. Consider the company's reputation, customer service, and discounts offered.

Always check the cost of insurance on a car before you make the purchase since there can be big differences in rates between models. Check out insure.com's car insurance comparison tool to research average premiums for several thousand models.

If you have an older model car that has a low cash value, consider dropping the collision and/or comprehensive coverage. If you do this, you will need money in your emergency fund for this purpose. Never cut uninsured/underinsured motorist and medical coverage! Look for coverage in your policy you may not need, such as roadside service and rental reimbursement.

Ask for all discounts that apply to you. Your insurance company may offer a variety of discounts, such as:

- having completed a driver's education or defensive driving course
- having more than one car insured
- having auto and homeowner's with the same company
- being accident free for a period of time
- being a senior citizen
- being a good student
- being a non-drinker

INSURANCE TO AVOID

Credit life insurance is the most overpriced insurance you can buy and is sold piece by piece to consumers who are buying big-ticket items, such as automobiles and appliances. Retailers use deception to sell this coverage. A finance agent for the retailer might offer it as "only $5 extra per month." The way to cover items like these is to buy one policy that covers all your needs because credit life insurance is grossly overpriced. A good rule of thumb is to never buy insurance from a lender.

I have never purchased credit life insurance for these reasons but found myself the unwitting owner of a credit life policy on my automobile. It was added on to our contract without our authorization when we purchased the car. After signing dozens of papers, we later discovered our signature authorizing a credit life policy that added about seven hundred dollars to the cost of our car! We were never asked about it and most certainly would have turned it down.

When I couldn't get the dealership to respond to my requests to drop this coverage, I contacted the Georgia insurance commissioner. That office put me in contact with the insurance company in Texas, who dropped the coverage and forced the dealer to reimburse my creditor for the insurance, which ultimately reduced the payoff on the car. Had we felt the need to have life insurance on our car, we could have purchased a $20,000 term policy for a small fraction of what this policy cost.

Extended warranties on automobiles and appliances give retailers big profits on sales. You may have good reasons for purchasing an extended warranty. Statistically speaking, however, the chances of collecting are low relative to their cost. I once had an automobile finance manager try to convince me to purchase an extended warranty by saying: "95 percent of our new car owners buy extended warranties." I didn't have the courage to challenge this statement, but I sincerely doubt that it was true.

Avoid purchasing **service contracts** on appliances because, just like extended warranties, the chances of collection are low. Department stores like Sears make a fortune selling service contracts on their products. Other types of insurance to avoid include:

Charge card insurance (insures you against unauthorized credit or debit card charges)
Note: U.S. federal law limits your liability on credit and debit cards to $50
Credit disability insurance (makes payments for you if you become disabled and can't work)
Mortgage life insurance (pays off your house if you die)
Air travel life insurance (covers accidents only during the flight itself)
Waiver of premium (pays premiums on a life policy if you become disabled)
Rental car insurance (check with your insurance company to see if it will cover a rental car)

CONCLUSION

Insurance is a necessity in our modern world. We should not refuse to pay for insurance that is needed by our family. Failure to do so assumes that others will have to support us if disaster occurs, such as a long hospitalization stay, an automobile accident that injures ourselves or others, a fire that destroys our home, or the death of the breadwinner. However, consumers often purchase too much insurance, the wrong kind of insurance, or insurance that is unnecessary. This is a waste of money and, as we have already learned, it can mean the loss of multiple dollars for the future.

Caveat emptor! Let the buyer beware! Be careful to buy insurance only from reputable agents and reputable companies who have high ratings from A. M. Best. Don't let high-pressure sales people "few-dollar" you into the poorhouse. Remember, financial independence is only an illusion. You cannot insure every risk.

The prudent see danger and take refuge,
but the simple keep going and suffer for it.
Proverbs 27:12

SCRIPTURES TO LOOK UP THIS WEEK

Directions: Look up the following scriptures and write a summary for each.

Ecclesiastes 11:2 ____

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Ecclesiastes 9:10 ____

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Proverbs 10:4 ____

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Proverbs 12:11 ____

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Proverbs 22:4 ____

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Proverbs 24:33-34 ____

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II Thessalonians 3:10-13 ____

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Colossians 3:23-24 ____

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