

Insurance is the area in most people's finances that they spend the most amount of money on but they understand the least. The average American family spends \$2,000 to \$5,000 per year on insurance. Outside of debt, this is where most people can save the greatest amount of money.

Insurance is a very valuable asset. It is also important to have the right coverage for the right purpose. As with all areas of spending, buying something you don't need is a terrible waste of money.

Insurance can have such a dramatic impact on people's financial life, both in terms of the amount of money spent and in terms of the money you receive in times of financial crisis. Therefore it is extremely important that you become as educated as possible about insurance. Don't simply rely on what you learn about insurance from this article.

Do your own research. Go the library or bookstore and you will find dozens of books designed to help the average person understand insurance better. Information and education are two of your most powerful money saving strategies.

First it is important that you understand some basic concepts regarding insurance:

1. The purpose of insurance is to protect you from catastrophe, not inconvenience.

You should insure yourself against large or catastrophic losses - ones that could wipe you out financially - don't insure losses that you can afford to pay out of your pocket. You'll pay much more in premiums than you need to if you expect insurance to pay for everything.

2. When you buy insurance, you (almost) always lose financially.

For most of us, we will pay far more in premiums than we ever receive back in claim payments. When you think about it however, that's good. While you're happy to have the security of insurance, do you really want to collect? Would you really want to collect a settlement because your house burned down? Get a new car because yours was totaled? Have your heirs

received a \$250,000 death benefit?

All insurance can do is protect us from financial loss and hardship. Major loss takes an emotional toll that cannot be compensated for. Insurance companies are designed to be profitable, to make money based on the odds of misfortune - it's similar to gambling in that only a few people come out ahead, receiving more in claims than what they paid in premiums. Nonetheless, we need insurance, just in case.

3. When buying insurance, you should assume as much risk as possible.

Assuming risk means be willing to cover more of the smaller losses out of your pocket rather than ask the insurance company to pay for them. Why would you do this? Wouldn't it be great if they paid for everything?

Actually, no it wouldn't. One of the biggest costs insurance companies have is the administrative cost of processing and paying a claim. This cost is a constant, it is the same whether your claim is for \$250 or \$2500. The more claims you file, the greater the company's cost.

When you have a low-dollar (say \$250) deductible as compared to a high-dollar deductible (say \$1000), an insurance company's potential cost is increased in two ways. First, they will have to pay more in the case a claim is filed (everything beyond \$250). Second, they will have more administrative costs because more claims will be filed with a lower deductible.

By raising deductibles, you increase the amount of loss you assume responsibility for. This decreases the potential cost to the insurance company. This decreased cost is passed on to you in the form of lower premiums.

4. Avoid wasting money on duplicate coverage and specialty coverage.

Duplicate coverage exists when two or more policies cover the same person for the same loss. For example, perhaps you and your spouse both have health insurance through work. Insurance laws dictate that you cannot profit from a loss. Therefore, you cannot be paid from two different policies for the

same loss. Hence, duplicate coverage is a complete waste of money.

Avoid specialty policies or policies with narrow coverage (flight insurance, cancer policies, a towing rider on your auto insurance, etc.). There is a fixed cost of issuing and maintaining a policy. You pay this cost with all policies, so the fewer policies you have by combining coverage, the better. Here's what your policies should cover in general:

- Health insurance should cover all diseases.
- Disability insurance should replace regular income.
- Life insurance should pay off all your bills and provide income without buying separate credit insurance.
- Auto insurance should cover you when you drive any vehicle, including rentals.

AUTO INSURANCE

Auto insurance is the largest insurance expense for most families. People tend to overpay for auto insurance because they buy the same type of coverage they have always bought and assume their needs never change. Let's look at some powerful money saving strategies for auto insurance:

- Raise your auto deductible from \$200 to \$500 for collision and comprehensive coverage and you can save as much as 30% on your premium. With the national average annual auto insurance premium of \$1000, raising your auto insurance premium can **save you \$300 per car, per year.**
- Avoid specialty coverage like emergency road service, towing, specialty coverage of audio equipment. This is insuring losses you can afford to cover yourself, which is a losing proposition. **Save \$50 per year.**
- Avoid policies that duplicate coverage. Don't buy medical coverage through your auto policy (other than the state minimum required amounts). The general health policy is a better value and already covers such health problems.
- When the blue book value on your vehicle sinks to \$2000 or less,

consider dropping collision and comprehensive insurance. People think collision and comprehensive insurance will replace their car if totaled. NOT TRUE! If your car is totaled, you will be paid the auction value (less than the trade-in value) less your deductible. This will not replace your car. Save money with the decreased premium and assume the risk yourself. **Save \$500 per year!**

- Only file claims for more than \$500 in damage. When you file claims, rates will be raised. Don't use the insurance, just because you have it – use it when you need it!
- Drivers under age 26 have the highest rates. If you are a parent paying the bill, put your kid's car in your name and on your policy to save money on premiums. Of course, any accidents they may have will affect your insurance.
- Don't assume that just because one company has good rates for your friend that you will get good rates as well. Rates vary within a company from driver to driver depending on gender, age, driving history, type of car, amount of driving, profession, etc.
- Shop around for price quotes every year, even if you have a good rate now. Why? Auto insurance rates are updated at least every year. These rates reflect how much the company paid in claims last year. Have you ever had your rates go up even though you didn't have an accident? Your rates with another company might go down if their loss experience is less than your current company.

Every company has different prices in different areas at different times. Some of the companies that consistently offer the best rates include:

- Aetna: (203) 273-0123
- AIG: 800-807-9458
- GEICO: (301) 986-3000
- USAA: 800-531-8319 (for people on active or reserve military duty and their children)
- USF&G: (301) 547-3000

What coverage do you need? All states have minimum coverage

requirements. In Minnesota, for example, the minimum coverage requirements are:

- personal liability - \$30,000 per person / \$60,000 per accident.
- personal injury - \$20,000.
- property damage (to others) - \$10,000.
- Under/uninsured motorist - \$25,000 per person / \$50,000 per accident.
- It is recommended you have liability insurance equal to the amount of your net worth. In today's lawsuit-happy society, you can be taken for everything you have. You should have only the minimum injury coverage, as your health insurance will cover you there.
- If you have a large net worth, you should consider getting umbrella liability coverage. It costs around \$200/year for \$1,000,000 coverage. Its purpose is to protect your assets from lawsuits.
- The cost of insurance is different for different makes and models of cars. Don't believe what car salesmen tell you about the cost. Call your agent to make sure.
- The Insurance Institute for Highway Safety's free booklet "Injury, Collision & Theft Losses" can tell you which recent models have racked up better or worse insurance claims. For a copy, write to Publications, P.O. Box 1420, Arlington, VA 22210.

Get every last discount you're entitled to. Discounts vary from state to state and company to company, but the following list of discounts, based mostly on information provided by State Farm, will give you a notion of what's out there.

Note that an auto insurance policy is made up of a number of different types of coverage. Two of them together, collision and comprehensive, account for about half of the premium. Discounts often apply to some coverage but not to others. Here are some common examples of insurance discounts:

- **Accident-free.** After three years without a chargeable accident, policyholders get a 10% break on collision, comprehensive and several other types of coverage; after six years, the discount rises to 15%.
- **Multiple automobile.** Insuring more than one car with the same company can mean a discount of 15% on most coverage.

- **Short annual mileage.** If you drive your car less than 7,500 miles a year, you may get about 15% off.
- **Low "damage-ability."** That's insurance jargon for a car that's statistically less likely to result in an expensive claim, either because it's cheaper to repair or less appealing to car thieves. A typical discount is 10% to 30% off collision and comprehensive premiums.
- **Good student.** Discounts of up to 25% are available to unmarried drivers under age 25 who rank in the top 20% of their class, have at least a B average or the equivalent, or are on the dean's list or honor roll at their high school or college. If the student is off at school more than 100 miles away, ask about an additional discount.
- **Age 50.** If you're 50 or older with no unmarried drivers under 25 hanging around the house, you can get 10% off the usual adult rate.
- **Defensive driving course.** If you complete a course sponsored by your state, you'll often be eligible for a discount, usually around 5%. This discount frequently applies only to drivers age 55 and up.
- **Passive restraints.** If your car has airbags or automatic seatbelts, you'll save up to 40% on some coverage. Antilock brakes will also get you a break (commonly about 5%) at some insurers and in some states.
- **Non-commuter.** Driving less than 30 miles a week to and from work will earn you a 15% discount off the rate paid by drivers who rack up 100 or more miles. If you participate in a carpool, you may also be eligible for a discount.
- **Anti-Theft devices.** Depending on your state and the type of device, you could save up to 15% of your comprehensive premium. This discount is worth checking out before you sink a lot of money into a security system.

PROPERTY/HOMEOWNER INSURANCE

Of all the things you need to insure, your home – most likely your most expensive asset – is probably at or near the top of your list. Here are some tips on how to save money while still feeling secure that your home and your investment is adequately protected.

- **Raise Your Deductibles.** The Insurance Information Institute, an industry group, says raising a \$250 deductible to \$500 will typically save you up to 12% on your homeowners premium. The average homeowner premium is \$500. By raising your deductible to \$500, the average homeowner can **save \$48 per year.**
- A \$1,000 deductible will save you 24%, and a \$2,500 deductible as much as 30%. Raising deductibles this high can **save you \$120 to \$150 per year.**
- **Get rid of specialized coverage.** It often only covers small risks: things you should cover yourself.
- **Get replacement value coverage for your home and its contents.** It costs 10 to 15% more but because many items depreciate quickly, experts believe replacement value is a better value than market value coverage.

LIFE INSURANCE

Most people typically misunderstand life insurance. That's a shame because many people overspend tens of thousands of dollars on life insurance over their lifetimes. This is where we must not forget to apply our basic laws of insurance, especially #1 – "The purpose of insurance is to protect against catastrophe" and #2 – "You almost always lose financially."

It is important to first understand the specific purpose of life insurance. The general purpose is to replace the income of the person who dies. One way to look at life insurance is as a "guarantee" of completing one's financial plan. When the insured dies, if the insurance benefit is large enough, it can be invested and generate enough interest income each year to replace the income of the deceased.

Most people make the assumption they will always need life insurance. Hopefully however, as one's estate or net worth increases, the need for life

insurance will decrease because the value of the estate can provide enough interest income to replace lost income.

Given the purpose for life insurance, let's look at who needs it. You don't need to buy products that you don't need. Once you determine if life insurance might be something of value for you, then we'll look at different types of life insurance.

Who Needs Life Insurance?

The people who typically need life insurance are income earners with dependent children. If these income earners die, their life insurance should provide a lump sum of money which can be invested to produce enough interest income to replace lost income. A spouse who stays at home with children, even if he or she doesn't earn an income, should be covered as well. If the primary caregiver of a couple's children dies, the other spouse would require additional income to provide childcare while the he or she continued to work.

Others who need life insurance would include single-income couples where one spouse stays home and is dependent upon the other's income.

In general, from a personal finance perspective, these are the only types of people who need life insurance. Please be aware however, that there are specific circumstances where other factors determine if life insurance is needed. Some examples are business ownership, large estate management and income tax strategies. For the typical person, these scenarios do not come into play, so these situations are not included in this overview.

Do children need life insurance?

10 to 15% of life insurance is sold to children. This doesn't seem to make much sense since they don't have dependents or income. Life insurance for children is typically sold as a "savings plan" for college or on the basis of parents "caring about and loving" their children. We'll look more at this concept of using life insurance as a savings plan. You will see that if you are looking for an investment for college for your kids, it is difficult to think of any investment that costs more and gives you less of a return on your

investment (premium) than life insurance.

Do single people need life insurance?

25% of all life insurance is sold to single men and women. Single people don't need life insurance unless they have dependent children. Why would they need to replace their income (primary purpose of life insurance) if no one, other than themselves is dependent on it?

The insurance industry gives several reasons why singles and children should have life insurance. One argument says the earlier you start a life insurance policy, the lower your premiums will be. We'll see later how misleading this concept is, but for now realize just as there is no such thing as a "free lunch" in life, there are no "freebies" in life insurance. Another reason used to sell life insurance to children or single people is the concept of guaranteed insurability. You may not need insurance now, but you might in the future. Guaranteed insurability means you are guaranteed the right to buy insurance, even if you develop a terminal disease and wouldn't otherwise be eligible for life insurance. We'll see how this is misleading as well.

Types of Life Insurance

Though life insurance is sold in many different formats, all life insurance is really just a variation of three basic types of life insurance: Term Life Insurance, Whole Life Insurance and Universal Life Insurance.

Term Life Insurance

Term Life Insurance is "plain vanilla" insurance. 100% of the premiums paid go into protection for your heirs. If premiums are discontinued, the coverage ends. It is the least expensive form of life insurance, yet it does everything most people need a policy to do. Simply, it protects against the catastrophe of dependents losing their income source.

Whole Life Insurance

Whole Life Insurance is a combination of insurance and an investment. A

portion of the premium goes into what is known as “cash value.” This is the most expensive form of life insurance because you overpay your premiums, at least in the early years of the policy. You pay much more than the cost of the insurance, sometimes as much as 1,000% more to create the cash value. Whole Life is sold as an investment as well as insurance protection.

Universal Life Insurance

Universal Life Insurance combines insurance and investment. It is similar to term insurance in that the cost of insurance coverage is low. It is similar to Whole Life in that you overpay premiums to build an investment amount, like cash value. With Universal Life, you can choose the amount of money (within limits) that goes to paying for the insurance and the amount that goes to build the investment portion of the policy.

Life Insurance Myths and Realities

Term Life Insurance is typically the least expensive type of insurance, often as much as 80 to 90% less in price, yet many people buy other types of life insurance. Why is this? Let’s look at how Whole Life and Universal Life policies are presented so that people look at them in the most favorable light.

Myth #1 – Whole Life Insurance is an Investment.

When you buy a Whole Life policy, you will pay the same premium every month and will have a fixed amount of death benefit. One stated benefit of Whole Life is that it’s an insurance policy with an investment plan, the cash value that increases in value. Some of your premium goes into cash value so it increases over time. Therefore, most people believe that the cash value is an additional amount of money your beneficiaries would receive, beyond the insurance amount or it is something you would receive if you cancelled the policy.

Here’s the ugly truth about Whole Life Insurance cash value. IT DOESN’T BELONG TO YOU! Cash Value is the property of the insurance company. Many people mistakenly think that if they have a \$100,000 policy with a \$20,000 cash value, and they die, their heirs will receive the insurance amount and the cash value, or a total of \$120,000.

Here's what really happens with cash value. If you die, your beneficiary receives the insurance amount OR the cash value amount, whichever is larger, but they don't get both! So, with Whole Life, you spend years overpaying premium to build cash value, but the cash value doesn't belong to you and you don't get any of it! Does that sound like a smart way to buy life insurance?

Myth #2 – If you need money, you can borrow against the Whole Life cash value.

This is true, but again, it isn't as good as it sounds. People assume the cash value belongs to them and we know that's not true.

When you borrow against cash value, you are charged interest. Even though you typically expect to pay interest on a loan, this surprises people because they think it's their money to begin with. Furthermore, if you borrow against cash value, any loan that is not repaid is subtracted from your death benefit. Say you have a \$100,000 whole life policy and you borrow \$10,000. If you die before paying it back, your heirs only receive \$90,000!

Myth # 3 – Universal Life Insurance is a good deal.

Universal Life Insurance was created in the early 1980s. Many upstart insurance companies were promoting a new alternative to Whole Life. They proposed that you should take the money you would use for Whole Life premiums, buy an inexpensive Term Life policy and invest the remaining amount of money you would have spent on Whole Life. Universal Life insurance was positioned as being similar to Term Life because the insurance costs were low and similar to Whole Life but with more flexible and higher earning investment choices.

For most people, Universal Life is a better deal than Whole Life, but sales commission charges, administrative fees, and other charges are very high. These expenses mean that your investment return in a Universal Life policy is typically much lower than it would be with a regular investment, like a mutual fund.

For example, if you spend \$1200 a year on a Universal Life policy, the

salesperson typically makes around an 80% commission, or \$960. If you could buy the same amount of insurance in a Term Life policy for \$200 dollars a year and invested the other \$1000, you would probably only pay about \$150 in commissions. If you want the most for your money, because of high sales costs and other reasons, you typically are better off separating your investments from your life insurance.

Myth #4 – Disappearing Premiums.

Some Universal Life policies are sold with the idea that your premium will eventually “disappear.” The idea is that once the investment portion grows large enough, it will produce enough income to cover the premium cost. There are several problems with this. First, because of high expense charges, it can take a very long time for cash value to grow to this point. Returns quoted are often current rates which are typically much higher than guaranteed rates. Second, remember that the investment portion of the policy and any interest growth it builds belongs to you in a Universal Life policy. It is still your money paying the premium – you just don’t have to write a check for it each month!

Myth #5 – Term Insurance is not a Good Long-Term Choice.

While it is true that the cost of term insurance goes up as you get older, this should come as no surprise because cost of any life insurance policy increases each year. The difference is in how the premiums are paid. While your Whole Life or Universal policy premium may stay the same every year, the insurance still costs more. The cash value or investment portion of the policy funds the increased costs. These extra costs as you get older are actually costs you have paid for in advance with higher-than-necessary premiums when you were younger.

Though term rates go up over time and eventually become higher than the Whole Life or Universal Life rates on policies you started years ago, the cost of insurance is based on your age and actually remains the same regardless of the type of policy you have. The Whole Life and Universal Life policies just avoid increasing your premiums by taking from the cash or investment value of the policy. Bottom line, when life insurance costs go up each year, you always pay for it. The difference is whether the additional cost comes

directly from your pocket or from your earlier over-payment of premiums.

A Final Word On Life Insurance

We feel that life insurance is an essential portion of a sound financial plan. We just have two basic areas of disagreement with the life insurance industry in general. First, we believe in most cases, Term Life insurance provides the best value. Second, we believe that for most people, with good spending habits, you won't need life insurance for your entire life because you will be able to build investments large enough to replace your income.

One word of caution:

If you currently have Whole Life or Universal Life Insurance policies, **DON'T CANCEL THEM.** First shop around for term rates. Look at the rates for 10, 20, 30 years into the future or however long you think you will need the coverage. When you find a policy that makes sense for you, apply for it. If you are accepted, then you can decide what to do with your existing Whole Life or Universal Life policy. The last thing you want to happen is to find out you can't get another Life Insurance policy after you have cancelled your existing policies.

Canceling a Whole Life or Universal Life policy usually wastes a great deal of money. Even if you want to stop paying premiums on these expensive policies, there are ways to get the maximum value from a policy while you stop paying on it. If you just cancel a policy, you may receive what is called a surrender value, but this is typically much less than the cash or investment value.

Consider a few options. Check with your agent and see how long your coverage will continue if you stop paying premiums. Universal Life policies often have this feature. Find out what the maximum amount you can borrow is and what would happen if you cancelled after borrowing. See if you can convert your policy to Term Life (be sure to compare rates). See if you can convert your policy to what are called "Paid Up Adds" – this is insurance that is completely paid for. Figure out what the best option is for you using your smart spending skills.

HEALTH INSURANCE

- Look at the benefits of raising your deductible, even if your employer pays part of the premium.
- Many people have HMO/Managed Care coverage - research your coverage and see if there are ways you can save money. Even if the employer pays for health care, many employees pay an increasing portion.

GENERAL

- Don't overlook disability coverage. You will need 60 to 75 percent of your salary coverage until you can return to work. The eligibility period is the key to controlling the rate (1 month, 3 month, 6 month, etc.).
- Consider linking your car and home insurance. Some insurers will give you a better price (about 5% to 15% off) if you buy both policies from them. Having your home and auto policies with the same company may also be a requirement if you want to buy an "umbrella" policy, which extends your total liability coverage to, for example, \$1 million. An umbrella policy is a worthy idea if you have a lot of assets to protect.
- Call for your state's insurance guide. More than half the states publish consumer guides with comparison prices and other useful data on the insurers that do business there. The information may not be totally up to date or a perfect match for your situation, but it's a good place to start. Phone your state insurance department for details.
- Shop both independent and "captive" agents. Independents represent a number of companies and can, in theory at least, get you competitive price quotes. (Note, though: The rap on independents is that some of them may be cozy with just one or two high-priced companies.) Captive, or "exclusive" agents, represent a single company – often a big one such as Allstate or State Farm. Call as many agents as you have the time and patience to deal with, but try to get three price quotes at a minimum. You're likely to find quotes at least a hundred dollars apart for the very same coverage.

- Don't ignore the "direct writers" who don't have agents. A handful of companies, including some very good ones, don't use agents at all, but instead sell directly to certain groups. Highly regarded USAA (800-531-8000), for example, sells its policies directly to active or reservist military officers and their families. GEICO sells directly to government employees.