THE COMPLETE IDIOT'S GUIDE® TO

Managing Your Money

Second Edition

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alpha books

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Chapter 25

Getting the Right Insurance Coverage for Your Needs

In This Chapter

- Why you need to protect yourself
- Insurance strategies that will save you a few bucks
- Assessing your life, health, and wealth
- Insurance you don't need

Many folks believe that paying a lot of money on insurance premiums is like flushing your money down the toilet—that is, until tragedy strikes. Then those expensive insurance premiums seem like the best thing since the invention of the paper clip.

You need to insure your health and protect your wealth. And the more you have to protect, the more you'll spend on insurance. Typical insurance policies include homeowner's insurance to protect your home, automobile insurance to help in case of an accident (whether or not it's your fault!), life insurance to help your loved ones financially when you die, and disability insurance to cover you if you aren't able to perform your current job.

This chapter defines the types of insurance you need. In addition, it will help you get the best buy for your insurance dollars and show you how to shield yourself from unexpected disasters.

Term Insurance 101

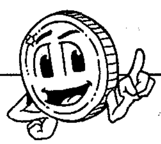
Term insurance is usually the least expensive form of insurance coverage and is very affordable when you're young. As you get older, your risk of dying increases, so the cost of term insurance goes up. This risk is known as the *mortality rate*.

As with most other insurance coverages, you pay premiums annually, semiannually, or quarterly for term insurance. For this premium, you receive a predetermined amount of life insurance protection. If you are the insured spouse and you die during the term you are insured, your beneficiaries will collect. If not, all of the premiums are gone, since there is no cash buildup in the policy, as there is in other types of life insurance policies that promote savings features (and hefty commissions). You will probably be required to take a physical examination to qualify for term insurance.

Term insurance is very inexpensive, which is why it's a popular life insurance policy. However, it only provides for death protection—there's no build-up of the money you pay in premiums.

When you buy term insurance, you can buy it with level (same) premiums for one year, called *annual renewable term* (ART), and renewable until age 90. Other term policies and specified time periods are typically five, 10, 15, or 20 years. At the end of these time periods, the term insurance is renewable at sharply higher premium levels because you are older and statistically more likely to die during this time period.

Some people refer to term insurance as "renting coverage" because the only way your insurance policy pays out is if you die during this period. The payouts are offered in a lump sum payment or a steady stream of payments to your beneficiaries.



Asset Advisory

Young women who are non-smokers tend to pay the least amount in premiums for term insurance. Because the cost of term insurance does not depend solely on age (where the younger you are, the lower your premiums are), and women live longer than men, women will pay less—especially if they don't light up.

Make sure your policy offers a *guaranteed renewability feature*, so you don't have to take a medical test to continue coverage for another term, especially as you get older. Also, if you have an annual renewable term policy, you can convert it to a whole-life policy—without a medical exam. This is called *guaranteed conversion*, and allows you to convert from rising-premium term insurance to a fixed-premium whole life (cash value policy, which you'll learn about later in this chapter) policy. Here's a tip: If you think you may do this sometime down the road, make sure your term insurance policy is convertible into a whole life policy without another medical examination. There's an additional cost for this provision, but as you get older you'll end up saving more in premiums by doing so and avoiding the medical examination.

Here are some things to keep in mind when looking at a term insurance policy.

- **Make sure the illustrations that your insurance agent gives you show the rates you will pay and the maximum guaranteed rate they can require you to pay.** There is a state law that regulates the maximum guarantees. But remember, policy illustrations are not guarantees—even if they're in black and white. Term premiums are subject to change based on mortality and the insurance company's finances.
- **Compare a *level premium term* policy to an annual renewable term (which increases after each term).** You know that premiums on ordinary ART policies increase in cost every year, right? Well, some companies offer a form of *level premium term,* in which they project that the annual premium will remain the same for 5, 10, or 20 years. At the end of the specified time period, your policy may kick back into a policy that has increasing premiums every year, or remain level for five years and *then* kick back into increasing premiums. Ask your agent if the premiums are projected or guaranteed. Insurance companies are not obligated to meet projected premiums—even if they are in the illustrations they give you.
- **Don't always settle for a short-term level premium policy.** Why? Because the premiums may skyrocket after the short-term is over. Again, because this is the life insurance industry, it depends on the policy. Make sure the agent explains all details in black and white.
- **Choose a guaranteed annual renewable term to avoid medical exams.** This ensures that you do not have to have a new medical exam every year to renew your term policy. Avoid those policies, which are known as *reentry term.*

If you would like quotes on term insurance, contact one of the following quote services. There is no obligation to purchase term insurance, but make sure they can handle the transaction in your state if you do buy a policy.

TermQuote (800/444-8376) maintains a database of 70 companies and will search to find the lowest cost term insurance policy based on your specifications, your age, and health condition.

SelectQuote (800/343-1985) tracks term insurance prices nationwide.

INSurance INFOrmation (800/472-5800) provides only advice—they do not sell insurance—but will find the lowest cost term insurance policy for you and can even reevaluate your existing policy.

Insurance Quote Services (800/972-1104) sends a free booklet "Simple Guide to Insurance Savings," in addition to providing a quote service on low-cost term insurance. They will do a simple analysis on your life insurance needs based on your criteria and personal situation.

Cash Value Insurance

Sometimes known as *permanent insurance*, cash value insurance generally covers longer-term needs because term insurance becomes too expensive as you get older. But beware: Cash value insurance only makes sense for a few people and generates a lot of commissions for the insurance agent (unless you buy low-load or no-load insurance).

Cash value insurance combines life insurance and a savings "account." Most of the money you pay in premiums goes toward life insurance, and a few bucks are deposited into this "account" that is supposed to grow in value over time. Sounds like a winner, huh?

Wrong. The biggest hit your account takes in the early years you're building it is the commission that your insurance agent earns, which is shown to you in the illustration he or she shows you. What most folks don't know is that the commission is built right into the premium you pay for the insurance. It may take years until the true return (what the insurance company promised you) on your account is equal to what it's supposed to be. To find out how much and what portion of your premium is going into your account, ask your insurance agent to show you the *surrender value* on the piece of paper (usually a ledger) he has. If the amount in the first few years is ZILCH, that's what your little account is getting.

All of the cash value insurance policies offer a tax-deferred savings feature to the insurance protection component of the policy. It is merely a death benefit plus an investment fund.

Interestingly enough, both term and cash value policies come in two varieties: participating and nonparticipating. Why all this gobbledygook? It seems confusing, but pay attention and you'll know more about how to make life insurance *work for you* than anyone you know!

Participating insurance entitles you to receive dividends (kind of like stock dividends) from the policy. These dividends are considered a refund of the portion of the premium that the insurance company did not pay in death benefits or administrative expenses over the previous year. This means that if the insurance company is collecting all of these premiums and no one died or administrative costs for the year were low, all the policy holders would get a "refund" in the form of dividends.

So what do you do with these dividends? You can take them as cash—and, of course, pay taxes to the IRS because the dividends are considered income. You can reinvest your dividends and *reduce* the future premiums you have to pay. Or, you can buy additional "paid-up" (more) insurance. The choice is yours.

Non-participating policies pay no dividends, so there's nothing to reinvest. Instead, your premiums are fixed when you buy a policy at a set amount. True, these premiums on a non-participating policy will be less than those on a participating policy, but non-participating policies *do not* offer the perks of reinvesting your dividends for future growth or whatever you choose to do with the money.

Be careful; some insurance company illustrations show that dividends from a paid-up policy can cover the premiums for a new policy when they *don't*. Instead, the new policies will really borrow against the death benefit (like a loan) in order to pay the premiums. Watch out for the fine print!

Because cash value insurance policies are not straightforward (it would make life too easy if they were), here's a rundown of the terms you can expect to hear about from an insurance agent:

- **Whole Life:** Your premium stays the same every year, and your death benefit is fixed. Since the amount of the premium is much more than what you would need to pay death benefits in the early years, the extra money is "deposited" into your "account" (inside the policy), which earns interest and grows tax-deferred. You can choose from two types of whole life policies. In the first, you pay the same level premiums into your old age—where you can borrow against the policy to get some extra cash in your retirement years. In the second, you pay premiums for a fixed number of years only; after that, the cash value in your "account" pays for the premiums. This is known as *vanishing premiums*. But be careful. If you don't have enough cash value built up to pay for those future premiums, your policy will be the thing that vanishes! And then you're stuck with kicking in more money. Whole life premiums are often invested in long-term bonds and mortgages.
- **Universal Life:** Unlike a standard whole life insurance policy, universal life offers you flexibility because it allows you the decision of changing the premium payments or the amount of the death benefit, as long as certain minimum requirements are met. (Sometimes, if you don't meet the minimum requirements or you violate the rules, your tax liability may skyrocket if you borrow or withdraw the money.) *You* decide how to design your policy. You can pay hefty premiums, build up a lot of tax-deferred cash value in your account, and then later change your mind that you want your cash value to pay for your premiums. Or, you can opt for lower death benefits and a larger cash buildup or a smaller cash buildup and higher death benefits. It's up to you. You can even take a cash withdrawal and lower the death benefit. There's no interest expense if you do this, but even if you pay back the withdrawal, this permanently lowers the death benefit. Typically, there's enough cash value earnings to cover the cost of the insurance. Universal life premiums are invested in and reflect the current short-term rates available in the money market.
- **Variable Life:** Even though the annual premiums are fixed, the cash value of your account doesn't earn a fixed rate of return. The growth of your account in the policy depends on what investment choices you make. Generally, the investment choices are mutual funds managed by the insurance company. You have the option of shifting your money around. Note that the death benefit also rises

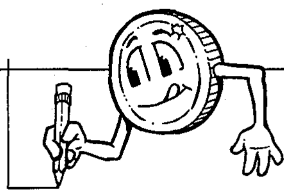
and falls based on the performance, but it will never drop below the original amount of insurance coverage you specified on your contract.

- **Single-Premium Life:** The person who would benefit from this type of policy is someone who is older, has a lump sum of cash to invest on a tax-deferred basis that meets with IRS guidelines, and wants insurance benefits for his or her beneficiaries. These policies can earn a fixed rate of interest (like those in a whole life or universal life), or you can choose your own investment (as in a variable life policy).

Whatever you do, don't look upon a cash value insurance policy as retirement savings or your first means to accumulate growth on a tax-deferred basis. Even if your insurance agent tells you that your cash value account is compounding on a tax-deferred basis, that shouldn't be the reason to buy a cash value policy. If you're seeking tax-deferred growth, you should be participating in a company's 401(k) or an individual retirement account.

Insure Your Paycheck!

Have you ever thought about what would happen if you were suddenly unable to perform the work that provides your income? You should. According to the Health Insurance Association of America, if you are between the ages of 35 and 65, your chances of dying are equal to your chances of being unable to work for three months or more because of a disability through illness or injury. It is stressful enough trying to deal with an injury or illness that you don't want to have to worry about whether or not you're going to receive your salary while you're off work.



The Money Line

Some disability factoids:

One year of disability can wipe out 10 years' worth of savings.

Forty-three percent of all foreclosures result from a disability in the family.

Less than 50 percent of the labor force is covered by disability insurance.