Buying Insurance – How to Choose a Policy

By Annette Simon, Mosaic Wealth Management, Bethesda, Maryland
www.mosaicwm.com **Phone: (301)571-2480**

Generally, catastrophic losses with a low probability of occurring are insurable risks. Hence, most people need the following types of insurance:

- Life
- Long-term disability
- Catastrophic Medical
- Long-term Care
- Homeowners (or rental)
- Automobile

The general rule of thumb in selecting coverage is to buy a policy that insures you for the catastrophic loss, and to self-insure for the smaller, predictable losses. Here are some tips on what to look for in the various insurance categories:

Life Insurance

Keep in mind that insurance is intended to cover a loss. In the case of life insurance, the loss is the income that would have been earned by the deceased. If your family has sufficient investment resources to cover their cost of living without your income, you do not need life insurance at all. If they don't have enough now, but they will in 10, 20, or even 30 years, then a term life insurance policy is clearly the best choice for your insurance needs.

Term life insurance is a relatively generic product, as long as you buy from a financially stable company (Ratings of insurance companies are available online – try www.insure.com). Look for the least expensive level-premium policy that matches the term of your need. If, for example, you have small children, and only need life insurance through the years when they will be your dependents, then a 20- or 25-year level-premium policy will be best.

How much life insurance do you need? Again, this depends upon your survivors' cost of living and your other resources. If, in your absence, the family needs $50,000 of income each year, and you already have investments that will generate income of $20,000 then you need enough life insurance to provide $30,000 of income or $600,000 assuming a 5% yield.

Since term insurance is relatively inexpensive, and interest rates in recent years have been it's better to err on the high side. Your family will probably not miss an extra $500 each year, but they will certainly feel the difference between living on the income generated by $500,000 versus $1,000,000 of insurance.

Long-term Disability

Like life insurance, the purpose of disability insurance is to replace lost income. However, while many people have no need for life insurance, most working individuals do need long-term disability coverage. A healthy person's likelihood of experiencing an extended disability at some point in his or her earning years is much higher than his or her probability of dying prematurely.

Disability policies are very complex and vary in how disability is defined, how long you can receive a benefit, whether you will receive a partial benefit for a partial disability, and how long you must wait before receiving any benefits. The best policies define disability as the inability to work in one's own profession, and define that profession as narrowly and precisely as possible. Thus, a neurosurgeon who is unable to perform brain surgery can collect benefits, even if she is still able to practice medicine in another specialty. This type of coverage is getting difficult to find, and many insurers are offering "own profession" coverage for only a few years of disability, providing "any profession" coverage thereafter.

Because disability insurance is intended to replace earnings, many policies provide benefits only until age 65 – even though many people plan to work beyond that age. Better policies offer a lifetime benefit, or at least a reduced benefit after age 65.

Unlike term life insurance, disability coverage is relatively expensive. Selecting a longer exclusion period – the period of self-insurance before disability benefits are paid out – is one strategy for lowering disability premiums. Choosing a 180 day exclusion period (and building your emergency fund to a level that would support your family for six-months) will reduce the cost of disability coverage.

Finally, don't assume that your employer is providing sufficient disability coverage. Many group plans provide only 50% of your base income; others are capped at relatively low income levels. The federal government's disability coverage pays 60% of the employee's salary in the first year of disability, but only 40% thereafter. In many cases, purchasing a private, supplemental disability policy is a very good idea.

Next time: Buying Insurance Continued.