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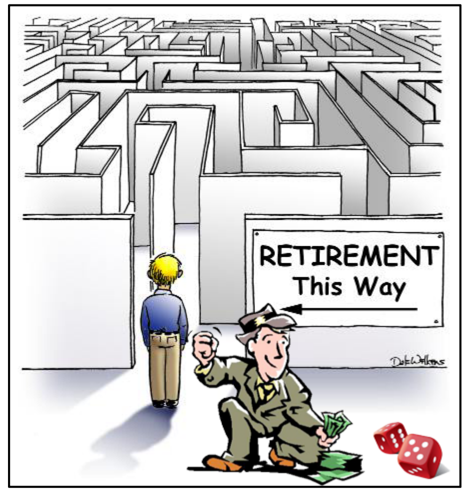
Insurance: Don't gamble away your retirement

Navigating the Retirement Maze



"Fun is like life insurance; the older you get, the more it costs."
-- Frank McKinney (1868-1930), American cartoonist and humorist

When I do a financial profile for current and prospective clients, I always include insurance coverage as part of the review. Why? Because for all the effort that people put into saving and investing during their careers, it can all be wiped out by a single unplanned incident. The purpose of insurance is to protect against adverse events that could derail a family's financial future.

Getting the proper types of insurance, as well as the appropriate amount of coverage, is critical to your financial welfare. So is not purchasing insurance you don't need. I'll discuss the types of insurance that you should consider having, as well as how much to insure.

Insure your health, protect your wealth

One of your major lifetime costs is health maintenance. The Affordable Care Act of 2010, better known as "Obamacare," mandates "minimum essential coverage" for health care insurance. Requiring all individuals to carry a minimum level of health insurance helps ensure that that a medical crisis won't devastate the family fortune. However, getting the lowest cost health care policy available may not be the best choice, particularly if you or a family member has a specific medical condition. Medication costs can vary significantly between plans, as can copays and coinsurance. Thus, when annual enrollment comes around, you should do a "pro forma" of your anticipated medical costs for the coming year, and determine which policy offering is the most cost effective for you.

Medicare is similar, in that different options are available for Medicare Part C (Medicare Advantage) and Part D (prescription drugs). The website Medicare.com includes calculators for evaluating plans and estimating costs. Despite the fact that most people do their Medicare assessment once and then proceed to sign up for the same plan year after year, I strongly recommend doing a reassessment at least every other year, as plans, plan costs, and health needs change, and your initial selection may no longer be your best choice.

Long term care insurance (LTCI), is more complex, as it is a high probability and high cost insurance event, and premiums can be a significant burden on retirement savings. I wrote two columns about LTCI several years ago (available on my website), and the basic rules for assessing LTCI coverage still hold. However, some newer options have appeared in the marketplace since that time. I will cover these in a future column.

Money for your life

Life insurance serves two main purposes: protecting a family financially in the event of an untimely demise, or as a lifetime savings vehicle for high net worth individuals. For the "99 percent" using it for the former, stick with term life insurance, and get guaranteed level coverage until your children or partner are self-sufficient. I come across very few individuals who would benefit from whole life policies, and only certain types of policies.

An equally important type of insurance is long-term disability (LTD), because a working adult is much more likely to become disabled than to die during the course of their career. Most LTD policies kick in either 60 or 90 days after the disabling injury, and typically cover for the duration of the disability or up to age 65. Employers usually provide some LTD, but for higher income individuals it usually isn't sufficient to replace lost income. Another consideration is that if LTD is employer-provided, you will pay income tax on the proceeds, whereas the proceeds of any policies paid out of pocket will produce tax-free income. Consider what your exposure would be to loss of income by either partner, and cover that gap with enough LTD.

Insuring "things"

Homeowners insurance provides coverage of damages to your house, possessions, costs associated with living elsewhere if major reconstruction is required, and liability for injuries that occur on your property. One item worth checking is whether your existing policy covers at least 80 percent of the replacement value of your house, as most insurers will not fully cover losses if this threshold is not met, even if losses are below the insured amount. As for deductibles, the higher the deductible, the lower the policy cost. Most people should be taking a $1,000 deductible, as that is usually quite affordable.

Similar rules apply for auto insurance. There are state mandated minimums, but nearly all drivers should take extra coverage for liability (damage to others' property, bodily injury), underinsured "other drivers," and collision if you can't afford to buy another car out of pocket. Medical coverage for yourself is probably redundant with your health care policies. Again, go with a high deductible that you can easily pay.

This umbrella isn't for rain

The event that seldom happens but can destroy your lifetime financial health is if you or a family member gets sued for injuries sustained on or because of your property. It could be an auto accident, a person slipping on your icy walkway, or a child falling off of your play gym. We live in a litigious society where million dollar settlements are not uncommon, so it makes sense to protect against this possibility.

Many people come to my office lacking "umbrella" liability insurance, which surprises me considering its relatively low cost. In order to get $1 million of liability coverage, your insurance company will first require that you insure to the liability maximums on both your auto and homeowner insurance policies, typically $500,000 per incident. For an additional $200 to $300 per year, umbrella insurance covers the gap between that and the policy limit. Higher umbrella limits cost less incrementally. One in eight personal liability awards are for over $1 million, yet one in five high net worth households do not carry any umbrella liability insurance. This type of insurance is a "must have" for anyone, including those who haven't yet built up their retirement assets but don't want to see a career of garnishments from wages due to a liability settlement against them.

Think of your insurance policies as the protective shell around your lifetime assets. Not unlike Goldilocks, you don't want to carry too little insurance nor overpay for unnecessary insurance, but get the amount that is "just right" for you and your family.

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