The Ultimate Guide to Understanding Insurance

for young professionals

BY

ALLSTREET
WEALTH

The idea of insurance is fairly straightforward.

You have an asset of some form, and you pay an insurance company to protect it.

An asset could be your health, your ability to earn income, your car, your home, or your estate.

If something happens to the insured asset, the insurance company will generally cover the necessary costs.

However, we know that insurance itself and all of the intricacies that come with it aren't straightforward at all.

So we wrote this quick guide to help you get a better understanding of how different kinds of insurance policies work and the role they play in your financial life.

Read the guide

The Importance of Insurance and What It Is

The biggest reason to have insurance is to protect yourself from financial loss.

It's easy to look at the monthly payments and think that money could be better used elsewhere, but the truth is that insurance is a necessity. You hope you never have to use it but when the time comes and you need it, you'll be thankful that you took the time to purchase a proper policy.

Insurance helps keep your financial life on track for when life's unexpected events take place.

Whether you get in a fender bender or a ski accident that takes you away from work for several months, insurance is designed to provide financial benefits for when things go wrong.

Common Insurance Terms

Because there are many different forms of insurance and a lot of industry-specific terms, it's important to get an understanding of the basics:

Beneficiary - A beneficiary is the person set to receive the benefits (usually financial) from an insurance policy, secondary to the policyholder. This is most commonly associated with life insurance policies.

Carrier - Another term for insurance company, the company providing you with your policy

Claim - A claim is when you request funds from the insurance company. For example, if you have auto insurance and someone hit your car, you would file a claim with your insurance company so that they can investigate the accident and properly issue funds if necessary

Coverage - The specific benefits and features of your insurance policy.

Deductible - The amount of money you would pay in the event of a claim before your insurance company begins paying out. The higher the deductible, the lower the monthly premium. The lower the deductible, the higher the monthly premium.

Premium - The amount you pay each month to the insurance company to keep your policy active.

Quote - When shopping for insurance policies, insurance companies will issue a quote, which will outline your monthly premiums and deductible amount. You generally have to provide some personal information for them to produce an accurate quote.

Underwriting - The process of an insurance company evaluating their risk and determining the appropriate costs of a policy.

A Quick Overview of How Insurance Works

While all insurances serve different purposes and function differently, all insurance policies and the process of getting a policy generally follow the same structure:

1. You search online and talk to friends & coworkers to find an insurance provider

2. You request a quote from them to get an idea of the costs by providing details about yourself and your situation

3. If you decide that you want to move forward and become insured by them, you would begin paying premiums to the insurance company (premiums can be paid annually, but are generally paid monthly)

4. Because you’re essentially prepaying the cost of an accident with your monthly premiums, when an event occurs that falls under the scope of the insurance policy, you get paid out in accordance to your policy’s guidelines (which would depend on your deductible and coverage amounts)

Most Common Types of Insurance

In this guide, we're going to break down:

- Health insurance
- Life insurance
- Car insurance
- Disability insurance
- Homeowner and renters insurance
- Umbrella insurance

Health Insurance

For a lot of young professionals, health insurance becomes a topic of discussion just a few months before we turn 26 because we're about to be kicked off of our parent's plan. Health insurance isn't fun to deal with, but having a proper policy is essential. Without health insurance, one unexpected medical event could put a strain on your finances and in some cases, cause bankruptcy. It's unfortunate, but it's the system that we have to deal with.

The most effective way to reduce this risk is by being aware of your options and purchasing an appropriate health insurance policy. Health insurance helps cover a portion of medical costs and each month, you're required to pay a 'premium', which keeps your policy active. The premium you pay is put into a "pool" with everybody else's money and used when a claim payout is needed to be made.

Because insurance policies vary drastically from person to person, you need to be aware of the guidelines for your policy which will include what doctors/hospitals are eligible for coverage, your out-of-pocket max, your deductible, and monthly premiums.

Your employer will most likely have some form of health insurance available as part of your company benefits package and you may not have to pay anything out of pocket, but it's important to evaluate the policy to ensure that it fulfills your specific needs. For self-employed individuals, you'll either need to purchase a private plan through a marketplace, join your spouse's plan, or join an organization that offers group benefits at reduced costs.

All plans offer different benefits and features, but these are a few universal key terms to keep in mind as you search for a plan:

Copayment (copay) - When you receive certain health-related services, such as standard doctor visits or medication prescriptions, you're required to pay a fixed amount (your copay). This amount and services included will vary from policy to policy so be sure to ask questions and get an understanding of what your specific policy provides.

Coinsurance - Coinsurance refers to the cost of care that you share with the insurance company. This is separate from your deductible (which is the amount you pay before insurance kicks in). Coinsurance is most commonly displayed as a percentage, such as 90/10, meaning that the insurance company will pay 90% of the medical bill and you'll pay 10%.

Deductible - Most plans require that you pay a certain amount of your medical expenses before the insurance company starts making payments. For example, if your plan has a $3,000 deductible, you'd need to spend $3,000 on qualifying health expenses before the insurance company would begin covering costs.

Out-of-pocket max - Your out-of-pocket max refers to the most you'll pay for health care services. For example, if your plan had an $8,000 annual out-of-pocket max and you had a surgery that cost $50,000, the most you'd pay is $8,000 and insurance covers the rest.

An example of financial planning around insurance is **pairing a high-deductible health plan with a health savings account (HSA).**

With high deductible health plans you pay more out of pocket each year for medical services and less in monthly premiums, but you also have the ability to use a Health Savings Account (HSA), which provides a unique triple-tax advantage.

The money you save into the account is tax-deductible, the money grows tax-free, and when used for qualifying medical expenses, it can be withdrawn tax-free.

For young, healthy, higher-earners, it can make sense to forgo a lower deductible and opt for a higher deductible and lower monthly premiums to use those dollars elsewhere.

Life Insurance

Life insurance is designed to provide a financial benefit to your beneficiaries after passing. It's tough to think about when you're young, but planning for the worst-case scenario is an essential part of financial planning.

We don't want to think about it, but we need to be prepared for it and that's why getting it done and out of the way is so important.

To determine if you need life insurance, a general guideline is asking yourself "does anyone rely on me financially?"

If the answer is yes, you should probably have life insurance. If the answer is no, you most likely don't need it yet.

Life insurance generally comes in two forms: **Permanent life and Term life**

Term life insurance is much more affordable and what we generally recommend for young professionals. Term policies last a specified amount of time, typically 10, 20, and 30 years. Just like with health insurance, to keep your policy active and you insured, you must pay the monthly premiums.

Permanent insurance lasts your entire life rather than a set amount of years and is much more costly than term insurance.

Policies and benefits can come in many different forms and it's recommended to speak with multiple agents and a trusted advisor to be sure that a permanent policy is right for you and your situation before purchasing.

To determine the size of life insurance policy you need, you have to take a look at your financial picture and obligations. There are many calculators out there that can help you get a rough estimate - this one from Bankrate is solid - but you'll need to evaluate your expenses, debts, replacement of income, college costs, and financial goals to determine the true appropriate amount of coverage.

One back-of-the-napkin calculation commonly used is taking your income and multiplying it by 10, plus $100,000 per child and amount of outstanding debt.

Some factors that play into life insurance and it's costs:

- Your gender
- Your age and health
- Family medical history
- Marital status
- Location and lifestyle

The main reasons you want to have life insurance:

To replace income and pay off liabilities - If other people rely on you financially, life insurance is designed to provide your beneficiaries with financial benefits that should replace your income and cover the costs of current liabilities if a proper policy was purchased. Examples of costs that life insurance could cover include funeral expenses, a remaining mortgage balance, car loans, credit card debt, and future college costs.

To leave an inheritance - Similar to the previous point, some people purchase a larger policy than what they need on paper to be able to provide more financial benefits for their loved ones. Larger policies generally come with higher premiums so this needs to be taken into account, but life insurance can serve a few different roles within a financial planning setting.

Disability Insurance

The purpose of disability insurance is to protect your most impactful asset - the ability to earn income. If you were to become injured or unable to work, disability insurance is designed to issue payouts to help replace a portion of your income. Disability policies come in two forms: **long-term or short-term**.

Short-term disability policies generally pay out 100% of your income for a few weeks to a few months and each policy varies so be sure to check your exact payout structure. Long-term disability pays out a lower percentage, generally around 50-60%, but lasts all the way to age 65. Your employer may provide some forms of disability insurance and it's recommended to enroll in their plans after evaluating the cost, but it's worth determining if the policy provides enough coverage and purchasing additional coverage if necessary.

One thing to keep in mind with disability insurance is whether or not you're paying the monthly premiums on a pre-tax or after-tax basis. You want to pay them on an ***after-tax*** basis because if the time comes and you need to be paid out, you would receive the money tax-free. If you paid with pre-tax dollars, you'd owe taxes on the benefits.

Similar to health insurance, self-employed individuals need to go out and get their own policies to help replace income in the event you're unable to work.

An important distinction to make when selecting a policy is whether it's classified as **any-occupation or own-occupation**.

Any-occupation is much more limiting because if you're unable to perform your job but can do something else, generally no benefits are paid out.

Own-occupation is preferred as it will pay out benefits if you're unable to do your current job. The same short-term and long-term options are available and you need to take the time to evaluate the proper coverage amount for your situation.

Homeowners And Renters Insurance

Determining which type of property insurance comes down to whether you’re renting or you own the place you currently live in.

The biggest difference between homeowners' and renters' insurance is the addition of “dwelling” coverage. This covers physical damage to the property itself and since renters are not responsible for the building, dwelling coverage is only included in homeowner policies.

Generally, it’s required to have homeowners’ insurance to get a loan and landlords typically require renter’s insurance for tenants.

In general, renters and homeowners’ insurance both cover personal property, personal liability, some weather/natural events, abnormal living expenses, and medical payments if someone was to be injured within your property.

Depending on where you live, you may be required to purchase additional insurance coverage for natural disasters, such as earthquake or flood insurance.

Homeowners’ insurance generally costs more than renter’s insurance as it covers the dwelling itself, and most properties require tenants to have renter’s insurance to live in an apartment so those costs need to be included when estimating future living expenses.

For those who own investment properties, you may need to purchase a separate policy - landlord (rental property) insurance - to cover potential costs.

Auto Insurance

Auto insurance helps protect your finances against car problems. As the owner of the vehicle, you enter an agreement with the insurance company and in the event of an accident or theft, you have the ability to file a claim and be paid out in accordance with your policy.

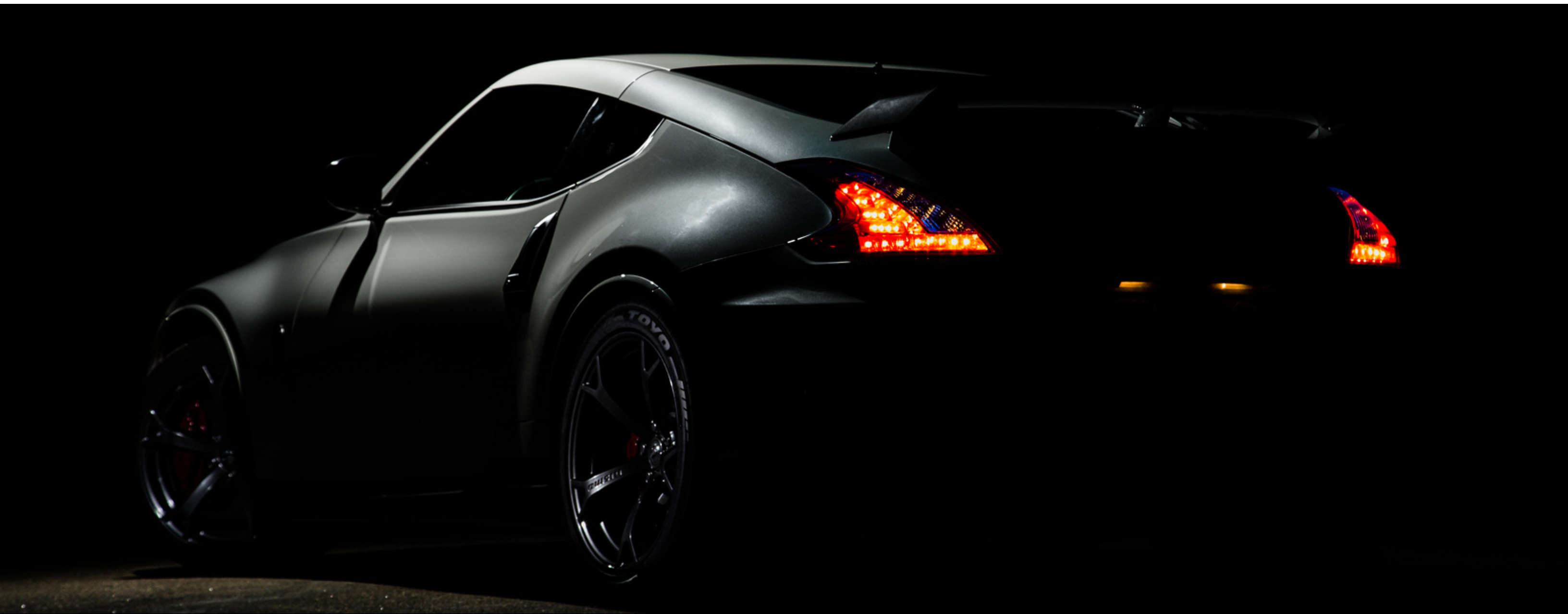
Auto insurance generally comes in two forms: **Full coverage or liability-only**

Liability is much more affordable, sometimes under $100/month, but it comes with limitations that can outweigh the cost savings. It generally only covers the cost of damage to another vehicle, and you're then responsible for any other costs incurred, such as replacing a stolen car.

Since most states require car insurance, the trade-off here is lower monthly premiums.

Full coverage is more expensive but would cover the cost of theft or damage, bodily injury or property damage, and the cost of medical expenses in relation to a claim.

Each policy will vary so it's important to dive into the details to understand what your policy includes.



Umbrella Insurance

Umbrella insurance is a type of insurance that you get on top of all your other policies to help cover you for losses that go beyond those policies. It acts like an *umbrella* over the other policies.

What it covers:

- Injuries
- Damage to property
- Certain lawsuits
- Personal liability situations

However, it does not cover for:

- your injuries or damage to your personal property
- a criminal or intentional action causing damage to someone else
- liability you assume under a contract

The Takeaway

Insurance premiums can feel like a waste of money if you never use the insurance, but the peace of mind and financial security that insurance provides is worth way more than the monthly costs.

Without insurance, one unexpected event could cause cash flow problems, drain savings, and in some instances, cause bankruptcy.

It's important to work with a trusted insurance agent as the industry is known to oversell and not look out for everyone's best interest, but part of being responsible and going through adult life is protecting the things that we love and that we've worked hard for, and having proper insurance coverage is the best way to do so.