



## Insurance Made Easy: What Are You Really Paying For?

Insurance is one of those things we routinely pay for while hoping we never have to use it. You can spend thousands of dollars over many years insuring your life, house and automobiles without filing a major claim. That can make insurance seem like money disappearing into a black hole.

But insurance is not supposed to make you money. Its primary purpose is to protect you from a financial loss that you could not comfortably absorb yourself.

### You Are Buying Protection Against Risk

Suppose your five-year-old television quits working. Replacing it might be annoying and expensive, but it probably won't bankrupt you. You don't need an insurance policy for every financial inconvenience.

Now suppose you cause an automobile accident that seriously injures another driver. Or your house burns down. Those losses could amount to hundreds of thousands of dollars.

Insurance transfers much of that financial risk to an insurance company. You pay a relatively predictable amount—the premium—in exchange for protection against specified losses that could otherwise be financially devastating.

## Learn Five Important Insurance Words

A **premium** is what you pay for the insurance.

A **deductible** is the portion of a covered loss you must pay before the insurer pays its share. If you have a \$1,000 deductible and a covered property loss is \$5,000, you ordinarily absorb the first \$1,000 and the insurer pays the remaining covered amount, subject to the policy terms.

A **coverage limit** is the maximum the policy will pay for a particular type of covered loss.

An **exclusion** identifies something the policy does not cover.

A **claim** is your request for payment after a covered loss occurs.

Those five words will get you surprisingly far when reading an insurance policy.

## Higher Deductible, Lower Premium

The deductible allows you to share some of the risk with the insurance company. Generally, increasing the deductible reduces the premium because you have agreed to absorb more of a loss yourself.

That can make good financial sense if you have adequate emergency savings. Saving \$200 a year by accepting an additional \$500 of deductible risk might be reasonable if you could comfortably produce that \$500 tomorrow.

It makes less sense if the deductible is so high that you could not afford it after an accident or other loss.

## Insurance Has Limits

One of the biggest insurance mistakes is assuming that "I'm insured" means "everything is covered." It doesn't.

Policies contain limits, exclusions, conditions and definitions. Homeowners insurance, for example, generally covers many common hazards but ordinarily does not cover flooding. Flood insurance normally must be obtained separately.

Likewise, expensive jewelry, art, collectibles and other valuables may have special coverage limits.

## **Don't Buy Insurance on Price Alone**

Price matters, but a cheap policy that leaves a major risk uncovered may prove extraordinarily expensive when you finally need it.

Compare deductibles, coverage limits and exclusions along with premiums. Also consider the insurer's financial condition, customer service and claims reputation.

Most importantly, know what you are buying.

Insurance is essentially a financial safety net. You may never fall into it, but if you do, you want to know beforehand that the net is strong enough to catch you.