Fundamentals of PERSONAL FINANCE

Making informed financial choices

Your Insurance Options

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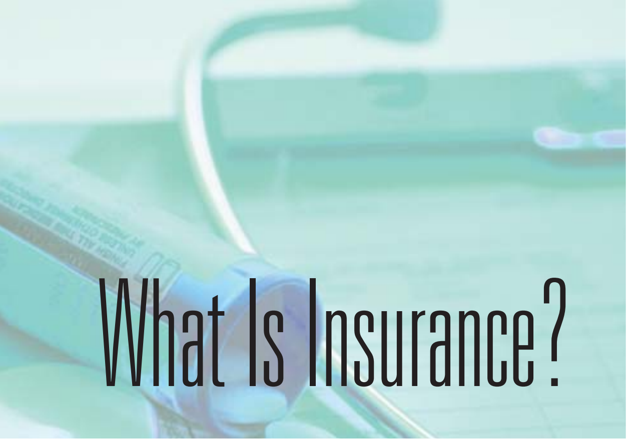


What Is Insurance?

Two of three Americans think they have the right amount of insurance, yet fewer than one of three understands the details of their insurance coverage very well.

How much is security worth to you? That's the question you have to ask when you consider buying any type of insurance coverage. You see, insurance is a tool to reduce risk—both yours and the company that provides the insurance.

Insurance pools your resources with resources of a larger group of people to minimize everyone's risk. When you buy insurance, you pool your risk with other people in the hopes of reducing your potential for financial loss. Insurers are relying on this fact—as more people participate, the ability to predict the group's behavior becomes more accurate.

And despite the widespread availability of insurance, few people really understand the purchases they make. In fact, most people's eyes glaze over when they discuss the topic. They think it's too complicated.

It's not too complicated. But it isn't simple either. Insurance and its terms and conditions are not part of people's normal lexicon, so it does take some effort on your part to understand what you are buying and whether you are making a good buying decision. Insurance is no different than any other product you buy: Investigate before you invest or you're likely to be sold something you don't want or need.

Insurance is a tool to reduce risk——both yours and the company that provides the insurance.

Where Should You Start?

First, assemble some useful resources. Your goal is to educate yourself about insurance products and alternatives so you can buy only what you need at a fair price. Keep in mind that you also must evaluate your insurance purchase on a regular basis—annually—to ensure it meets your needs.

Stated simply, buy insurance to protect yourself and your family from losses you cannot afford to pay. In other words, buy insurance to protect against catastrophic losses that would play havoc on your finances. Don't buy insurance to protect yourself against normal expenses.

Let's start with some basic terminology.

Insurance policy

This is a conditional contract between the insurance buyer and seller that spells out the rights and responsibilities of both parties. A conditional contract means policyholders have certain responsibilities to meet if a loss covered by the contract occurs. Not completing these can result in nonpayment. These responsibilities may include notifying the insurance company or agent of a loss in a timely manner; protecting your property from further damage; preparing a detailed list of items

Who Sells Insurance?

Essentially there are three types of insurance companies—stock insurance companies, mutual insurance companies, and privately owned companies.

While an insurer is any individual or organization that provides insurance coverage, stock insurance companies are stockholder owned and designed to return a profit for the owners. Mutual insurance companies are policyholder owned and operate on a not-for-profit basis. Travelers Insurance is an example of a stockholder-owned company. The CUNA Mutual Group in Madison, Wis., is an example of a mutual insurance company.

Individuals who sell insurance are called agents. They can enter into, change, and cancel insurance policies on behalf of the companies they represent. There are two types of agents:

Independent agents—As their name suggests, they are independent agents working to link insurance policy buyers and sellers. Typically, they work for a number of companies. They offer more selectivity, but not necessarily the lowest price option.

Exclusive agents—They represent one company and sell specific lines of insurance for that company. While exclusive agents are limited to the policies their companies offer, their fees may be lower because their sales commissions tend to be lower.

Many insurance agents may have received professional designations such as Chartered Life Underwriter for life insurance or Chartered Property and Casualty Underwriter for auto and homeowner's insurance. Such designations may indicate a higher level of expertise.

damaged, and their actual cash or replacement value; being prepared to show the insurance provider or its representative the damaged items; and completing a statement for your insurance provider that tells how a loss occurred.

Premium

This is the fee the buyer pays to the insurance provider/seller for insurance protection or coverage. Failure to pay in a timely manner negates the contract's provisions.

Insurable interest

You are eligible to buy insurance only if you stand a chance of suffering a loss; it's called having an insurable interest. In other words, you can't buy insurance on your neighbor's car because you have nothing at risk.

Principle of indemnity

This means insurance pays—within the specified limits of the policy—no more than the actual financial loss you suffer.

Deductibles

This determines if you will pay a portion of any loss and how much that portion will be. This feature affects your premium (your fee). The higher the deductible (amount you will pay), the lower your premium. Choose the highest deductible you can afford to keep your premium cost down.

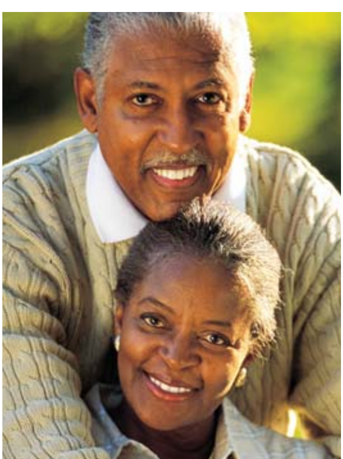
Co-insurance

In many cases, the insurance buyer and seller share in the payment of a loss. That's called co-insurance. This split is often 80% for the insurer, 20% for the insured.

Hazard or loss reduction

Many policies give buyers a price break for good behavior—a good driving record, being a nonsmoker, or having smoke detectors in their homes. This price break is called a hazard or loss reduction.

There are insurance offerings for just about anything—from life to health to homeowners to auto to pet insurance. We'll cover the major offerings—not pet—and trust you'll understand that the principles you learn here will apply to just about any insurance you buy. And we'll suggest some valuable resources for you to use along the way.





Auto Insurance

When Vicki found out the driver of the car that hit her van was uninsured, she also was surprised to learn that consumers spend more on auto insurance than on any other type of insurance. The average spent on vehicle insurance is more than $1,500 per household and more than $100 billion annually. Of all the drivers she has "met," hers was uninsured—and broke. Fortunately, no one was injured and damage was minimal.

That's not always the case, of course, which is why vehicle owners need insurance. Simply put, vehicle insurance combines liability and property damage coverage under one policy for vehicle owners and drivers. More than two-thirds of all states require automobile owners to have such insurance coverage, while other states require owners to show some sort of financial responsibility.

Most auto insurance policies provide protection for liability for you; uninsured or underinsured motorists; medical payments; and physical damage to the insured vehicle. Each area has its own policy limits, conditions, and exclusions.

Maybe you live in a state where auto insurance is a requirement. But keep in mind that state mandates often are *minimum* coverage. If you want to protect yourself from a lawsuit or big repair bills, consider buying more protection. In reality, if you cause a serious accident your home, investments, and savings may be at risk if you are not adequately insured. If you are at fault in an accident, your liability insurance will pay for bodily injury and property damage expenses caused to others, up to your coverage limits. Bodily injury coverage also may cover lost wages—within the limits of the policy you bought, of course.

Let's face it. Auto insurance is a big bugaboo. If you live in or near a major metropolitan area, you'll pay more because there are more vehicles there and more potential for mishap and theft. And today's sophisticated machines are expensive to repair—another reason for rising vehicle insurance rates.

Annual premiums vary significantly—

depending on where you live, the type of vehicle you drive, your age, sex, and driving record. The Northeast accounts for four of the five most expensive states for auto insurance, according to figures from the National Association of Insurance Commissioners *(www.naic.org)*. The number of claims filed is the primary driver for insurance prices. In 2000, the national average combined annual premium was nearly $786.

Some states have attempted to become both more pro-consumer and more pro-insurance industry. In June of 2001, the Consumer Federation of America (CFA) reported that auto insurance rates in California actually dropped 4% between 1989-1998. That decline followed passage of Proposition 103, which required insurers to open their books to justify rate increases or decreases. Prop 103 also provided insurers financial incentives for efficient performance and provided consumers with "good driver" incentives. During that same time frame, auto insurance rates were rising more than 25% in the rest of the country.

Whose fault is it? Once in awhile someone hits you and is actually insured. Who pays? It depends on whether you live in a fault or no-fault state. In a fault state, the person responsible for the accident is liable. In a no-fault state it means your policy must pay regardless of who caused the accident. In other words, you are part of the problem just for being involved. These states enacted the laws to keep insurance costs down and reduce potential for injury fraud. In either case (fault

Your Credit Rating Will Affect Your Premiums

Before you buy auto insurance, answer this question: How good is your credit rating?

What does a credit rating have to do with auto insurance you ask? Plenty. You see, a growing number of insurers are using credit data to help determine your insurance rates. In fact, 92 of the 100 largest personal auto insurance companies use credit data to underwrite new business, according to a study by Conning & Co., an insurance research and asset management firm in Hartford, Conn.

The fact is drivers with the worst credit ratings file 40% more claims than drivers with strong credit ratings, says the Insurance Information Institute in New York. Indeed, a Casualty Actuarial Society study says people with good credit but poor driving records had better loss ratios than people with bad credit records and clean driving records. All this translates into higher insurance premiums for consumers with bad credit—as much as 20% to 50% more, according to Conning & Co.

Here's a suggestion. If you're having credit problems, stick with your current auto insurer until you improve your credit rating. If you must shop for a new policy, ask if they use credit data in their decision-making process.

or no-fault) your insurance company will investigate the accident, handle settlement negotiations, defend you in case of a lawsuit, and handle payments—within the prescribed limits of your policy.

So what coverage do you need? Liability for bodily injury is absolutely essential. **Liability insurance** is the foundation of your auto insurance policy. Only a couple of states do not mandate liability coverage.

Essentially there are two types of liability coverage—bodily injury and automobile property. Medical payments insurance covers injuries of the driver of the insured vehicle and any passengers regardless of who causes the accident. You want to protect your assets, protect yourself, and protect the injured parties.

What does that mean? It means that the state minimum liability limits are just that—the bare minimum. Buy enough liability insurance to protect your net worth. A homeowner should buy at least \$100,000/\$300,000 (\$100,000 for each person injured to a maximum of \$300,000 for each accident). When it comes to protecting yourself, what are you worth? Fact is few states allow you to insure yourself for more than you would pay to protect the guy you hit—so you might want to buy more than the minimum coverage here, too. After all, you might not be as lucky as Vicki was if hit by an uninsured or underinsured motorist.

Collision insurance is essential for any new car you buy or any car you are financing. This insurance protection buys you repairs and fix-its, no matter who was at fault for the accident, so long as your vehicle has a reasonable resale value. Insurers write collision insurance to cover the fair market value of your car. If the car is five years old and you total it, you'll get "book value" for that car *(www.edmunds.com)*.

Comprehensive insurance is a must for new cars. It provides protection for unusual things like hail, flood, fire, vandalism, and stones coming up off the highway and damaging your windshield.

The average spent on vehicle insurance is more than \$1,500 per household annually.

Some policies cover cars you rent when traveling on vacation. Always talk to your insurance agent to see what protection you have before taking a trip. Signing those multitude of waivers at the car rental agencies can be very intimidating.

Uninsured or underinsured motorist insurance is another option to consider. In Vicki's case, had it been a serious accident she might have used this option to repair her van. It covers your vehicle and sometimes it will even cover lost wages. If you have top-notch life, health, and disability coverage, however, this may not be necessary.

Another vehicle insurance option to consider is **umbrella insurance.** If you have substantial net worth, you should look into this option. An umbrella policy provides liability protection over and above the limits on your auto and homeowners policies.

State Minimum Liability Limits (in $1,000s)

Policy limits for auto insurance are usually quoted with three figures (see below). Each figure represents a multiple of $1,000. The first number represents bodily injury coverage, per person; the second number represents bodily injury coverage, per accident; and the third number is the property damage coverage. So the Alabama minimums are $20,000 for bodily injury per person; total $40,000 bodily injury per accident; and $10,000 the maximum property damage coverage per accident.

Alabama	20/40/10	Kentucky	25/50/10	North Dakota	25/50/25
Alaska	50/100/25	Louisiana	10/20/10	Ohio	12.5/25/7.5
Arizona	15/30/10	Maine	50/100/25	Oklahoma	10/20/10
Arkansas	25/50/25	Maryland	20/40/15	Oregon	25/50/10
California	15/30/5	Massachusetts	20/40/5	Pennsylvania	15/30/5
Colorado	25/50/15	Michigan	20/40/10	Rhode Island	25/50/25
Connecticut	20/40/10	Minnesota	30/60/10	South Carolina	15/30/10
Delaware	15/30/5	Mississippi	10/20/5	South Dakota	25/50/25
D.C.	25/50/10	Missouri	25/50/10	Tennessee	25/50/10
Florida	10/20/10	Montana	25/50/10	Texas	20/40/15
Georgia	25/50/25	Nebraska	25/50/25	Utah	25/50/15
Hawaii	20/40/10	Nevada	15/30/10	Vermont	25/50/10
Idaho	25/50/15	New Hampshire	25/50/25	Virginia	25/50/20
Illinois	20/40/15	New Jersey	15/30/5	Washington	25/50/10
Indiana	25/50/10	New Mexico	25/50/10	West Virginia	20/40/10
Iowa	20/40/15	New York	25/50/10	Wisconsin	25/50/10
Kansas	25/50/10	North Carolina	30/60/25	Wyoming	25/50/20