

Introduction To Insurance

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Introduction

In one form or another, we all own [insurance](#). Whether it's auto, medical, liability, disability or life, insurance serves as an excellent risk-management and wealth-preservation tool. Having the right kind of insurance is a critical component of any good financial plan. While most of us own insurance, many of us don't understand what it is or how it works. In this tutorial, we'll review the basics of insurance and how it works, then take you through the main types of insurance out there. (To read more about insurance, see our [Special Insurance Feature](#).)

What Is Insurance?

[Insurance](#) is a form of risk management in which the insured transfers the cost of potential loss to another entity in exchange for monetary compensation known as the [premium](#). (For background reading, see [The History Of Insurance In](#)

[America.](#))

Insurance allows individuals, businesses and other entities to protect themselves against significant potential losses and financial hardship at a reasonably affordable rate. We say "significant" because if the potential loss is small, then it doesn't make sense to pay a premium to protect against the loss. After all, you would not pay a monthly premium to protect against a \$50 loss because this would not be considered a financial hardship for most.

Insurance is appropriate when you want to protect against a significant monetary loss. Take [life insurance](#) as an example. If you are the primary breadwinner in your home, the loss of income that your family would experience as a result of our premature death is considered a significant loss and hardship that you should protect them against. It would be very difficult for your family to replace your income, so the monthly premiums ensure that if you die, your income will be replaced by the insured amount. The same principle applies to many other forms of insurance. If the potential loss will have a detrimental effect on the person or entity, insurance makes sense. (For more insight, see [15 Insurance Policies You Don't Need.](#))

Everyone that wants to protect themselves or someone else against financial hardship should consider insurance. This may include:

- Protecting family after one's death from loss of income
- Ensuring debt repayment after death
- Covering [contingent liabilities](#)
- Protecting against the death of a key employee or person in your business
- Buying out a partner or co-shareholder after his or her death
- Protecting your business from business interruption and loss of income
- Protecting yourself against unforeseeable health expenses
- Protecting your home against theft, fire, flood and other hazards
- Protecting yourself against lawsuits
- Protecting yourself in the event of disability
- Protecting your car against theft or losses incurred because of accidents
- And many more

Fundamentals Of Insurance

How does [insurance](#) work?

Insurance works by pooling risk. What does this mean? It simply means that a

large group of people who want to insure against a particular loss pay their premiums into what we will call the insurance bucket, or pool. Because the number of insured individuals is so large, insurance companies can use statistical analysis to project what their actual losses will be within the given class. They know that not all insured individuals will suffer losses at the same time or at all. This allows the insurance companies to operate profitably and at the same time pay for claims that may arise. For instance, most people have auto insurance but only a few actually get into an accident. You pay for the probability of the loss and for the protection that you will be paid for losses in the event they occur.

Risks

Life is full of [risks](#) - some are preventable or can at least be minimized, some are avoidable and some are completely unforeseeable. What's important to know about risk when thinking about insurance is the type of risk, the effect of that risk, the cost of the risk and what you can do to mitigate the risk. Let's take the example of driving a car. (For more insight on the concept of risk, see [Determining Risk And The Risk Pyramid](#).)

Type of risk: Bodily injury, total loss of vehicle, having to fix your car

The effect: Spending time in the hospital, having to rent a car and having to make car payments for a car that no longer exists

The costs: Can range from small to very large

Mitigating risk: Not driving at all (risk avoidance), becoming a safe driver (you still have to contend with other drivers), or transferring the risk to someone else (insurance)

Let's explore this concept of risk management (or mitigation) principles a little deeper and look at how you may apply them. The basic risk management tools indicate that risks that could bring financial losses and whose severity cannot be reduced should be transferred. You should also consider the relationship between the cost of risk transfer and the value of transferring that risk.

Risk Control

There are two ways that risks can be controlled. You can avoid the risk altogether, or you can choose to reduce your risk.

Risk Financing

If you decide to retain your risk exposures, then you can either transfer that risk (ie. to an insurance company), or you retain that risk either voluntarily (ie. you identify and accept the risk) or involuntarily (you identify the risk, but no

insurance is available).

Risk Sharing

Finally, you may also decide to share risk. For example, a business owner may decide that while he is willing to assume the risk of a new venture, he may want to share the risk with other owners by [incorporating](#) his business.

So, back to our driving example. If you could get rid of the risk altogether, there would be no need for insurance. The only way this might happen in this case would be to avoid driving altogether. Also, if the cost of the loss or the effect of the loss is reasonable to you, then you may not need insurance.

For risks that involve a high severity of loss and a low frequency of loss, then risk transference (ie. insurance) is probably the most appropriate protection technique. Insurance is appropriate if the loss will cause you or your loved ones a significant financial loss or inconvenience. Do keep in mind that in some instances, you are required to purchase insurance (i.e. if operating a motor vehicle). For risks that are of low loss severity but high loss frequency, the most suitable method is either retention or reduction because the cost to transfer (or insure) the risk might be costly. In other words, some damages are so inexpensive that it's worth taking the risk of having to pay for them yourself, rather than forking extra money over to the insurance company each month.

The Risk Management Process

After you have determined that you would like to insure against a loss, the next step is to seek out insurance coverage. Here you have many options available to you but it's always best to shop around. You can go directly to the insurer through an agent, who can bind the policy. The process of binding a policy is simply a written acknowledgement identifying the main components of your insurance contract. It is intended to provide temporary insurance protection to the consumer pending a formal policy being issued by the insurance company. It should be noted that agents work exclusively for the insurance company. There are two types of agents:

1. Captive Agents: Captive agents represent a single insurance company and are required to only do business with that one company.
2. Independent Agent: Independent agents represent multiple companies and work on behalf of the client (not the insurance company) to find the most appropriate policy.

Underwriting

[Underwriting](#) is the process of evaluating the risk to be insured. This is done by the insurer when determining how likely it is that the loss will occur, how much the loss could be and then using this information to determine how much you

should pay to insure against the risk. The underwriting process will enable the insurer to determine what applicants meet their approval standards. For example, an insurance company might only accept applicants that they estimate will have actual loss experiences that are comparable to the expected loss experience factored into the company's premium fees. Depending on the type of insurance product you are buying, the underwriting process may examine your health records, driving history, insurable interest etc.

The concept of "insurable interest" stems from the idea that insurance is meant to protect and compensate for losses for an individual or individuals who may be adversely affected by a specific loss. Insurance is not meant to be a profit center for the policy's beneficiary. People are considered to have an insurable interest on their lives, the life of their spouses (possibly domestic partners) and dependents. Business partners may also have an insurable interest on each other and businesses can have an insurable interest in the lives of their employees, especially any key employees.

Insurance Contract

The insurance contract is a legal document that spells out the coverage, features, conditions and limitations of an insurance policy. It is critical that you read the contract and ask questions if you don't understand the coverage. You don't want to pay for the insurance and then find out that what you thought was covered isn't included. (For more insight, read [Understand Your Insurance Contract.](#))

Insurance terminology you should know:

Bound: Once the insurance has been accepted and is in place, it is called "bound". The process of being bound is called the binding process.

Insurer: A person or company that accepts the risk of loss and compensates the insured in the event of loss in exchange for a [premium](#) or payment. This is usually an insurance company.

Insured: The person or company transferring the risk of loss to a third party through a contractual agreement (insurance policy). This is the person or entity who will be compensated for loss by an insurer under the terms of the insurance contract.

Insurance Rider/Endorsement: An attachment to an insurance policy that alters the policy's coverage or terms. (To learn more, read [Let Life Insurance Riders Drive Your Coverage.](#))

Insurance Umbrella Policy: When insurance coverage is insufficient, an umbrella

policy may be purchased to cover losses above the limit of an underlying policy or policies, such as [homeowners](#) and auto insurance. While it applies to losses over the dollar amount in the underlying policies, terms of coverage are sometimes broader than those of underlying policies.

Insurable Interest: In order to insure something or someone, the insured must provide proof that the loss will have a genuine economic impact in the event the loss occurs. Without an insurable interest, insurers will not cover the loss. It is worth noting that for property insurance policies, an insurable interest must exist during the underwriting process and at the time of loss. However, unlike with property insurance, with [life insurance](#), an insurable interest must exist at the time of purchase only.

Now that you have the basics of insurance, let's discuss specific types of policies.

Property And Casualty Insurance

Property and [casualty insurance](#) is insurance that protects against property losses to your business, home or car and/or against legal liability that may result from injury or damage to the property of others. This type of insurance can protect a person or a business with an interest in the insured physical property against losses. Let's examine some of the things to look for in the different types of property/casualty insurance. (For background reading, see [Do You Need Casualty Insurance?](#))

Auto Insurance

- **Coverage:** An auto insurance policy typically covers you and your spouse, relatives who live in your home and other licensed drivers to whom you give permission to drive your car. The policy is "package protection", which provides coverage for both bodily injury and property damage liability as well as physical damage to your vehicle. This damage can include both that caused by the collision and damage cause by things "other than collision", such as flood, fire, wind, hail, etc. (For more insight, read [Shopping For Car Insurance.](#))
- **Common Types of Coverage:** Auto insurance typically covers personal injury (PIP), medical payments, uninsured motorist, underinsured motorist, auto rental, emergency road assistance and other damages to your car not caused by a collision such as flood, fire and vandalism. Other coverage is available, too.

- **Deductible:** The deductible is the amount that you will pay out of pocket when you file a claim. Typically, the higher the deductible, the lower your premiums.
- **Insurance Rates:** How much you pay will depends on many factors, including your driving record, the value of your vehicle, where you drive, how much you drive, your marital status, your desired coverage, your age, sex and even your credit history. (For tips on reducing your rates, see [12 Car Insurance Cost Cutters.](#))

Homeowners Insurance

Our homes and their contents are our greatest assets. That is why it is so imperative that we protect their value. [Homeowners insurance](#) helps us achieve that goal. Let's break down the different concepts that encompass this area. (For background reading, see [Beginners' Guide To Homeowners Insurance.](#))

- **Coverage:** Homeowners insurance typically covers the dwelling (the structure), personal property and contents, and some forms of personal liability. The policy may cover direct and consequential loss resulting from damage to the property itself, loss or damage to personal property, and liability for unintentional acts arising out of the non-business, non-automobile activities of the insured and members of that insured's household.
- **Types of Insurance:** Are you ready to decipher the codes? There are six standard forms of homeowners insurance containing personal property coverage. (For more insight, see [9 Things You Need To Know About Homeowners Insurance.](#))
 1. HO 00 02 (Homeowners 2, Broad Form): This form of insurance provides broad form coverage on your dwelling and other structures and insures against loss of use. To be specific, the broad form of coverage insures against windstorm, hail, aircraft, riot, vandalism, vehicles, volcanic, explosion, smoke, fire, lightening and theft , plus rupture of a system, artificially generated electricity, falling objects and freezing of plumbing.
 2. HO 00 03 (Homeowners 3, Special Form): This "special form" insurance offers coverage for more causes of loss than the HO 00 02.
 3. HO 00 04 (Homewoners 4, Contents Broad Form): This is a renter's policy. Even if you don't own your home, you should consider having this type of insurance. Your landlord's insurance will not cover damage to your personal property or liability against you. Think about how much it will cost to replace all of your furniture, clothing etc. If you feel this isn't a loss you

could bear, consider buying this type of insurance. (To learn more, read [Insurance 101 For Renters.](#))

4. HO 00 05 (Homeowners 5, Comprehensive Form): This type of policy essentially combines the HO 00 03 form with the HO 00 05 endorsement into one comprehensive form to provide open perils coverage on personal property in addition to the dwelling, other structures and loss of use. The HO 00 05 rider can only be combined with an HO 00 03 policy.
5. HO 00 06 (Homeowners 6, Unit Owners Form) : This is a condominium policy. This type of policy is different from a homeowners insurance policy in that it is designed for individuals who live in a unit structure owned and insured by a condo association, townhouse association cooperative, homeowner's association, planned community or other similar type of organization. The insurance the association provides only covers the outside dwelling, not the contents of your unit, so it's important to consider purchasing this type of insurance to protect against personal property losses and liability. (For more on condos, read [Does Condo Life Suit You?](#))
6. HO 00 08 (Homeowners 8, Modified Coverage Form): This form of insurance settles losses on an actual cash value basis and is usually only used to cover older structures where the cost of replacement far exceeds the value of the structure. This type of insurance is offered when insurers are not willing to offer HO 00 02, 03 or 05 coverage because there may be an incentive to intentionally destroy the structure.

Now let's take a look at what is usually not covered under these types of insurance. These are known as "exclusions", but you may be able to get coverage in these areas with a [rider](#) or umbrella policy. Your individual policy may exclude more items than listed below, so consult with your agent.

1. Ordinance or Law: If the dwelling does not comply with local building codes, the insurer will not be liable for the cost of construction to bring the structure up to code.
2. Earth Movements: This includes two distinct types of earth movements, including shifting earth (landslides) in the foundation of a home and earthquakes. These may be considered two separate coverage areas, so being covered for one may not mean being covered for the other.
3. Water Damage: This includes flood, water backing up in sewers or drains, water seeping through basement walls etc.

4. **Neglect:** This excludes losses resulting from direct or indirect neglect and failure to use reasonable means to protect property.
5. **War:** Damage caused by any type of war or nuclear weapons attack.
6. **Nuclear Hazard:** This defined as any nuclear reaction, radiation, or radioactive contamination, (whether controlled or uncontrolled). Any loss caused by nuclear hazard as it is defined will not be considered loss caused by fire, explosion, or smoke, even if these perils are specifically named in your policy.
7. **Intentional Loss:** Any damage intentionally done to one's own property is excluded for obvious reasons.

As with any type of insurance, it is critical that you read the insurance policy so that you know exactly what it will cover. The amount of coverage you should consider should be based on the replacement cost value of your home or property. Replacement costs on one's dwelling provides that if, at the time of loss, the amount of insurance covers at least 80% of the replacement cost of the dwelling, the loss will be paid on a replacement cost basis. Keep in mind that this still leaves the homeowner on the hook for the remaining 20% in the event of a total loss.

Oftentimes, the bank or institution holding your mortgage will require that you maintain a specific amount of coverage. However, even if your home is paid off, you should still consider having the appropriate amount of insurance protection, which might include coverage for physical damage as well as liability protection for the owners.

Other Considerations

Depending on where you live and given the unpredictability of nature, specifically the weather, you should consider other types of insurance to protect your property. For example:

Flood Insurance

Flood insurance is becoming more and more popular as places that normally would not experience floods are suddenly finding themselves suffering losses as a result of extreme weather. To the surprise of many of these homeowners, their regular homeowners insurance policy did not cover against flood. This is a separate type of coverage that you will have to purchase if you consider flood to be a risk for your business or property.

If you live in a flood-prone area and you have a mortgage, the lender will require you to purchase adequate coverage to insure the property. If you own the

property, you can elect to self-insure and not buy insurance, but you have to remember that any damage caused as a result of flooding will be your financial responsibility. The cost of this kind of damage can run from the hundreds to thousands of dollars, so it's worth considering purchasing the insurance to transfer this risk, especially, if you live in a flood zone. If you don't live in a flood-prone area, you may qualify for a discounted rate, which means a lower premium for you.

Windstorm Insurance

Like flood insurance, windstorm insurance is a separate type of coverage that protects your home or business against wind damage. Wind damage may result from items flying and destroying your property as a result of a hurricane, hail, snow, sand or dust. Coverage for windstorm may be limited in states prone to hurricane and tornadoes. If you live in a state like Florida, Louisiana, Texas or the Carolinas, which are frequently barraged by tropical storms or hurricanes, this should be an integral part of your asset protection planning. Consult with your agent or broker for more details on this type of coverage.

Umbrella Liability Policies

Umbrella insurance helps you protect your assets if you are sued. If you are worried that the liability insurance coverage you have through your auto or property policies is still not enough, you can consider adding an umbrella policy. An umbrella policy is basically an additional policy that kicks in when your other insurance policies have reached their limits. The amount of coverage and types of coverage offered by these policies varies, as will their premiums. You can tag on an umbrella policy to your homeowners or auto insurance policy to protect your assets against liability or lawsuits. (For background reading, see [Cover Your Company With Liability Insurance](#) and [Filling The Gaps In General Liability Insurance](#).)

Certain exclusions apply, including:

- Owned or leased aircraft or watercraft
- Business pursuits
- Professional services
- Any act committed by the insured with the intent to cause personal injury or property damage

Umbrella policies are fairly inexpensive to acquire, and coverage ranges from \$1 million to \$ 5 million or more. You might expect to pay between \$200 to \$500 for \$1 million in coverage. There is no specific "umbrella [deductible](#)". Because an umbrella policy is written on top of any auto or personal property coverage you have, the benefit does not kick in until you satisfy the deductible on those policies and have used up the coverage from either the auto or property policy.

Homeowners Tips

Homeowners insurance is a critical component of anyone's risk management planning. There may always be a threat of property loss from fire, theft or bad weather. Having an accurate home inventory of your possessions can make settlement claims a lot easier and faster. Insurance agents suggest that all homeowners keep receipts, descriptions, photos or video of the items they own. Once your list and evidence of ownership is itemized, store this in a safety deposit box or other safe location outside of your home, along with a copy of your policy.

Health Insurance

[Health insurance](#) may be the most important type of insurance you can own. Without proper health insurance, an illness or accident can wipe you out financially and put you and your family in debt for years. So what is health insurance and how does it work?

Health insurance is a type of insurance that pays for medical expenses in exchange for premiums. The way it works is that you pay your monthly or annual premium and the insurance policy contracts healthcare providers and hospitals to provide benefits to its members at a discounted rate. This is how hospitals and healthcare providers get listed in your insurance provider booklet. They have agreed to provide you with healthcare at the specified cost. These costs include medical exams, drugs and treatments referred to as "covered services" in your insurance policy. (To learn more, read [Find Secure And Affordable Post-Work Health Insurance.](#))

As with any type of insurance, there are exclusions and limitations. To know what these are, you have to read your policy to find out what is covered and what is not. If you elect to have a medical procedure done that is not covered by your insurance, you will have to pay for that service [out of pocket](#).

The range of coverage for expenses varies depending on the type of plan, as will the restrictions. You can purchase the insurance directly from the insurance company through an agent or through an independent broker but most people get their insurance coverage through employer-sponsored programs. (For more on this, read [How To Choose A Healthcare Plan.](#))

Additional Costs

Aside from premiums, there are other costs associated with your health insurance coverage. Let's explore what these are and how you would calculate them.

Premiums: This is the amount that you pay for coverage.

Deductible: The amount that you pay out of pocket. Like any other type of insurance, the [deductible](#) can range in amount depending on how much you would like to pay out of pocket. Generally, the higher the deductible, the lower the premiums.

Co-insurance: The percentage of covered expenses paid by the medical plan. The [co-insurance](#) amount is per family per calendar year. For example, in a co-insurance arrangement, there can be an 80/20 split between the insured and the insurance carrier in which the insured pays 20% of the cost of care up to the deductible, but below the out-of-pocket limit set forth by the policy. This is typically associated with coverage provided by a PPO.

Co-payment: Sometimes referred to "[co-pay](#)", this is a set cap amount that you will pay each time you receive medical services. This is typically associated with coverage through an HMO (which will also be discussed a little later). For example, every time you visit your doctor, you may have to pay \$20 as a co-payment. These payments usually do not contribute toward out-of-pocket policy maximums. The co-payment and the coinsurance are not one in the same. (For related reading, see [20 Ways To Save On Medical Bills.](#))

Stop-Loss Limit: The cumulative dollar amount of covered expenses in excess of the deductible after which the coinsurance payment stops and the insurer pays 100% of covered expenses. The purpose of the stop-loss limit is to limit the out-of-pocket costs for the insured individual. The "out-of-pocket max" is the maximum out-of-pocket expense you will incur before your insurance carrier pays 100% of covered services. At this point, all you will have to pay is your premiums.

What's important to remember for out-of-pocket expenses is that not all expenses go toward meeting the out-of-pocket max. Co-payments and premiums do not apply to the out-of-pocket expense maximum. Your deductible and coinsurance do apply toward this amount. It's worth noting that this may not be a standard feature with every policy.

Let's look at an example to clarify what is meant.

Let's say your health insurance plan has the following features:

- *Deductible:* \$500
- *Coinsurance:* 80/20 (you pay the 20%)
- *Out of Pocket Max:* \$5,000

Now, let's say that you go to the hospital and incur \$7,500 worth of medical expenses. How much do you have to pay? Let's do the math.

Let's start by subtracting your deductible from the total expense amount:

$$\mathbf{\$7,500 - \$500 = \$7,000}$$

Remember that you have to pay the deductible before the insurance kicks in.

Now you have to pay 20% of the \$7,000, which would be:

$$\mathbf{\$7,000 \times 0.20 = \$1,400}$$

All in all, you will have to pay \$1,900 out of pocket (\$500 deductible + \$1,400 of coinsurance).

You will have to continue paying out of pocket until your total out-of-pocket expenses reach the \$5,000 max set in your policy. At that point, you will no longer pay the coinsurance or deductible.

With out-of-pocket expenses, co-payments, coinsurance and premiums why get insurance at all? The answer is simple: while these costs certainly do put a pinch in your wallet, their costs are not nearly as painful as those from a long-term illness or emergency.

Types of Plans

Indemnity Plan

An [indemnity plan](#), sometimes called a fee-for-service plan, is a type of insurance that reimburses you according to a schedule for medical expenses, regardless of who provides the service. These plans cover things such as:

- Hospital stays
- Surgical expenses
- Major medical coverage

Under these plans, the insurer pays a specific amount per day for a specific number of days. The amount paid can be calculated either as a percentage (80/20) or for actual expenses.

Health Maintenance Organizations (HMO)

The HMO is the most common type of insurance policy people own and the one most frequently provided by employers. HMOs provide a wide range of comprehensive healthcare services to a group of subscribers in return for a fixed periodic payment. With this type of coverage, you select a primary care physician that acts as the [gatekeeper](#) for you to receive virtually all the medical care required during a year. The gatekeeper concept is the health insurer's attempt to control the cost and quality of care by coordinating health services with other providers. Specifically, your primary care physician is responsible for determining what care is required and when a patient should be referred to a specialist.

These policies tend to be the least expensive form of health insurance, but they do come with annoying restrictions. Aside from having a gatekeeper, you can only select doctors and hospitals approved in the insurance carrier's network. This becomes a problem if you already have a great relationship with a doctor who is not in the network. If you use a non-network provider, your HMO will not cover the costs unless it's for an emergency. Other than this, most preventive care services are covered.

Preferred Provider Organization (PPO)

PPOs are a group of healthcare providers that contract with an insurance company, third-party administrators, or others (like employers) to provide medical care services at a reduced fee. There are two major differences between HMOs and PPOs in that:

1. The healthcare providers in the PPO are generally paid on a fee-for-service basis as their services are needed, much like a traditional doctor's visit.
2. You are not required to use the PPO's healthcare providers or facilities - you can go outside the network. That said, going outside the network usually means paying a higher co-payment or deductible.

Point of Service (POS)

A point of service plan is a hybrid plan that combines aspects of an HMO, PPO and indemnity plan. This type of plan is more flexible in that it allows you to decide at the time you need services to elect to use the POS plan's physician to arrange in-network care (HMO feature), or to go outside the network or hospital and pay a higher portion of the cost.

(For information on buying private health insurance, read [Buying Private Health Insurance](#).)

Disability Insurance

Aside from health insurance, [disability](#) is a very critical type of insurance individuals should consider having. When it comes to your personal finances, long-term disability can have a devastating effect if you are not prepared. Think about this: the probability of becoming at least temporarily disabled during your working years is higher than the probability of dying during your working years. (For related reading, see [The Disability Insurance Policy: Now In English.](#))

Disability insurance can replace a portion of the salary you were making before you became disabled and unable to work after a serious injury or illness. But before you seek coverage, you should first understand the different types of disability definitions used by insurers.

Definitions of Disability

Different policies offer many characteristics and definitions for disability including:

Any Occupation: This is the strictest definition in which the insured is considered disabled only if he or she is unable to perform any duties pertaining to any occupation.

Modified Any Occupation: Disability applies only if you are unable to perform any duties pertaining to any occupation for which you have been trained, received education or have work experience.

Own Occupation: This is the most flexible definition for liability. You are deemed to be disabled if you are unable to engage in the principal duties of your own occupation. Most insurance carriers are doing away with this definition.

Split Definition: This definition can be within one's own occupation for a specific time period or with any occupation after the maximum benefit period has passed.

Loss of Income: This definition avoids the problem of having to determine partial or total disability. A policy with this definition pays the insured in the event of loss of income due to illness or injury.

The Impact of Disability Definitions

How your disability policy defines disability will influence many things including:

- When you are eligible to receive benefits
- How much the policy will cost - the stricter the definition, the higher the cost
- How long the benefits will last

Obtaining Coverage

You can obtain disability coverage on your own or through your employer. Disability policies tend to be cheaper and have simpler [underwriting](#) (if any) than individual policies. Many of these policies have dual definitions of disability and others have restrictive provisions. Most group policies offered through work usually end after you leave your employer, or may only pay benefits for a specific amount of time or have caps on the amount of monthly benefits you can receive (ie. max of \$5,000 per month). If the employer pays the premium, the benefits are taxable income to the employee. If the employee pays the premium, then the benefits are tax free.

Disability insurance providers rate their premiums based on your job and the level of risk involved in doing that job. Moreover, certain risky careers - skydiving or deep-sea diving instructors, roofers, etc. - may not even qualify for coverage.

Other factors to consider when obtaining coverage include:

Elimination Periods: This is the amount of time you have to wait before benefits are paid after your disability begins - the longer the [elimination period](#), the lower the [premiums](#). The most popular elimination period ranges from 30 days to 90 days, but can be longer. This waiting period acts as a [deductible](#), forcing the insured to bear part of the loss. Also important to remember is that payments normally begin 30 days *after* your elimination period has ended.

Probation Period: This is the time period a policy must be in force before it covers the insured for specific perils such as undisclosed [pre-existing conditions](#). This protects the insurance company from selling a policy to someone who is ill or recovering from an illness or other condition.

Disability Insurance Riders: As with any type of insurance you can add additional features to your coverage for an additional premium. These may include:

- Guaranteed Insurability: This [rider](#) guarantees your right to purchase additional disability insurance on specific dates or occurrences without having to show that you are in good health, but only that your income is sufficient to meet the underwriting requirements.
- Cost of Living adjustments (COLA): This rider increases policy benefits by a certain amount annually to match [inflation](#), usually equal to the percentage increase in the [Consumer Price Index](#), subject to a maximum specified in the contract (ie. 5%). The [cost of living adjustment](#) increases usually happen after your disability begins and generally start after the disability has continued for a

year. It is highly recommended that anyone owning or considering a disability policy purchase a COLA rider in order to help protect the value of the policy's real benefits each year. (For related reading, see [All About Inflation.](#))

Duration of Benefits

When talking about disability insurance there are two types of duration:

Short Term: This type of coverage provides coverage for disabilities of up to two years, but most policies pay up to six months on average.

Long Term: This type of coverage protects for a longer time period (on average more than six months), often until age 65 or for life.

Certain exclusions may apply to disability policies that are worth identifying, and these may vary from policy to policy.

- Two-year maximum benefit period for mental or nervous disorders
- One-year maximum benefit period for alcohol or drug abuse related claims
- Exclusion for payment of disability claims if injury or disability occurred during the commitment of a crime
- Exclusion for disability claims resulting from an act of war. This is not very common, but may exist in certain contracts.

Long-Term Care Insurance

As our lifespans are extended, our family structures change and medical care improves, the need for [long-term care](#) will continue to increase. A great number of people over 65 will spend some time in a nursing home, assisted living or extended care facility. The cost of such care can quickly erode the assets of even the most well-prepared savers. The risk of outliving your money in this situation can be great, and one of the best ways to transfer this risk is to purchase [long term care](#). (For background reading, see [A New Approach To Long-Term Care Insurance](#) and [Failing Health Could Drain Your Retirement Savings.](#))

Long-term care (LTC) is defined as a need for assistance with some of the activities of daily living (often called ADLs). ADLs include functions that most of us perform each day, like eating, bathing, using the bathroom, dressing, transferring and maintaining continence. The need for assistance may be due to physical inability or mental impairment, such as memory loss, Alzheimer's or dementia.

The reason to buy long term care insurance is to protect your assets in case you

need to pay for assisted living, home care or a nursing home stay. Long-term care insurance helps you pay for these services, which can be very expensive and, over time, can be financially devastating. A policy also ensures that you can make your own choices about what long-term care services you receive and where you receive them in advance.

Within the long-term care insurance contract, there are two broad levels of care outlined in the policy, including:

- Skilled Nursing Care: This is usually for someone with an acute condition that requires intensive medical attention for a period of less than 100 days. The two objectives of skilled care are to help the person with comfort and assistance if the situation is terminal or to assist the person during a recovery period.
- Hospice Care: This is the term used for the care provided to individuals facing a terminal condition, or who have less than six months to live. This care can be provided in a home or a facility.
- Non-Skilled Nursing Care/Custodial Care: This is for a person with a chronic condition from which he or she will not recover. This type of care is usually received at home or in assisted living facilities. This type of care lasts beyond 100 days, and even up to several years.

There are many settings in which long-term care can be administered or provided. The type of LTC policy determines where you can receive your services.

- Home Care: Pays for care in your home. According to "Long-Term Care Planning" (2007) by Allen Hamm, as of 2007, more than 10 million people received care at home and home care is projected to increase 178% by 2030.
- Facility Care: Pays for care in a facility, such as an assisted living community, adult day center, continuing care retirement community or nursing home.
- Respite Care: Pays for services that enable some relief (rest or vacation period) to family members providing care giving. This can be provided either in the home or at a facility.

Like other types of insurance policies, the cost of insurance coverage depends on the specifics of that coverage. Several factors can influence how much a policy may cost the insurer, including the place in which the care is received, the reason for care or severity of the patient/insured's condition, the geographic location of the care, the daily benefit amount, the [elimination period](#), the time frame in which benefits will be paid, etc. One thing is certain: the actual cost for continued medical care is not cheap, with some nursing homes costing upwards of \$75,000 a year for private rooms. The national average daily rate for nursing home care is \$206 for a private room and \$188 for a semi-private room ("Long-Term Care Planning" (2007) by Allen Hamm).

Who Needs It?

You may never need long-term care. But one thing is for sure: the need for care assistance dramatically increases after age 65. One study from the U.S. Department of Health and Human Services reveals that one in four people turning age 65 will spend one year or longer in a nursing home, and by the year 2020, 12 million older Americans will need long-term care. So, when should people consider buying LTC insurance and how are other assets considered? While anyone between the ages of 18 and 84 can probably buy long-term care insurance, if you are in reasonably good health, the younger you are when you acquire the policy, the cheaper it will be. On the flip side, the average age of people admitted to a nursing home is 83. That means you might pay for nearly 40 years before ever using the policy.

Types of Policies

There are a few types of policies available for consumers today. Most are known as "[indemnity](#)", "expense incurred", or "cash" policies. Indemnity plans are also called "per diem" policies that pay up to a fixed benefit amount regardless of what you spend (ie. you may spend more or less than the policy covers). Expense-incurred policies reimburse you for actual expenses incurred up to your fixed benefit amount, as defined by the daily benefit you purchased with the policy. With a cash-based policy, as long as the policy gets triggered by the ADLs, you will not be required to incur expenses to receive the benefits of your claim. So, for example, if you are being cared for by a relative (for free presumably), then you would still be "paid" even though you are not incurring expenses to receive care. (For more on LTC plans, see [Protecting Your Income Source](#) and [Take Advantage Of Employer-Sponsored LTC Insurance](#).)

Final Considerations

The purchase of LTC insurance should not be a stand-alone decision and must be incorporated with all other planning. When considering the purchase of an LTC policy, you may wish to consider purchasing optional benefits. One such option might be to buy a policy that is guaranteed renewable. You don't want to

be surprised should your health decline one day that your policy is not renewable. You should also consider investing in an inflation rider to protect the purchasing power of whatever daily benefit you purchase.

Typically, those who apply for LTC are given the option to buy a 3% or 5% inflation rider using [simple](#) or [compound interest](#). Of course, compound interest at 5% gives you the best inflation hedge, but also costs you more money. Additionally, if you think there is any possibility that you may not use your benefits, you may want to consider a "return of premium" rider. Finally, given that the average stay in a nursing home is about 30 months, you may want to consider a policy that will give you benefits for a minimum of three years (this is referred to as a policy's maximum benefit period).

Life Insurance

Life insurance was initially designed to protect the income of families, particularly young families in the [wealth accumulation](#) phase, in the event of the head of household's death. Today, life insurance is used for many reasons, including [wealth preservation](#) and [estate tax](#) planning. (For background reading, see [The History Of Insurance In America](#).)

Life insurance provides you with the opportunity to protect yourself and your family from personal risk exposures like repayment of debts after death, providing for a surviving spouse and children, fulfilling other economic goals (such as putting your kids through college), leaving a charitable legacy, paying for funeral expenses, etc. Life insurance protection is also important if you are a business owner or a key person in someone else's business, where your death (or your partner's death) might wreak financial havoc.

Life insurance is a great financial planning tool, but should never be thought of as a savings vehicle. In general, there are often far better places to hold and grow your money as you get older.

Who Needs It?

Not everybody needs life insurance. If you are single and have no dependents, it may not be worth the expense. If, however, you have anyone who financially depends on you (even partially), life insurance may be appropriate for you. When considering life insurance, the questions to ask yourself are this:

- Do I need life insurance?
- How much do I need?
- How long will I need it?

- What type of policy makes sense for me? (this will be answered in our next section)

Your need for life insurance will depend on your personal circumstances, including your current income, your current expenses, your current savings and your family's goals. Rules of thumb might indicate that purchasing life insurance that covers six to 10 times your gross annual income is the right amount of coverage. But, that's merely a guide. Your family may need more or less than that. When deciding how much coverage is necessary, you really have to lay out the details of what you have versus what goals you'd like for your family once you are gone, keeping in mind that their security can often carry a higher price tag than you originally thought. (For more insight, see [How Much Life Insurance Should You Carry?](#) and [Five Life Insurance Questions You Should Ask.](#))

Types Of Life Insurance

Life insurance protection comes in many forms, and not all policies are created equal, as you will soon discover. While the death benefit amounts may be the same, the costs, structure, durations, etc. vary tremendously across the types of policies.

Whole Life

[Whole life insurance](#) provides guaranteed insurance protection for the entire life of the insured, otherwise known as permanent coverage. These policies carry a "cash value" component that grows tax deferred at a contractually guaranteed amount (usually a low interest rate) until the contract is surrendered. The [premiums](#) are usually level for the life of the insured and the [death benefit](#) is guaranteed for the insured's lifetime.

With whole life payments, part of your premium is applied toward the insurance portion of your policy, another part of your premium goes toward administrative expenses and the balance of your premium goes toward the investment, or cash, portion of your policy. The interest you accumulate through the investment portion of your policy is tax-free until you withdraw it (if that is allowed under the terms of your policy). Any withdrawal you make will typically be tax free up to your basis in the policy. Your basis is the amount of premiums you have paid into the policy minus any prior dividends paid or previous withdrawals. Any amounts withdrawn above your basis may be taxed as ordinary income. As you might expect, given their permanent protection, these policies tend to have a much higher initial premium than other types of life insurance. But, the cash build up in the policy can be used toward premium payments, provided cash is available. This is known as a participating whole life policy, which combines the benefits of

permanent life insurance protection with a savings component, and provides the [policy owner](#) some additional payment flexibility. (For related reading, see [Buying Life Insurance: Term Vs. Permanent](#) and [Permanent Life Policies: Whole Vs. Universal](#).)

Universal Life

[Universal life insurance](#), also known as flexible premium or adjustable life, is a variation of whole life insurance. Like whole life, it is also a permanent policy providing cash value benefits based on current interest rates. The feature that distinguishes this policy from its whole life cousin is that the premiums, cash values and level amount of protection can each be adjusted up or down during the contract term as the insured's needs change. Cash values earn an interest rate that is set periodically by the insurance company and is generally guaranteed not to drop below a certain level. (For related reading, see [Cashing In Your Life Insurance Policy](#).)

Variable Life

[Variable life insurance](#) is designed to combine the traditional protection and savings features of whole life insurance with the growth potential of investment funds. This type of policy is comprised of two distinct components: the general account and the separate account. The general account is the reserve or liability account of the insurance provider, and is not allocated to the individual policy. The separate account is comprised of various investment funds within the insurance company's portfolio, such as an equity fund, a money market fund, a bond fund, or some combination of these. Because of this underlying investment feature, the value of the cash and [death benefit](#) may fluctuate, thus the name "variable life". (For more on this, read [Variable Vs. Variable Universal Life Insurance](#) and [Vary Your Options With Variable Insurance](#).)

Variable Universal Life

Variable universal life insurance combines the features of universal life with variable life and gives the consumer the flexibility of adjusting premiums, death benefits and the selection of investment choices. These policies are technically classified as [securities](#) and are therefore subject to [Securities and Exchange Commission](#) (SEC) regulation and the oversight of the state insurance commissioner. Unfortunately, all the investment risk lies with the policy owner; as a result, the death benefit value may rise or fall depending on the success of the policy's underlying investments. However, policies may provide some type of guarantee that at least a minimum death benefit will be paid to [beneficiaries](#).

Term Life

One of the most commonly used policies is [term life insurance](#). Term insurance can help protect your beneficiaries against financial loss resulting from your death; it pays the face amount of the policy, but only provides protection for a

definite, but limited, amount of time. Term policies do not build cash values and the maximum term period is usually 30 years. Term policies are useful when there is a limited time needed for protection and when the dollars available for coverage are limited. The premiums for these types of policies are significantly lower than the costs for whole life. They also (initially) provide more insurance protection per dollar spent than any form of permanent policies. Unfortunately, the cost of premiums increases as the policy owner gets older and as the end of the specified term nears. (To learn more, read [Buying Life Insurance: Term Vs. Permanent](#) and [What is term insurance?](#))

Term policies can have some variations, including, but not limited to:

Annual Renewable and Convertible Term: This policy provides protection for one year, but allows the insured to renew the policy for successive periods thereafter, but at higher premiums without having to furnish evidence of insurability. These policies may also be converted into whole life policies without any additional [underwriting](#).

Level Term: This policy has an initial guaranteed premium level for specified periods; the longer the guarantee, the greater the cost to the buyer (but usually still far more affordable than permanent policies). These policies may be renewed after the guarantee period, but the premiums do increase as the insured gets older.

Decreasing Term: This policy has a level premium, but the amount of the death benefit decreases with time. This is often used in conjunction with mortgage debt protection.

Many term life insurance policies have major features that provide additional flexibility for the insured/policyholder. A renewability feature, perhaps the most important feature associated with term policies, guarantees that the insured can renew the policy for a limited number of years (ie. a term between 5 and 30 years) based on attained age. Convertibility provisions permit the policy owner to exchange a term contract for permanent coverage within a specific time frame without providing additional evidence of insurability.

Food for Thought

Many insurance consumers only need to replace their income until they've reached retirement age, have accumulated a fair amount of wealth, or their dependents are old enough to take care of themselves. When evaluating life insurance policies for you and your family, you must carefully consider the purchase of temporary versus permanent coverage. As you have just read, there are many differences in how policies may be structured and how death benefits are determined. There are also vast differences in their pricing and in the

duration of life insurance protection.

Many consumers opt to buy term insurance as a temporary risk protection and then invest the savings (the difference between the cost of term and what they *would* have paid for permanent coverage) into an alternative investment, such as a brokerage account, mutual fund or retirement plan.

Life Insurance Considerations

There are other important considerations that you should know about life insurance before you buy it. (For more insight, read [Life Insurance Clauses Determine Your Coverage.](#))

Tax Treatment

The [death benefit](#) proceeds of [life insurance](#) policies are not taxable to the beneficiaries. They are, however, included as a part of the [estate](#) in some cases, depending on how the life insurance policy is owned. This, however, is beyond the scope of this tutorial. Distributions from cash values of whole life policies (loans or withdrawals) may be tax-free or taxable depending on whether they exceed the cost basis (or premiums paid) of the policy. Meanwhile, the earnings or growth of the cash value is tax deferred until a distribution is made. (For related reading, see [Life Insurance Distributions And Benefits.](#))

Standard Provisions

A life insurance policy and your application for the coverage constitute a binding contract between the applicant and the insurer. It is understood that the information provided by the applicant is warranted to be true and that no misrepresentations have been made to attain coverage. The incontestable clause protects the insurance company if at a later date, as benefits are paid, it is revealed that the insured lied about his or her health or risk exposures. Once a policy is in force for at least two years, the validity of that contract cannot be questioned under the incontestable clause, unless in the case of fraud. If the insured commits suicide within one or two years of the policy being in force, then no death benefits will be paid, only a refund of premiums.

Beneficiaries

In the assignment of [beneficiary](#) designations, there are always two categories: primary and [contingent beneficiaries](#). The primary beneficiary is the person (or entity) who is first entitled to the death proceeds. Of course, more than one primary beneficiary can be named. The contingent beneficiary is the person (or entity) who would be entitled to the [death benefits](#) if the primary beneficiary or beneficiaries are dead or unable to receive benefits. One easy way to deal with beneficiary assignments of multiple family generations is to use either the "per

capita" or "[per stirpes](#)" description. It's easy to accidentally disinherit family members without proper wording. If your intent is to leave your benefits, for example, to your surviving children, a "per capita" designation might be appropriate, whereby your surviving children would share the proceeds equally. If however, your intent is to fairly distribute proceeds by line of descent, then the "per stirpes" designation accomplishes this. If this is done, the children of a deceased beneficiary will each receive an equal share of the benefits intended for that family line. It is critical that both primary and contingent beneficiaries be named to ensure the proper planning.

Beneficiary designations can be deemed [revocable](#) or [irrevocable](#), depending on the contract's flexibility. If revocable, the policy owner can change the beneficiary designation at any time without the beneficiary's consent or notification. With an irrevocable designation, the policy owner cannot change the beneficiary designation without the beneficiary's consent, such as in a business or [key man policy](#). (For more insight, see [Life Insurance Distribution And Benefits](#).)

Distribution Options

Life insurance benefits can be distributed in a number of ways. The most obvious is the [lump sum distribution](#), which is essentially a one-time payment in cash. With an "interest option", the death benefits are left with the insurance company but paid out at a later time, in which case a minimum guaranteed rate of interest is paid to beneficiaries. Beneficiaries can also opt for an "[installment option](#)", whether a fixed installment period or fixed installment amount. The latter option is sometimes used by policy owners to ensure that the beneficiary does not spend all the money at once. Finally, the "life income" option, which is much like an [annuity](#), also pays the life insurance proceeds over time, but based on the beneficiary's life expectancy. The life income option has several payout possibilities:

Straight Life Income: Proceeds are paid to the beneficiary on the basis of [life expectancy](#).

Life Income with Period Certain: The beneficiary is paid for as long as he or she is alive, but with a minimum number of guaranteed payments.

Life Income with Refund: The beneficiary is paid as long as he or she lives, and if original principal remains after the beneficiary dies, then it is paid to a contingent beneficiary.

Joint and Survivor Income: Income is paid to two beneficiaries, with payments continuing to the survivor after the first payee dies.

Other Insurance Policies

The list of insurance products is not limited to health, life, or property protection; in fact, there are many other risk management solutions available in other forms of insurance too.

Specified Disease Insurance

Taking a step beyond health insurance, specified disease insurance (such as cancer insurance or Alzheimer's insurance) helps people guard against the incredible financial burdens of specific long-term diseases or conditions. These types of policies often provide a cash benefit for just about every part of the treatment regimen, from hospital confinement to treatment and drugs. Benefits are often paid directly to the policy owner. When considering this type of policy, it is important to determine the waiting period required before benefits are paid, the maximum benefits and maximum length of time benefits are payable, as well as the exact definition of the disease covered. (For related reading, see [Critical Illness Insurance: Get Paid If You Get Sick](#).)

Professional Liability Insurance

Professional [liability insurance](#) is a specialty coverage not covered under any property or homeowners endorsements. Professional liability coverage protects professionals, such as doctors, financial advisors, etc., against financial losses from lawsuits filed against them by their clients or patients. While practitioners from different professions are expected to have extensive technical knowledge and experience, mistakes might happen and they can be held responsible in a court of law for any harm they cause to another person or business. These types of policies are often called "[errors and omissions](#)" or "malpractice" policies. (To learn more, read [Don't Get Sued: Five Tips To Protect Your Company](#), [Filling The Gaps In General Liability Insurance](#) and [Cover Your Company With Liability Insurance](#).)

Title Insurance

[Title insurance](#) offers protection against loss arising from problems connected to the title to your property. This is often incorporated with the home-buying process, when a formal [title search](#) is completed before a lender extends credit toward the purchase of a home. As with mortgage insurance, it protects the lender but the borrower must pay the premium, which is a single payment, up front. You may want title insurance because it will protect you against human errors or oversights relating to the clean transfer of property titles. Consumers can choose among a variety of options, but the top three policies include owner's, lender's and extended coverage title insurance.

Credit Insurance

Credit insurance is an optional protection purchase from lenders and is often associated with mortgages, loans or credit cards. It protects the lender and the borrower on the chance that he or she is unable to repay the debt due to death, disability or involuntary unemployment. Before you consider buying this type of insurance, do your homework. It might make more sense, and may be more cost effective, to purchase life, disability or other types of coverage that do not limit you to a specific debt. (For more insight, see [15 Insurance Policies You Don't Need.](#))

Conclusion

Insurance is an integral part of any personal financial plan. The type of insurance and the amount of coverage you obtain all depends on your unique financial and family circumstances, and must be evaluated carefully. When considering purchasing coverage, you should review all the potential risks and the financial impact of these risks on your financial health. This will help you determine what options to look for and what questions to ask. What you need to keep in mind is that you do not want to be underinsured or overinsured, which means you have to do your homework before you buy. And as with any type of financial product, you must read the fine print and consult with a competent advisor.

Let's review what we've learned:

- [Insurance](#) is a form of risk management in which the insured transfers the cost of potential loss to another entity in exchange for monetary compensation known as the [premium](#).
- Insurance works by pooling risks. Because the number of insured individuals is so large, insurance companies can use statistical analysis to project what their actual losses will be within the given class. This allows the insurance companies to operate profitably and at the same time pay for claims that may arise.
- [Underwriting](#) is the process of evaluating the risk to be insured. This is done by the insurer when determining how likely it is that the loss will occur, how much the loss could be and then using this information to determine how much you should pay to insure against the risk.
- The insurance contract is a legal document that spells out the coverage, features, conditions and limitations of an insurance policy.
- Property and [casualty insurance](#) is insurance that protects against property losses to your business, home, or car and/or against legal liability that may result from injury or damage to the property of others. This type

of insurance can protect a person or a business with an interest in the insured physical property against losses.

- An auto insurance policy typically covers you and your spouse, relatives who live in your home and other licensed drivers to whom you give permission to drive your car.
- Homeowners insurance typically covers the dwelling (the structure), personal property and contents, and some forms of personal liability. The policy may cover direct and consequential loss resulting from damage to the property itself, loss or damage to personal property, and liability for unintentional acts arising out of the non-business, non-automobile activities of the insured and members of that insured's household.
- Umbrella insurance helps you protect your assets if you are sued. If you are worried that the liability insurance coverage you have through your auto or property policies is still not enough, you can consider adding an umbrella policy.
- [Health insurance](#) is a type of insurance that pays for medical expenses in exchange for premiums. The way it works is that you pay your monthly or annual premium and the insurance policy contracts healthcare providers and hospitals to provide benefits to its members at a discounted rate.
- An [indemnity plan](#), sometimes called a fee-for-service plan, is a type of insurance that reimburses you according to a schedule for medical expenses, regardless of who provides the service.
- The HMO is the most common type of insurance policy people own and the one most frequently provided by employers. HMOs provide a wide range of comprehensive healthcare services to a group of subscribers in return for a fixed periodic payment.
- PPOs are a group of healthcare providers that contract with an insurance company, third-party administrators, or others (like employers) to provide medical care services at a reduced fee.
- A point of service plan is a hybrid plan that combines aspects of an HMO, PPO and indemnity plan. This type of plan is more flexible in that it allows you to decide at the time you need services to elect to use the POS plan's physician to arrange in-network care (HMO feature), or to go outside the network or hospital and pay a higher portion of the cost.
- Disability insurance can replace a portion of the salary you were making before you became disabled and unable to work after a serious injury or illness.
- Disability insurance providers rate their premiums based on your job and the level of risk involved in doing that job.
- The reason to buy long term care insurance is to protect your assets in case you need to pay for assisted living, home care or a nursing home stay.
- Life insurance provides you with the opportunity to protect yourself and your family from personal risk exposures like repayment of debts after

death, providing for a surviving spouse and children, fulfilling other economic goals (such as putting your kids through college), leaving a charitable legacy, paying for funeral expenses, etc.

- [Whole life insurance](#) provides guaranteed insurance protection for the entire life of the insured, otherwise known as permanent coverage. These policies carry a "cash value" component that grows tax deferred at a contractually guaranteed amount (usually a low interest rate) until the contract is surrendered.
- [Universal life insurance](#), also known as flexible premium or adjustable life, is a variation of whole life insurance. Like whole life, it is also a permanent policy providing cash value benefits based on current interest rates.
- [Variable life insurance](#) is designed to combine the traditional protection and savings features of whole life insurance with the growth potential of investment funds. This type of policy is comprised of two distinct components: the general account and the separate account. The general account is the reserve or liability account of the insurance provider, and is not allocated to the individual policy. The separate account is comprised of various investment funds within the insurance company's portfolio, such as an equity fund, a money market fund, a bond fund, or some combination of these.