

SMART WOMEN...

Smart Decisions



Understanding the Importance of Insurance

By Susan A. Myers

An unexpected occurrence, such as a death, disability, or other personal loss, is certainly not the type of event for which you can easily plan. Yet the financial ramifications can be staggering—not only to you, but to your family as well. Therefore, it is important to make a risk management plan part of your overall financial strategies.

Insurance, in all its varied forms, is quite simply a method for handling risk. In order to plan an effective insurance program, you need to consider the risks to which you and your family are exposed and how financial loss could affect you. For each risk exposure, the key elements to consider are the severity and frequency of loss.

All Risks Are Not Created Equal

Insurance is oftentimes required in certain situations: For example, some states require a driver to obtain auto insurance in order to receive or maintain a license, and some lending institutions will not approve a mortgage application if the potential owner does not also purchase homeowner's insurance. In these situations, while a base level of coverage may be required, you, as the insured, still may have choices as to the amounts and levels of coverage purchased, according to your specific risk needs.

Some risks may be so negligible that you may decide to accept more responsibility for any potential loss. In insurance language, you "self-insure" for risks you choose to accept. For example, it is rarely cost-effective to carry a large amount of collision coverage on a ten-year-old automobile. Since collision coverage generally pays actual cash value, and since a ten-year-old car may have little current fair market value (FMV), it is common to self-insure a larger portion of collision coverage in such cases. In making this choice, you assume more responsibility for any accidental damage to the vehicle that you might cause.

In contrast, in other situations, the risk is so large (or the cost of self-insurance so

great) that the best strategy is to try to avoid the risk entirely. You practice risk avoidance in daily life when you invoke the phrase "not worth the risk" to describe your decision not to participate in some events. In addition to required coverages, you may oftentimes customize insurance to protect against certain extras according to your needs. For example, it may be wise to purchase a **policy rider** for your homeowners policy if you own an antique art collection that is worth more than the value of more standard coverage.

Sometimes, for instance, risk can be reduced by taking extra measures to control the potential conditions that may lead to loss. Installing an automobile anti-theft device or a home security system may reduce the chances of burglary to your car or home.

Risk Transfer and Risk Sharing

Buying insurance is the process of transferring risk you cannot afford, or choose not to accept. Since you may be unable to afford to rebuild your home and replace all its contents in the event of fire, you may choose to transfer that risk to an insurer by purchasing the appropriate amount of **homeowners insurance**. However, even in situations of risk transfer, it is quite common to share some of the risk. For example, the deductible on an **automobile** or homeowners insurance policy is a form of risk sharing—you accept responsibility for a small portion of the risk while transferring the bulk of the risk to the insurer.

Taking a closer look at the different types of risks that are faced on a daily basis can help you answer questions such as the following: What is my risk level and how much of that risk can I afford to shoulder? What types of insurance, in addition to required coverage, might I need? And, how much coverage should I purchase? The fundamental rationale behind all forms of insurance is to determine what risks can be transferred on a cost-effective basis.

Please give me a call to discuss your financial needs.

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