SPECIAL REPORT

How to Insure Your Way to a Rock-Solid Retirement

Editor, *Retirement Watch*
by Robert C. Carlson

IMPORTANT NOTE: This special report is for information and educational purposes only. Please consult the latest issue of ***Retirement Watch***, ***Bob's Journal*** or www.RetirementWatch.com for the latest information before taking any action.

How to Insure Your Way to a Rock-Solid Retirement

Copyright © 2024, by Bob Carlson. All rights reserved.
No quotes or copying permitted without written consent.

Published by:
Eagle Products, LLC
122 C Street NW, Suite #515
Washington, DC 20001
1-800-552-1152

Email: CustomerService@RetirementWatch.com
Website: www.retirementwatch.com

How to Insure Your Way to a Rock-Solid Retirement

Bob Carlson, Editor – Retirement Watch

Stop Overpaying and Underinsuring

Successful Americans are paying too much for insurance yet don't have enough coverage. Those are the findings of a recent survey from ACE Private Risk Services (now a part of Chubb). The problem actually is worse than earlier surveys.

It's easy to see how the situation developed. Most successful people didn't start that way. In their young adult years, they did the responsible thing and bought the insurance they needed. The purchases generally were made through mass market insurers and agents. The trouble is the insurers and brokers didn't grow in the same direction as the clients.

Now, the clients are successful professionals and business owners with significant investable assets, homes and businesses. Their needs aren't being met by mass market insurers and agents. That's why these clients are paying too much yet are underinsured.

Insurers and brokers experienced in dealing with successful people often can reduce costs while improving coverage across the board, according to the ACE survey. A majority of brokers surveyed said they typically reduce a new client's premiums by 5%.

Here are the actions typically overlooked by successful people who haven't had an experienced advisor comprehensively review their coverage in recent years.

Increase deductibles. Raising deductibles reduces premiums. Low deductibles make some sense in the early adult years when cash is tight and there isn't a cushion of savings. But later in life, many people can handle a higher deductible when there is a covered incident. Unless you're very accident prone, you'll save more money long-term by raising deductibles to reduce premiums.

Safety discounts. Many people have loss prevention or safety devices that qualify for insurance discounts, or they easily could obtain the devices. Burglar alarms and leak detection systems are two common examples of features in the homes of many successful people that they don't think to notify the insurer about. An insurer or broker who is used to dealing with this group will first go through a checklist of such devices to ask which ones the client has, and then will advise which additional features would be cost-effective to obtain.

Consolidation. Discounts are available when a person or household purchases more than one policy from the same insurer. Some insurers that specialize in one type of coverage will form a partnership with insurers in other specialties to offer consolidation discounts. When you're using more than one insurer, research the discounts available for consolidating coverage at one of them.

Umbrella liability. Most people don't have enough liability coverage. Their only coverage is the standard limit in the homeowner's insurance. As a successful person, you're a target for lawsuits based on actions taken by you and your family.

Even inaction can result in a lawsuit that you negligently failed to remove a hazard or take other action. Umbrella liability insurance is relatively cheap and will protect the assets accumulated over your lifetime. Some professions are more vulnerable to lawsuits than others. The more activities you and your family engage in, the more likely you are to be sued for something.

Home coverage limits. Agents report that most people have inadequate coverage limits for a full or substantial destruction of the home. It likely will cost more to rebuild your home than the home's market value, especially if it is older and would need to be brought into compliance with current building codes.

Personal property coverage. Standard homeowner's policies have limited coverage for the contents of a home. The standard coverage formula is fine for young adults with few personal possessions to replace. But the cost of replacing the contents of your home is far more than its current value and probably much more than the standard policy limit would cover.

Protection from the uninsured. You or a family member could be harmed by a person without insurance or assets to pay for the damages. Be sure your auto policy has adequate uninsured motorist's coverage.

Be sure titles are correct. As part of your estate plan, you might have shifted some of your assets to a trust or limited liability company. Be sure these items are covered by your insurance. You don't want to suffer a loss and discover it isn't covered because legally you no longer own the car or home.

Do you have a new business? Some people turn their hobbies into businesses during retirement. That could create a new list of potential liability claims. You might be able to cover these under the personal umbrella liability policy, or you might require separate insurance. Be sure you're covered.

Check directors' and officers' liability. One of your activities might be to serve on the board of some organization. It might seem harmless and good community service to serve on the board of, say, a local youth sports league.

But what if one of the coaches made sexual advances to some players, and the parents sue the league, including the directors? Being on the board of any organization opens up the potential for personal liability suits. Even if the suit is frivolous, you need a lawyer. Be sure the organization has sufficient insurance to protect its officers and directors. If it doesn't, buy your own policy.

Now that most of your earnings years are in the past, one of the greatest obstacles to lifetime financial security is having a significant portion of your nest egg taken by a catastrophe or liability suit. Combine the cost-saving measures with the strategies for boosting coverage.

It's easy to fix these shortcomings. Meet with an insurance agent who is experienced working with well-off people. If you're like most people, you're likely to end up with more complete coverage at a lower cost.

Covering the Overlooked Insurance Risk

At the bottom of the list of insurance policies most people consider is disability insurance (DI). It's the last policy people buy and the first they cut when cash becomes tight. Yet, disability insurance is essential for a package of complete protection, and at many ages you're more likely to need it than other types of insurance. On the other end of the spectrum are people who have too much coverage.

Disability insurance provides cash flow to people who are unable to earn income because of physical or mental conditions. DI can be short-term, paying benefits for a limited period, or long-term, paying benefits for many years or until age 65. It's important for those in physically demanding jobs because they're most likely to lose their ability to earn income due to injuries or chronic conditions. But DI also covers disabilities that don't spring from work.

Your ability to earn income could be diminished by an auto accident or an accident while working around the home or even from falling. DI also kicks in when you are limited by a stroke, heart condition, other physical condition or a nervous or mental disorder. As I said, statistically at many preretirement ages, you're more likely to suffer one of these accidents or injuries than you are to die. DI is more likely to pay benefits than life insurance.

Group DI policies, offered by most employers of any size, are the foundation of disability protection plans. Under the typical plan, the employer pays for basic coverage, and there's an option for employees to obtain additional coverage by paying the additional premiums. A typical basic group benefit pays 60% of salary per month for a period of years. You might be able to pay additional premiums to increase the percentage of salary or the period covered. Coverage purchased through an employer's group plan is likely to be substantially less expensive than an individual policy.

When employer coverage isn't available or isn't adequate, consider an individual DI policy. An advantage to individual DI is you keep the coverage when you change employers, and you don't have to medically re-qualify when you change jobs.

Individual DI policies come in two types. Guaranteed renewable policies allow the insurer to increase the premiums only on a class of policyholders, but you won't be denied renewal because of your health or other conditions. Non-cancellable policies have fixed premiums as long as the premiums are paid on time. Most advisors prefer non-cancellable policies, because you're sure of the policy and its cost for the long term.

But the initial premiums are substantially higher. For example, LIMRA, an insurance information service, said a few years ago that the average guaranteed renewable individual policy was $600 annually while non-cancellable premiums were $2,000. Before buying a policy, consider the definition of disability that will trigger payment. A standard and desirable
coverage is “own occupation,” which pays benefits for someone unable to continue his or her career even when they are able to pursue other work. For example, it would pay benefits to a surgeon who might be unable to operate but be able to teach, consult or treat patients in a non- surgical setting. Another desirable provision is one that pays some benefits in case of partial disability. Some policies cover only total disability.

The broader the coverage, the higher the premiums. To reduce premiums, don’t insist on “own occupation” coverage or partial disability riders, also known as residual coverage.

You also can reduce premiums by lengthening the waiting period. DI policies pay only after you’ve been disabled for a minimum time, known as the waiting period. The longer you self-insure for temporary or initial periods of disability, the lower the premiums. Another way to reduce premiums is not to elect the inflation rider.

The level of coverage also determines premiums. Instead of trying to replace all or most of your current income, you can buy DI that covers your essential expenses. DI also offers a catastrophic benefit rider that pays additional benefits in case of a severe disability. Consider whether you want to pay extra for this rider or if it duplicates coverage available through a long-term care policy or other coverage.

Residual benefits and inflation coverage are valuable and worthwhile if you can afford them. But if either or both of those provisions make DI unaffordable, it’s better to have some coverage without those riders than to have no coverage.

It’s important to consider the long-term tax effects. The rule is that disability benefits, when paid, are tax-free if you didn’t receive a tax break on the premiums. If you deducted the premiums or they were tax-free because they were paid by the employer or through an employer plan, then any disability benefits you receive will be included in gross income.

You’re likely to be better able to handle the taxes when not disabled, so it generally makes sense to forego tax benefits on the premiums and ensure any disability benefits you receive are tax free.

You’ll want to reassess DI coverage as you near retirement. You might have accumulated enough assets when you are within five years or so of planned retirement that it makes sense to drop the coverage and invest the premiums. But carefully perform your analysis.

The last few years of employment often are valuable savings years that can pump up the nest egg. They also are when people are most likely to become disabled. Be sure you have a substantial cushion in your nest egg before dropping DI coverage.

You likely qualify for disability benefits under Social Security, but these benefits are limited. Social Security pays disability benefits only for total disability. If you can perform any work, you don’t qualify. The disability also must be permanent, which means it has lasted or is expected to last more than one year or result in your death. You also might qualify for

workmen's compensation benefits, but they pay only for a disability incurred as a result of your job.

Setting Up Your Financial Protection Plan

Turbulent weather, beginning with the monster hurricane season of 2005 and continuing through recent unusual weather, triggers a lot of thinking about insurance for homes, autos, belongings and personal liability. That's a good thing because most people have a lot of their insurance wrong. They have coverage gaps or are paying too much. Don't wait until you need the coverage to discover there is a problem. Review your insurance every year or two.

Before getting into policy details, first review who insures you and when the policies expire. Many insurers give discounts to customers who have more than one type of policy with them. Consider consolidating two or more policies. But don't make consolidation the prime goal. If you can get broader, cheaper or better coverage using different insurers, do so.

Your financial life also might be easier if all the policies are due for renewal at the same time each year. Consider shifting the policy effective dates.

Those moves might save time and money. A detailed review can also help. We'll start with auto insurance.

Uninsured motorist coverage is vital. Few drivers are aware of the number of uninsured drivers on the road and the threat posed by them. In eight states, including Florida and California, more than 20% of drivers are uninsured, according to the Insurance Research Council. The group estimates that in Colorado, 32% of drivers are uninsured.

Standard auto and health policies might not cover all the damage done by an uninsured motorist. Purchasing uninsured motorist coverage as part of your auto policy is fairly cheap and offers solid protection. The insurer will pay for damages as though the uninsured motorist had the minimum coverage in the state. Without this coverage, you might be surprised by what your regular auto and health insurance won't cover when the uninsured driver is at fault. The uninsured motorist coverage usually is extended to all members of your household, even if they are in someone else's auto at the time of an accident.

You know that premiums can be slashed by raising deductibles. High deductibles ensure that insurance is only for catastrophic losses and that regular savings or income pay for other losses. (Some states or insurers do not allow deductibles to exceed $1,000.) Raising deductibles is a good move if you have the financial resources to pay the higher deductible and are comfortable absorbing that much of a loss in case of an accident.

Most people do not pay much attention to the bodily injury and property damage limits in the policies. Of course, the higher the coverage limits, the higher your premiums will be. But you don't want to slash premiums if it leaves you exposed to significant liabilities for any accident caused by you or a family member.

The better strategy is to coordinate the liability and medical expense coverage with your other policies, especially an umbrella liability policy. Be sure there aren't gaps unless you are willing to cover them. For example, an umbrella policy usually won't kick in until a

minimum liability is incurred. Be sure that minimum is not higher than the auto policy's maximum liability. Otherwise, you pay the difference in addition to the deductibles.

Homeowner's Insurance Has a Number of Potential Pitfalls.

Most policies these days cover only losses from "named perils." Losses from other perils are the owner's responsibility.

Flood damage is not covered in standard policies. Coverage must be purchased from the National Flood Insurance program. Special coverage for some perils is available only through state programs.

For example, Florida residents generally need to get windstorm coverage through a statesponsored program. Consider all the hazards that could damage your home. Then, see which are not covered by the policy. Ask the insurer or agent how to get covered for those perils. Coverage might not be available, at least not for a price you are willing to pay. At least then you will know the risk you are taking in that location.

The replacement cost coverage in today's policies is something many people still get wrong. The covered amount should be the cost of rebuilding the dwelling, not its market value. There can be a dramatic difference between the two.

Insurers now want the covered amount to be at least 80% of their estimate of rebuilding the dwelling. If your coverage amount is less than that, you will cover the difference in addition to deductibles.

For example, suppose your home has a $500,000 replacement cost, but the covered amount is $250,000. That is less than 80%, so the insurer will cover only a pro rata portion of any losses, in his case 50%. If you suffer a $100,000 loss, the insurer will cover only $50,000. You pay the rest, plus the deductible.

Personal property is also covered under the homeowner's policy but requires more attention than most people give it. Most policies exclude or put a $1,000 limit on items such as jewelry, coins, furs, antiques and computers. When your holdings are more valuable, you need to purchase "scheduled coverage" for these items. A list of the scheduled items is attached to the policy and the premium for covering each item is separately calculated.

You might be required to get the items appraised and to periodically have the appraisal updated. It is a good idea to maintain evidence of ownership of the items and to keep that evidence secure in a disaster-proof location or at least away from the location of the property. You should have detailed descriptions of the items, photographs and any other supporting information. Some people maintain a video tour of their homes.

Those who own property in more than one state need to discuss the ramifications with their insurers or agents. Personal property generally is covered under a homeowner's policy regardless of where it is damaged, lost or stolen. But the rules might differ if you own more than one home. The insurer of one property might not cover personal property damaged or stolen at the other property. It also might matter to an insurer whether property normally was kept at one location or was transferred from one location to the other. Be sure you know which policy covers an item. Otherwise, you might find that there is a gap in your coverage.

Liability coverage also deserves more attention than most people give it.

A vacant property or rental home needs liability coverage. You could be responsible for any accident that happens on the vacant property, especially if there is some kind of attractive nuisance. Likewise, as the owner of a rental property, you could be responsible for the actions of the tenant. You can require the tenant to have insurance, but you also need separate coverage to protect you.

Almost everyone should have an umbrella liability policy.

Regular coverage for autos, homes and other items will have liability coverage with fairly low limits. An umbrella policy significantly increases your coverage for a wide range of liabilities at a low cost. Often $1 million of additional liability coverage costs less than $300 annually.

To ensure the umbrella policy does its job, first match its lowest payout level with the maximum coverage of other policies. For example, your auto liability might top out at $300,000. But a standard umbrella policy might cover only liabilities above $500,000. That puts you on the hook for the $200,000 difference unless one of the policies is amended.

Also, make sure all the potential sources of liability are listed in the umbrella policy. The listings should include all residences and vehicles, including watercraft, motorcycles, aircraft and recreational vehicles, whether owned or rented. Also list every driver who resides at one or more of your homes and be sure pets are covered.

An umbrella policy will exclude some activities for which separate coverage is available, such as serving as a director or officer of a business or organization. If you engage in such activities, be sure of coverage.

Household workers, both permanent and temporary, are another potential source of liability. You could be liable to them for injuries they receive or to others from the workers' actions. Be sure you have a policy that covers these situations.

Finally, set the umbrella coverage limit high enough. You want to cover existing assets and also future income and assets. The limit to choose is a tough call. An attorney or experienced broker might be able to offer the best advice on the maximum potential liability you face.

Handling the Crisis in Long-Term Care Insurance

Headlines beginning in late 2010 and continuing point to serious problems in long-term care insurance (LTCI). *The Wall Street Journal* blared: "Long-Term-Care Premiums Soar." This shortly was followed by news that a major player in LTCI, MetLife, was stopping the sale of new policies, and others followed with either sharp premium increases or withdrawals from the market.

The first article detailed sharp proposed premium increases on existing policies by Manulife Financial, a subsidiary of John Hancock, and indicated other insurers were implementing increases. The highest and most pervasive increases were from Hancock, and they averaged 40% for 850,000 of its 1.1 million policyholders. The article also reported on a couple who were given notice of a 47% premium increase from Lincoln National.

The proposed Hancock premium increases were a surprise. Hancock went many years without premium increases on existing policies. Most states imposed rate stabilization laws in the early 2000s, reducing some of the volatility of premiums since. The laws require insurers to justify large premium increases by documenting unusual or unexpected circumstances, and state regulators have to approve increases. Because of the laws, not all proposed premium increases go through. But most of the LTCI premium increases went through because the insurers had financial problems.

Several factors are behind the premium increases, and they all boil down to actual experience being different from the assumptions made when the policies were written.

- Interest rates are low. Rates and investment returns were much higher when the policies were written. The low returns of recent years led to a significant shortfall of investment income for insurers.
- People are keeping their policies. Premiums were determined assuming a percentage of people would pay premiums for a few years then let the policies lapse. Fewer people than expected dropped their policies, and that leads to more claims than expected.
- People are living longer. LTC is most likely to be needed by those 80 and older. As that age group increases faster than insurers expected, claims on policies are higher than planned.
- Long-term care costs keep rising. Again, these increases exceed what insurers planned.
- Some insurers did a poor job of underwriting. They issued policies to applicants without thorough medical reviews, underestimating the true risk that policyholders would file claims for benefits. That is fairly common in the history of LTCI, though it is unusual for a large, experienced LTCI carrier.

The result of all these factors is insurance companies losing money on LTCI, or at least earning a lot less than they expected and can earn elsewhere.

Despite the headlines, you shouldn't panic and dismiss the idea of purchasing LTCI. I've said in the past it's best to choose only from the most experienced LTCI issuers to avoid problems such as sharp premium increases.

Not all LTCI issuers are having problems. Bob Gertie of Advisor Insurance Perspectives expressed confidence that a few large insurers won't have significant premium increases. *The Wall Street Journal* reported that New York Life and Northwestern Mutual hadn’t raised premiums on existing policies when others were.

These episodes re-enforce points we've made in the past. Don't buy the lowest-cost policy; it's probably underpriced and will impose premium increases down the road. Choose an insurer that's been in the business for a while and check its history of premium increases.

To those we add two other criteria. Don't choose an insurer that does a lot of group or employer provided LTCI business. Also, buy policies in a new product line. The premiums will be higher than for an older policy line. But the newer policies probably have more realistic pricing and are less likely to face significant increases down the road.

What if you have LTCI and face steep premium increases? You can shop around for a new policy. You'll need to be medically qualified, and it's possible because of your age a new policy will cost more than the old, even after the premium increases.

You could also reduce premiums when staying with the current policy and adjusting policy terms such as:

- Benefit period or limit. Few people will use unlimited lifetime benefits. Accept a benefit ceiling of somewhere from $1 million to $5 million, or if the policy benefits are in years, select a three-to-five-year limit. Your premiums will drop. But you'll take the risk that you'll be among the few who need extended LTC.
- Daily benefit. Double check the cost of long-term care in your area to determine if the daily benefit in your policy is in line with your policy's terms.
- Elimination period. This is similar to a deductible. It is the period of time you pay for all long-term care before the policy coverage kicks in. Extend this period, and your premiums will fall.

Here are a couple of other steps to consider.

You could purchase one of the hybrid policies, which are life insurance or annuities with LTCI riders. These aren't for everybody but can meet the needs of many people. A hybrid life policy is likely to have higher lifetime LTC coverage than a hybrid annuity, and a standalone LTCI usually offers more coverage than one of the hybrids. The hybrids usually require a large single premium. Check the Archive on our members' web site for details of hybrid policies. Some insurers will let you pay for a lifetime of LTC benefits over five or 10 years, known generically as a short pay plan. You'll pay steeper premiums for those years, but it lowers the risk of premium increases.

I don’t recommend reducing premiums by dropping inflation protection. The inflation protection is too important.

Remember, LTCI is only about 30 years old. It's a relatively new and fast-changing industry. You have to expect changes and keep up with them. But the keys to affordable, reliable coverage are the same. Stay with the most experienced insurers who are careful about issuing policies. Adjust your policy terms to find a comfortable tradeoff between your premiums and the coverage levels.

Re-Evaluating Your Life Insurance

Many people are reconsidering their life insurance coverage. The latest estate tax law and low interest rates change the equation for many people. But don't make a quick decision. Make a careful review with your estate planner.

Most permanent life insurance was purchased to help pay estate taxes. Recent tax laws moved many estates out of the taxable category. Despite the change, most of you should avoid irrevocably terminating the life insurance. Consider the broader picture, and you might decide to keep the insurance for at least a while.

Life insurance likely has other benefits other than paying for estate taxes. For example:

- The insurance benefits provide liquidity for the estate to pay debts, allow equal inheritance shares without dividing ownership of assets and prevent the forced sale of assets.
- Life insurance might be required as part of a shareholder agreement or other contract. The insurance benefits also could help with business ownership succession by providing cash that allows purchase of the business from the estate.
- Life insurance can be a conservative, low return investment, so it could be a good addition to an estate that has primarily risky assets.
- The insurance can increase the legacy left for heirs or a charity. You could decide it's worthwhile to keep the policy in place to provide the benefits to loved ones or a charity.
- Life insurance, especially if it's owned through an irrevocable trust, has asset protection benefits. The benefits should be out of the reach of creditors of you and your heirs.

When you decide to keep the insurance, you still might want to make some changes. Most life insurance purchased for estate planning reasons is held in an irrevocable trust. While the trust is irrevocable, often there is flexibility. The trustee might be able to transfer the trust assets to a new trust with some different terms to reflect your new goals.

Some trusts were created with trust protectors, individuals appointed by the trust creator to monitor the trust and make selected changes to the terms. The trust protector could change the beneficiaries, move the trust to a state with more flexible laws or change the distribution terms. You might conclude that you no longer want the insurance policy. If so, don't simply stop paying premiums. Consider other options. The trustee might be allowed to distribute the policy to the beneficiaries. They would then own the policy and its cash value and could choose to keep it in force, cash it in or borrow against the cash value.

Don't make rash assumptions about life insurance because you might not face an estate tax problem. There are other reasons besides paying estate taxes to own life insurance, and there often is some flexibility in current arrangements that could let you change them. Take some

time to consider all the factors and discuss the options with your estate planner, life insurance agent and other financial advisors before making an irrevocable decision to drop the insurance.

Biography

Bob Carlson is editor of the monthly newsletter and website, *Retirement Watch*. He has served on the Board of Trustees of the Fairfax County Employees' Retirement System since 1992 and been chairman since1995. The system has more than $4 billion in assets. Carlson was a member of the Board of Trustees of the Virginia Retirement System, which oversaw $42 billion in assets, from 2001-2005. He was appointed to the Virginia Retirement System Deferred Compensation Plans Advisory Committee in 2011. His latest book is the revised edition of "The New Rules of Retirement" (Wiley, 2016; first edition 2004). He also co-authored "Personal Finance After 50 for Dummies" (with Eric Tyson; Wiley, 2015) and wrote "Invest Like a Fox…Not Like a Hedgehog" (Wiley, 2007). He has written numerous other books and reports, including "The New Rules of Estate Planning," "Securing Your Lifetime Stream of Income," "Tax Wise Money Strategies, Retirement Tax Guide," "How to Slash Your Mutual Fund Taxes," "Bob Carlson's Estate Planning Files" and "199 Loopholes That Survived Tax Reform." He also has been interviewed by or quoted in numerous publications, including *The Wall Street Journal*, Reader's *Digest*, *Barron's*, *AARP Bulletin*, *Money*, *Worth*, *Kiplinger's Personal Finance*, the *Washington Post* and many others. He has appeared on national television and on a number of radio programs. He is past editor of *Tax Wise Money*.

Carlson also was a Commissioner on the Fairfax County Redevelopment and Housing Authority. Carlson is an attorney and passed the CPA Exam. He received his J.D. and an M.S. (Accounting) from the University of Virginia and received his B.S. (Financial Management) from Clemson University. He also is an instrument rated private pilot. He is listed in many editions of *Who's Who in America* and *Who's Who in the World*.

RWRSR0524