How to Build Insurance Into Your Retirement Plan

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Saving for retirement isn't just about investing. A comprehensive retirement plan should also include protecting your savings from unexpected financial risks.

Most people have a period of vulnerability between the time they begin accumulating assets and the time they accumulate enough assets to retire. This vulnerability stems from the financial risks associated with events like premature death, disability, or an expensive lawsuit. While these common, but unexpected, events can be financially ruinous, you can mitigate their potential consequences by purchasing the appropriate policies and sharing risk with insurance companies.

When Life Insurance Makes Sense

The primary purpose of life insurance is to mitigate the risk that your loved ones will suffer financially if you die prematurely. If you don't have financial dependents, or if you have enough assets to provide for your loved ones when you die, then you may not need life insurance. However, if there are people in your life who would suffer financially if you died tomorrow, you should consider owning life insurance.

There are two primary types of life insurance: whole life and term life. With a whole life policy, you pay premiums for your entire life for a guaranteed payout to your beneficiary at the time of your death. While you are alive, some of the money paid in premiums is invested within the policy as tax-sheltered cash value.

With a term life policy, you pay a premium for a defined death benefit for a term of years (typically 10-30 years). Unlike with whole life policies, there is no cash value and your beneficiary will only receive a death benefit if you die within the term of the policy. For most people, 20 or 30-year renewable term life insurance is the most appropriate and cost effective means to mitigate the financial consequences of premature death.

Life insurance salespeople are paid large commissions to sell whole life policies, and frequently pitch them to consumers as both a good investment and a superior insurance product. In reality, whole life policies are very costly (compared with term coverage), are not great investments, and are difficult to cancel. In most cases, you are better off buying term coverage and investing what you save on premiums.

When determining how much insurance you need, a rough rule of thumb is 20-30 times your family's annual expenses (assuming you have no savings or outside income sources). As you accumulate enough assets to provide your dependents with enough income to live comfortably after you die, your need for life insurance decreases and (hopefully) eventually disappears.

The Benefits of Disability Insurance

Becoming catastrophically or permanently disabled can be financially ruinous because you may lose the ability to earn an income while simultaneously experiencing an increase in your cost of living. Owning disability insurance allows you to share the risk of a disability-related loss of income with an insurance company.

Short term and long-term disability policies are typically sold as separate products. While short-term disability insurance is nice to have, long-term disability insurance will pay you a percentage of your income (at least 60%) in the case of a longer-term disability, and is absolutely essential.

Group disability coverage is offered at a low cost by some employers and membership organizations as an employee/member benefit. If group disability coverage isn’t available to you, individual coverage is another option. Although individual coverage is often more expensive and contingent upon medical underwriting, the benefits are typically better than with group coverage.

Most disability policies stop benefit payments at age 65, so planning for income and expenses beyond that time is important.

How Liability Insurance Protects You

If you drive or own a car, an auto accident is likely your number one source of liability, and related judgments can easily reach millions of dollars. Purchasing personal liability umbrella insurance is the easiest way to put millions of dollars between a car accident creditor and your assets.

Most auto insurance policies have liability coverage limits of $300,000 to $500,000. If you have liability in excess of that amount, you’re responsible for the balance. If you aren’t able to pay the rest, a creditor could come after your assets, and potentially garnish your wages. If you have umbrella liability coverage, the umbrella policy will step in and pay what you owe above what your underlying auto policy covers, and up to the limits of the umbrella.

You can purchase umbrella liability insurance very cheaply through your auto or home/rental insurer. You shouldn’t have to pay more than $200-$300 per million dollars in coverage. Umbrella policies will also cover you for a broad range of other problems, such as liability stemming from other vehicles or your home.

Don't Overlook Protecting Your Assets

While most savers turn to stocks and bonds when thinking about investing for retirement, it’s important to remember to protect your assets from unexpected risks. Risk sharing through insurance is an easy way to accomplish that.

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