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Insurance and Investments

A good financial strategy is not just about "making money;" it is also about protection.

Provided by Chris Eller

Some people mistake investing for financial planning. Their "financial strategy" is an investing strategy, in which they chase the return and focus on the yield of their portfolio. As they do so, they miss the big picture.

Investing represents but one facet of long-term financial planning. Trying to build wealth is one thing; trying to protect it is another. An effort must be made to manage risk.

Insurance can play a central role in wealth protection. That role is underappreciated – partly because some of the greatest risks to wealth go unnoticed in daily life. Five days a week, investors notice what happens on Wall Street; the market is constantly "top of mind." What about those "back of mind" things investors may not readily acknowledge?

What if an individual suddenly cannot work? Without disability insurance, a seriously injured or ill person out of the workforce may have to dip into savings to replace income – i.e., reduce his or her net worth. As the Council for Disability Awareness notes, the average length of a long-term disability claim is nearly three years. Workers' compensation insurance will only pay out if a disability directly relates to an incident that occurs at work, and most long-term disabilities are not workplace related. Disability insurance can commonly replace 40-70% of an individual's income. Minus disability coverage, imagine the financial impact of going, for instance, three years without work and what that could do to a person's net worth and retirement savings.[1]

What if an individual suddenly dies? If a household relies on that person's income, how does it cope financially with that income abruptly disappearing? Does it spend down its savings or its invested assets? In such a crisis, life insurance can offer relief. The payout from a policy with a six-figure benefit can provide the equivalent of years of income. Optionally, that payout can be invested. Life insurance proceeds are usually exempt from income tax; although any interest received is taxable.[2]

Most people want a say in what happens to their wealth after they die. Again, insurance can play a role. At a basic level, those with larger estates may use life insurance to address potentially large liabilities, such as business loans, mortgage payments, and estate taxes. An ILIT may also shield the cash value of a life insurance policy from "predators and creditors." Beyond that, a sizable life insurance policy can be creatively incorporated into an irrevocable life insurance trust (ILIT), through which an individual can plan to exclude life insurance proceeds from his or her taxable estate.[3]

Yes, the estate tax exemption is high right now: $5.49 million. Even so, if a person dies in 2017 while owning a $5 million life insurance policy and a $500,000 home, his or her estate would be taxed. An ILIT would be a useful estate-planning tool in such a circumstance.[3]

Why do people underinsure themselves as they strive to build wealth? Partly, it is because death and disability are uncomfortable conversation topics. Many people neglect estate planning due to this same discomfort and because they lack knowledge of just how insurance can be used to promote wealth preservation.

The bottom line? Insurance is a vital, necessary aspect of a long-term financial plan. Insurance may not be as exciting to the average person as investments, but it can certainly help a household maintain some financial equilibrium in a crisis, and it also can become a crucial part of estate planning.

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Why Retirees Need Good Credit Scores

Careers & businesses end, but the need to borrow remains.

Provided by Chris Eller

We spend much of our adult lives working, borrowing, and buying. A good credit score is our ally along the way. It retains its importance when we retire.

Retirees should do everything they can to maintain their credit rating. A FICO score of 700 or higher is useful whether an individual works or not.

For example, some retirees will decide to refinance their home loans. A recently published study from the Center for Retirement Research at Boston College noted that in 2013, 50% of homeowners older than 55 carried some form of housing debt. In 2017, it is probable that picture is unchanged. Arranging a lower interest rate on any remaining mortgage payments could bring income-challenged retirees more money each month. A strong FICO score will help them do that; a substandard one will not.[1]

Most retirees will want to buy a car at some point. Perhaps buying a recreational vehicle is on their to-do list. Very few car, truck, or RV purchases are all cash. A good credit score can help a retiree line up an auto loan with lower interest payments.

Insurance companies also study retiree credit habits. Since the early 1990s, credit-based insurance scores have been fundamental to underwriting. Used in all but a few states, they play a major role in determining car insurance and homeowner insurance premiums.[2]

The Fair Isaac Co. (FICO) generates credit-based insurance scores, which are variants of standard credit scores. Job and income data do not matter in a credit-based insurance score. Instead, insurers add up factors from a person's credit history to project the likelihood of that person having an insurance loss. When a retiree consistently makes bill and loan payments on time, that helps her or his credit-based insurance score. The score is hurt when bill or loan payments are missed or delinquent or when debt levels become excessive.[2,3]

A strong credit rating can come in handy in other financial situations. It can help a retiree qualify for another credit card, should the need arise. If a senior wants to buy a smaller home (or move into an assisted living facility), a credit score may be a make-or-break factor. If a senior co-signs a loan for children or grandchildren, a credit rating will matter.

How can retirees boost their credit scores? Some obvious methods come to mind as well as less obvious ones. Besides paying bills on time and keeping credit card balances low, wiping out small debts can help lower a retiree's credit utilization ratio. Asking a card issuer to raise a debt limit on a card can have the same effect, provided the monthly balance stays low and is paid off routinely.[4]

Too few retirees review their credit reports, and about 20% of individual credit reports have errors. More retirees ought to ask the three big credit bureaus – Equifax, TransUnion, and Experian – for a free copy of their credit report. Every 12 months, they are entitled to one.[4]

Credit cards held for decades should be kept active, especially if they have good payment histories. The same goes for high-limit cards. Closing these accounts out can do more harm than good to a credit rating.

Remember that good credit counts at any age. TransUnion recently surveyed baby boomers and discovered that nearly half thought their credit scores would become less important after they turned 70. As you can see by the above examples, that is not true. A high credit score can help you buy and borrow long after your working days are done.[5]

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