



FINANCIAL WISDOM

- WEALTH BUILDER -

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What is Insurance?

Insurance surrounds each of us every day: When you get in your car, when you come home to your residence, and while you work. Insurance is always in the background discreetly doing its job. Most of us, however, do not think about it much or realize the very important function that all types of insurance provide. In fact, the role of insurance is so important that it is the focal point of a wise financial strategy.

Risk Transfer:

So, what is insurance? Technically, it is the process of risk transfer. When someone wants to be protected from a certain risk, they buy an insurance policy to reimburse them in the event the risk occurs.

On the insurer's side, they calculate a fee (the premium) to coincide with the likelihood of the event occurring. Auto accidents are more likely than earthquakes and so the premiums are much greater. Work accidents with short term loss are more likely than total disability so those premiums are higher for employers. Life insurance transfers the risk of a guaranteed event (death) and is priced based on the probability of you passing away at a given age and health risk. Therefore, premiums may vary greatly from person to person.

Insurance and a Financial Strategy:

How is insurance used in a financial strategy?

Financial strategizing is the process of formalizing your goals over time and creating a path to accomplish them.

One of the biggest setbacks to achieving these goals is an unforeseen event which cripples your plans. Insurance is one way of protecting your goals in case such an event does occur.

For example, let's say you plan on living in your home for many years to come. How do you account for an unexpected death while you still have a mortgage? You might transfer the risk of a premature death to an insurance company with a policy that could pay off the remaining mortgage if one of the household earners dies prematurely. The insurance company then absorbs the risk, not the family.

Not only does insurance do its job of assuming risk, it also defines its costs. We can obtain quotes for insurance by either picking up the phone or surfing the Internet. This is valuable information when setting up a financial strategy. For example, if you pass away, and one of your goals is to insure your spouse can travel while still residing in your house, you might purchase life insurance to replace your pension income.

Your financial team can help you obtain the right type of insurance for whatever goals you have. In the end, insurance provides you with two important functions. First, it allows you to accurately price each of your financial goals. Secondly, it allows you to transfer the risks of failure to an insurer to protect your financial strategy against interruptions from unexpected events.

Looking for the right type of insurance? We can help.

Grant Simpson, CMA

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The rate of return is used only to illustrate the effects of compound growth and is not intended to reflect future value of an investment fund or returns on an investment fund.

