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5 tips you need to know when buying insurance

By Steve Podnos, MD, MBA, CFP

Avoid common mistakes such as not enough disability insurance, with too many riders

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Our training as physicians doesn't include any information about insurance, one of the most expensive purchases we make during our careers. If we make a mistake when selecting our insurance policies, it can result in unnecessary expenses and unfortunate outcomes.

Mistakes can arise from misinformation, but mistakes also can arise because many insurance companies predominantly use brokers and agents who are paid for selling products rather than for providing advice with our best outcomes in mind. Fortunately, you can undertake the actions outlined here to avoid some of the most costly errors that doctors can make when purchasing different types of insurance. These tips will be especially valuable to physicians who anticipate working at least 20 more years.

1. FOCUS ON PROVIDING THE APPROPRIATE DEATH BENEFIT THROUGH YOUR LIFE INSURANCE POLICY

The most common major mistake I see practicing physicians make when buying life insurance is considering it a long-term savings investment. Life insurance has one important purpose: to replace income lost because of an untimely death. Some people also use life insurance to help with estate taxation, but that purpose is not pertinent to most physicians before they reach the late stage of their careers.

Physicians sometimes view life insurance as a long-term savings investment because insurance agents often propose this purpose when they suggest that young physicians buy various types of cash-value insurance rather than term coverage. The selling agent has an incentive to sell cash-value insurance: he or she often receives more than 100% of the first year's total premium as commission.

Cash-value insurance (alternatively called universal, variable, or whole-life insurance) involves a side savings account and internal term coverage. The cost of the savings account is a multiple of the cost of the insurance itself, so the premiums easily can reach tens of thousands of dollars a year, whereas adequate death benefit term coverage may cost a few thousand dollars annually.

If you are a young physician with dependents, you may need coverage equal to as much as 20 times your annual expected lifestyle expenses for your family as a death benefit should you die prematurely. The high premium costs associated with cash-value insurance, however, could lead you to purchase much less than that amount, and that mistake could have devastating consequences, not only because you'll have an inadequate death benefit policy but also because you probably won't realize the long-term "investment" success you expect.

So what should you do? Focus first on providing the appropriate death benefit through your policy. If you do so, you will find that 20- or 30-year guaranteed renewable level term policies will offer the most coverage for

your dollar. Only consider cash-value coverage when you have enough death benefit.

Some would argue against using only term insurance when a doctor or his or her family may need permanent insurance. Certainly, this argument is founded in some instances, for example in the case of a dependent with special needs who probably will require care long after the physician (and spouse, if applicable) are present. The counter argument, however, is that most families will accumulate substantial assets over a 20- to 30-year period while they are covered by the term insurance. In addition, the purchasing power of what looks like a large policy generally is markedly eroded over one's lifetime.

I've worked with physicians who, early in their careers, purchased a few hundred thousand dollars worth of death benefits. When they reached the latter part of their careers, they realized that this amount offered only a marginal benefit to them at that point. Learn from their experience.

Like most physicians, you may not realize that purchasing cash-value insurance means that you intend to continue paying for the internal cost of the death benefit for your entire life—even in retirement, when very few doctors require life insurance.

2. PURCHASE ENOUGH DISABILITY INSURANCE COVERAGE

As with life insurance, physicians often don't purchase enough disability coverage.

Disability insurance also has one important purpose: to replace income lost when the primary income-earner cannot work. If you are seriously disabled, not only is your income lost, but you continue to consume money. Unfortunately, all the income you lose may not be insurable because of limits on coverage for doctors. Most existing policies will cover only up to 60% of earned income, an amount further limited by an absolute cap of approximately $180,000 a year. So, a physician earning $300,000 annually can cover perhaps a little more than half of his or her usual income in the event of a serious illness or accident.

This "disability gap" is a serious problem for young families. One way to mitigate this problem is to pay disability insurance premiums with after-tax dollars so that you receive benefits tax free. Factor in the important need for young families to accumulate significant assets to self-insure for this gap as early as possible.

So why do doctors "under-purchase" coverage? Insurance brokers like to sell various riders, such as residual disability and return-of-premium riders. The costs of riders easily can double an annual premium cost of any given monthly benefit, so you could be tempted to purchase an inadequate monthly benefit.

I frequently see cases in which physicians have purchased $8,000 to $10,000 a month in disability benefits, with many riders on their policies, instead of fully insuring themselves at an allowed $15,000 a month. They do this to save on premium costs, but you can do better.

The monthly disability benefit is the most important aspect of disability insurance. If you are a young doctor, purchase the highest allowed amount of monthly benefit first (usually up to 60% of earned income, limited to around $15,000 per month with most policies). Only after doing so should you consider adding riders.

Consider the chance of a serious long-term disability and insure against that happening. Self-insure for shorter-term problems.

As with life insurance, as your family accumulates assets, you may have less of a need for maximum disability coverage, but this usually will not be the case in the first 20 years of your career.

Some riders to consider—only after obtaining the maximum base coverage:

- Residual and transitional riders offer a percentage of the full monthly benefit in the event that your income is partially reduced due to illness or injury.
- Own occupation riders provide benefits as long as you cannot perform in a specific function (for example,

if you are a surgeon unable to perform surgery, you could collect benefits even if you are able to conduct physical exams only).
- Return-of-premium riders refund premium dollars every so many years in which you don't make a claim.

Note that these riders essentially return an overpayment of premiums with a small amount of interest. Seek expert guidance in choosing any of these riders, but do so only after locking up maximal coverage for a serious event. One rider in particular that I always recommend is the catastrophic disability rider, which often adds another $8,000 per month of benefit for a low price and offers coverage if you are seriously injured or seriously ill.

Another aspect to consider with disability insurance is the elimination period, the amount of time you must be disabled before benefits begin. The shorter the elimination period, the higher the cost, because it becomes more likely that you will file a short-term claim. In most cases, a 90- to 180-day elimination period is appropriate.

3. CONSIDER BUSINESS OVERHEAD INSURANCE

Some solo physicians have not considered the effects of a disability on their savings and have not at least priced business overhead insurance.

This type of coverage pays for office overhead for a limited time period in the event that you die or are disabled. It usually is most appropriate for physicians in solo practice, because with a serious event, their overhead continues without income for some time. Group practices usually can cover both partial income changes and overhead costs internally without the need for this insurance. So if you are in solo practice, consider business overhead insurance.

4. MAKE SURE YOUR PROPERTY/CASUALTY INSURANCE DEDUCTIBLE IS LARGE ENOUGH

The purpose of property and casualty insurance is to share the risk of loss due to damage to your automobile, home, boat, or similar property. These policies typically are purchased from a single company, and the liability portion is often tied to an umbrella liability policy (see the next section). When damage occurs, the owner of the policy is responsible for a deductible amount before the insurance company pays out any funds.

The biggest mistake I see with doctors related to property/casualty insurance is that of choosing too small of a deductible. Making a claim often triggers the insurance company to increase premiums and, occasionally, to cancel the contract. Therefore, it's usually not wise to make small claims. So it makes sense to choose a high deductible and self-insure. The premiums you save over a few years usually will pay back the difference between a smaller and a higher deductible, and the policy owner's "profile" with the insurance company will lead to lower premiums, in general, long-term (as a result of fewer claims).

5. DON'T FORGET ABOUT UMBRELLA LIABILITY COVERAGE

Umbrella liability coverage increases the amount that insurance companies will pay toward liabilities that you may incur as a result liabilities incurred through automobile accidents, home accidents, and various other miscellaneous events (but not malpractice liability). The biggest mistake I see physicians make related to umbrella liability coverage is purchasing too little coverage—or even sometimes no coverage.

This insurance usually costs only a few hundred dollars per year per a million dollars of benefit. Most physician families should consider at least several million dollars in coverage, especially if the household includes teenage drivers. Rarely, however, do I see young physician families who have more than $1 million in coverage, and sometimes they have no coverage at all.

Agents have little financial incentive to offer this insurance and, therefore, rarely mention it, but an impartial adviser knows its importance.

ADVISERS CAN HELP

We entered medical practice poorly equipped to make some crucial business decisions, including decisions related to the purchase of insurance. Expert, impartial advisers, however, can help you make those choices.

HOW MUCH LIFE INSURANCE DO YOU NEED?

If you don't have dependents, you may not need any life insurance, but if you have one or more dependents, you probably need a substantial amount of coverage.

To avoid financial insecurity in the event of an income earner's untimely death, young families need coverage worth about 20 times their annual lifestyle expenses. For example, a family spending $150,000 a year should consider around $3 million in death benefit coverage.

Subtract from your total (20 times your annual lifestyle expenses) the value of any substantial saved assets, and add to the total any substantial future liabilities (for example, expenses related to the education of two or three children at a private school many years in the future) beyond usual lifestyle expenses. If you are part of a two-income couple, you may need less coverage, but consider what would be necessary should the untimely death of both you and your significant other occur.

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