Making S.M.A.R.T. Financial Decisions

When Things Go Wrong

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Did you play the game of Monopoly when you were a kid? I grew up playing Monopoly. That's me running the board. You know, some of the game was pretty realistic, educational even, but that was one card from the community chest that read, bank error in your favor. Collect $200. Do you remember that card? It was a pretty good one to get. There was also a TV show when I was a kid called The Millionaire. The premise was that each week a fabulously wealthy man named John Beresford Tipton, Jr., anonymously gave away $1 million, tax free, to a total stranger. We spent the next half hour watching what that million dollars did to each person's life. You may not be able to tell, but TVs were black and white back in my day. The Millionaire was a pretty entertaining show, and Monopoly is one the most popular board games in history. But I've never met anyone who was given a million dollars, and I've been wait-- watch out, there. I've been waiting over 50 years for a bank to make an error in my favor. Our lives are full of unexpected events. Some are positive, and some are negative. Unfortunately, unexpected financial events are usually negative.

We get hurt in accidents and can't work. We get sick and end up with medical bills that we can't afford. Homes burn down, and cars breakdown-- scary stuff that can hurt you financially if you're not prepared. But there are fortunately things you can do to protect yourself and your family from the worst effects of these unexpected, negative financial events, so that's what we're going to be talking about this week-- how to prepare for when things go wrong.

All right, let's fast forward a few years. You took this course, so your personal finances are in good shape. You've paid off your credit cards. Your savings rate is now 20% of your income, and your must-have expenses are less than 50%. And you've got an emergency fund of six month's income in the bank, and then trouble strikes. What are you going to do? Well, naturally, that's going to depend on the type of trouble and the size of the trouble.

For a lot of things, your first line of defense is going to be your emergency fund. That's going to work for things like repairing your car or replacing a broken refrigerator. Or even if you're out of work, you can use your emergency fund to help pay your bills until you've got income flowing again. What you don't want to do is use your credit card for this level of expenses. You know, after all, one of the reasons you've got an emergency fund is to avoid getting into credit-card debt. So if you use your credit card to cover things like this, it kind of defeats the purpose of having an emergency fund in the first place. So instead of paying for the fridge on a credit card, buy one with your emergency fund, then start paying yourself back or paying the fund back when you get your next paycheck. But what are you going to do for the big-ticket financial emergencies? You know, these are things nobody likes to think about, but they happen. Houses burn. People get sick or in accidents in their cars. For these big, emergency expenses, you're going to need insurance.

Now, insurance can be a bit confusing, even for the most financially adept. Everyone needs insurance, but not everyone needs every type of insurance. What types of insurance do you need? How much insurance? What types of insurance do you have? What does it cover? Take a moment and answer the following questions about your insurance. I'm going to briefly discuss different types of insurance here. We have separate videos on each of these, and you should watch the videos that are most relevant to you. We've also got three class assignments this week. These will take you a little time, but they might also save some money and make life easier for you and your loved ones if something does go wrong.

The first assignment this week is to get three quotes from three different insurance companies for policies with the same limits and the same terms. For most people, I'd suggest going with either auto or homeowner's insurance. If you don't have auto or homeowner's insurance, get quotes for a type of insurance that you do have or might be considering. There is more information about this assignment on the course website.

Second, I'm asking everyone with homeowner's or renter's insurance to spend 30 minutes photographing your most valuable possessions. You will store these outside of your home so that if you do ever lose your possessions in a fire, you've got a record of them when you file a claim with your insurance company.

And the third assignment this week is that everyone who doesn't have a will or health care directive to get one. There is information about how to do this on the course website, and there is also a video on wills and health care directives that you should watch.

Let's talk about health insurance first. Everyone should have health insurance, and now with Obamacare, everybody can have it. Many of you get your health insurance through your employer, and those who don't have health insurance and can't get it through an employer can enroll through the new federal health insurance programs. To learn more about health insurance, watch Robin Flagg's video on the course website.

Moving on to homeowner's insurance, if you own your home and you've got a mortgage, you almost certainly have got homeowner's insurance already. But do you have enough coverage, and are you insured for cash value or replacement cost? If you don't know the difference, watch the video on homeowner's insurance. And if you rent, you should consider getting renter's insurance. We've got a video on that which can help you decide whether you need this type of coverage.

Next, auto insurance, you know, if you own a car, you are legally obligated to buy auto insurance. And that's going to go for pickup trucks, vans, motorcycles, any vehicle you might be driving, but the state-mandated insurance minimums are going to be exactly that. Those are minimums. They're not going to be enough if you cause a big accident, and they're not going to pay you if you are hit by an uninsured driver. If you need to save money on your car insurance, you should consider increasing your deductible. Don't lower your liability limits, and watch the video on auto insurance. If you've got a lot of wealth, say you've got more wealth than the liability limits on your auto or your homeowner's policies, you should consider getting an umbrella insurance policy. These policies protect you from liability judgments beyond your homeowner's and auto insurance policies. For more information about umbrella policies, visit the course website.

Now, life insurance, this is a big one. And a lot of people say, well, do I need life insurance? Do I not need life insurance? There's a pretty simple basic rule. If someone else depends on your income-- such as your children, husband, wife, domestic partner-- you need life insurance. If nobody else is depending on your income, you simply don't need it. But if people do depend on your income and you need life insurance, you should buy a term life policy, not a cash value policy. And if you don't know the difference, watch the video. Disability insurance, you know, if you work for a living and you're not yet approaching retirement age, you need disability insurance. After all, you're much more likely to miss work from a disability during your working life than you are to die. And if you're approaching or past retirement age, you might want to think about getting long-term care insurance. We're going to talk about long-term care when we discuss retirement issues in more detail, and we also have a video interview on long-term care. Remember, insurance is for the extraordinary, unexpected expenses that could get you and your family into real financial trouble, the big stuff-- medical bills, disability, losing your home, losing your life. Nobody likes to think about these things, but if something catastrophic does happen, you're going to be glad that you did do a little thinking and planning.

One good way to save money is to remember not to insure the small stuff. Sure, refrigerators and TVs break sometimes, but replacing your TV is not a huge financial disaster. And that's why most experts recommend against buying extended warranties on consumer products. In the long run, if you buy extended warranties on all your electronics and appliances, you're going to pay more in premiums than you're likely to pay replacing the specific items that break. If your TV breaks, save for a couple of months. Buy a new TV. If you can't wait, if you just can't live without the TV till then, buy it from your emergency fund and pay yourself back, and don't use a credit card to replace your TV unless you're sure you're going to be able to pay off the entire amount when your next bill arrives. Most personal financial surprises are negative. Insurance isn't going to prevent such things from happening, of course, but with a little careful planning, insurance can keep you out of bankruptcy. And if these negative financial events happen to you, good insurance strategy can protect you, save you money, and free you up to enjoy the more positive things that life has to offer because odds are you're not going to win the lottery. And unlike John Beresford Tipton, Jr., I can't make you a millionaire.