



PART II: THE PROS AND CONS OF SELF-INSURANCE (THE CONS)

What would you say is the biggest detail individuals overlook when considering self-insurance?

Jeff Donham: While self-insurance presents certain pros, it is important to recognize that this approach is not without its cons. Self-insurance involves assuming financial responsibility for potential losses or damages instead of relying on traditional insurance policies. While it may seem appealing to some individuals, it is crucial to carefully evaluate the drawbacks associated with self-insurance before deciding whether it is the right choice for managing one's risks.

Can you elaborate on those cons a bit?

JD: Absolutely. I would say the three major cons associated with self-insurance are financial risk, lack of pooling and spreading of risks, and limited coverage:

Financial Risk: Self-insurance places a considerable financial burden on individuals. In the event of a significant loss or liability, self-insured individuals bear the full cost, which can potentially exceed their financial capacity. Unlike traditional insurance policies, which provide financial protection against unexpected events, self-insurance lacks the safety net of transferring risks to a third party. For individuals without substantial savings or resources, self-insurance can be a risky proposition.

Lack of Pooling and Spreading of Risks: Insurance operates on the principle of risk pooling, where many policyholders contribute premiums that collectively fund the claims of a few who experience losses. This spreading of risks reduces the financial impact on individuals and ensures that resources are available when needed. In contrast, self-insurance lacks the benefit of risk pooling. As a result, an individual's financial exposure may be concentrated, leaving them vulnerable to a catastrophic event that could deplete their resources.

Limited Coverage: Self-insurance inherently comes with limitations in terms of coverage. Traditional insurance policies often provide comprehensive coverage for a wide range of risks, including property damage, liability claims, medical expenses, and more. In contrast, self-insurance may not offer the same level of protection. Individuals may overlook certain risks or underestimate their potential impact, leaving them exposed to unforeseen expenses that they may struggle to manage on their own.

Do you have any final thoughts on weighing the cons of self-insurance?

JD: Yes. While self-insurance offers certain pros, it is important to recognize its drawbacks and carefully consider the implications before deciding to forgo traditional insurance coverage. The financial risks, limitations in coverage, and lack of risk spreading are key factors that individuals should evaluate. Self-insurance may be a viable option for those with significant financial resources, but for many individuals, the potential cons of self-insurance outweigh the benefits. Consulting with a qualified insurance professional or financial advisor can help individuals make informed decisions based on their unique circumstances and risk tolerance.

To learn more about the pros associated with self-insurance, read "Part I: The Pros and Cons of Self-Insurance (The Pros)".



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Prior to joining The Colony Group, Jeff worked for Northwestern Mutual where he provided financial planning services for a wide array of client needs including education, insurance, tax, investment, and estate planning. Prior to Northwestern Mutual, Jeff worked at LPL Financial where he delivered investment and asset allocation guidance for client portfolios.

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