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What first-time home buyers need to know about insurance

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The pressures of life in today's economy are pushing millennials into a relationship with a surprising player in the financial business.

It's insurance, the least-evolved entity in a financial world struggling to make itself relevant to millennials and the technology they use. If you're buying houses in an expensive market and working in contract positions, it's crucial to make sure you have proper insurance coverage against death, illness or injury.

We'll be studying the personal-finance implications of inflated housing prices for years to come. But one thing we already know is that high housing costs are putting more responsibility on owners to have proper insurance coverage. You can't afford to wing it, even if you're smart enough to have an emergency fund.

Full-time jobs with benefits that include group insurance can address millennial insurance needs to some extent. But a lot of young adults work temporary or contract jobs with no benefits. They'll need to look after their own insurance.

You can't avoid insurance talk when you buy a house because your lender will try to force-feed you policies that would pay your mortgage balance if you die or become disabled. A firm no is the correct answer to such a sales pitch. In this millennials' guide to insurance, you'll find out how to do better.

Expensive houses mean tight budgets, so you need affordable coverage. On that basis, consider term life coverage for you and your spouse with a 20-year term. Term life is basic protection against your death. If you go, your beneficiary receives a lump sum. How much? Lorne Marr, a certified financial planner (CFP) and director of new business development at LSM Insurance, suggests using your mortgage balance as a base amount.

If a couple rely to a large extent on one spouse's income, Mr. Marr suggests making the higher-income spouse's policy even larger than the basic mortgage amount so the lower-income spouse has something left over after the mortgage is paid.

The reasons why term life sold by an insurance company beats your bank's mortgage insurance are well summarized in a blog post by banker turned mortgage planner David Larock. The headline is "Why I won't sell mortgage insurance" (read it here). As for the 20-year life of the policy, that gets you to a point where your mortgage balance has been pounded down and isn't the liability it once was.

Starting a family demands more coverage, which you can easily take care of by adding additional term life. "A quick rule of thumb for people with kids under 10 years old is 10 times your annual income," Mr. Marr said. "If you have kids over 10, it's five times your annual income." Can't afford that much? Less coverage beats zero coverage.

There are two types of policies to protect you against the risk of not being able to earn an income. Critical illness pays a usually tax-free lump sum of money if you meet the hyper-strict definitions of the diseases covered by your policy. Disability insurance pays you a tax-free monthly income if your insurer is satisfied that you can't work due to illness or injury.

Mr. Marr says disability insurance is more comprehensive – it covers injury and illness – and it helps cover your regular income rather than just paying a lump sum. "If you had to choose one of the two, I would go with the disability."

There are three levels of disability coverage; a cheap option called "any occupation" that pays out only in the worst situations where you can't do any type of employment suitable for your background, "regular occupation," where the condition you have need only be severe enough that you can't perform the broad duties of your own profession and "own occupation," which applies if you can't do your own specialized job (example: brain surgeon).

Gen Y's best choice is regular occupation, Mr. Marr said. Coverage tops out at about 60 per cent of your gross income, in part because insurers want there to be a financial incentive for you to return to work.

Group insurance through an employer may suffice for your life and disability needs, but remember that this coverage lasts only as long as you stay at that job. If you move to a different firm without coverage or work for yourself, you'll need your own policy.