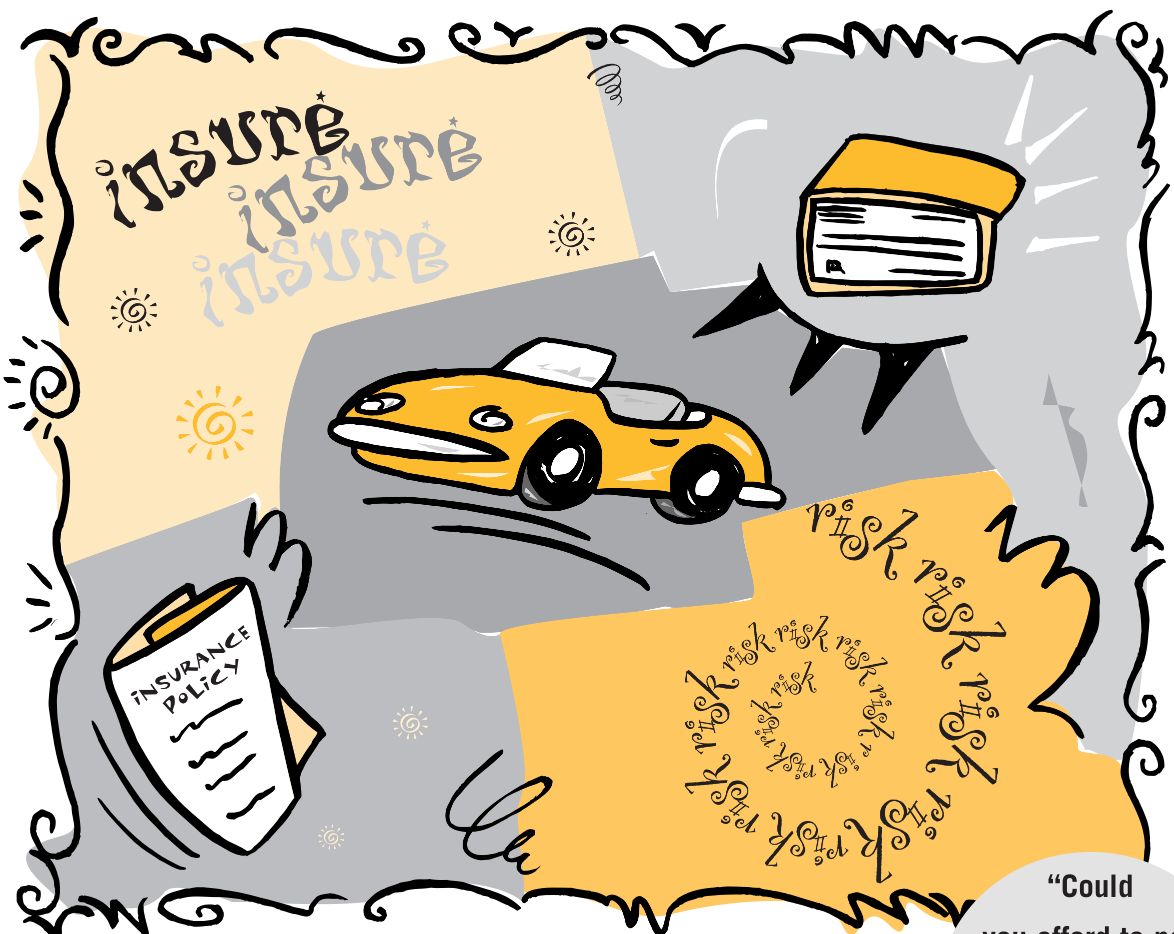
Unit Six

Insurance: Your Protection



"Could you afford to pay for the damages you caused in a car wreck?"

You're healthy, young, vivacious, and happy. Why in the world would you need insurance? You know the guy who was hit while riding his motorcycle or the girl who broke her leg playing soccer? I bet they (or their parents) had to make a call to their local insurance agent to handle the piles of paperwork that go along with, you guessed it, **Accidents!** Accidents, along with most everything else, have a cost. Not surprisingly, the more catastrophic the event, the more it costs. Are you convinced? If not, you may want to consider the information on the next page and think about how some of these statistics apply to your life.

Could you afford to pay for the damages you caused in a car wreck? What if you had to fork out five grand to repair damages from a hit-and-run or even a minor fender bender?

Some of the questions you will be able to answer by the end of this unit are:

- **Why have insurance?**
- **What is risk management?**
- **How can you keep your insurance costs down?**
- **What are the basic types of auto insurance?**
- **When should you take financial risks and when should you avoid them?**
- **How can you be a smart insurance shopper?**

Can You Believe?

With a partner, fill in the following:

The number of insurance claims for auto accidents involving teens is ____ % higher than those for adults.

Teen crash rates drop by ____ % six months after getting their licenses.

In the latest survey available, ____ % of the U.S. population experienced some level of disability in a year.

Head injuries cause about ____ % of all bicycling fatalities.

There is a ____ % chance you'll be involved in an alcohol-related traffic accident at some point in your life.

At work, a disabling injury occurs every ____ seconds.

16-year-old drivers have ____ times the risk of being in a crash compared to 18-year-old drivers.

Answer Key: 100, 40, 20, 75, 30, 8, 3

Overview: Risk Management

Risk is the chance that something unexpected will occur. **Risk management** means that you use various ways to deal with potential personal or financial loss. You have basically three options in how you handle personal or financial risk.

First, you can avoid risk altogether. To avoid the chance of being injured in a plane crash, you could take the train. To avoid the risk of being hurt in a car accident, you could walk or ride your bike to school. Some of these options are more practical than others. If you live 20 miles from school, walking or riding a bike to school each day is probably not realistic. But if it's that important to you to avoid a certain risk altogether, it can be done.

Most people prefer a more practical approach to handling risk, which leads to the second option, minimizing (reducing) risk. If you must travel in a car, wear a seatbelt. If you're the driver, you learn to drive defensively. You could drive a heavier car with safety features, like airbags, instead of a smaller, lighter car. You're still taking the chance of being involved in an auto accident, but you are lowering the risk of being seriously hurt.

The third option in handling risk is to pass it on (transfer) to someone else. That's where insurance companies come in, and many people choose this approach to help them manage their big financial risks. In effect, consumers trade small, predictable losses in exchange for the promise of help with big, unknown financial losses. To understand how this works, you need to know some insurance basics.

Insurance Basics

Insurance is protection against large-scale financial loss. In exchange for a relatively small payment, which is the premium, you're protected against the chance of a big financial setback, a large loss.

An **insurance premium** is the payment you make to an insurance company in exchange for its promise of protection and help. Premiums can be paid monthly, quarterly, semi-annually or annually.

In return for the premium, the insurance company protects you against "large losses." What's a large loss? For most people, a house burning down is a large loss. Spending weeks or months in a hospital recovering from an accident creates medical bills that pile up to become a large loss.

To rebuild a house from a fire might costs tens of thousands of dollars. But to insure that house against a fire might only cost several hundred dollars a year. Most people can't afford to rebuild a house with money out of their own pocket, because they have limited financial resources. Instead, they choose to transfer the potential cost of rebuilding their home to an insurance company for a small payment.

"In exchange for a relatively small payment, which is the premium, you're protected against the chance of a big financial setback, a large loss."

Keeping Your Costs Down

"Small payment" is a relative term. Auto insurance for teenagers, for instance, can run several hundred or even thousands of dollars per year. This stuff's not cheap, but there are strategies to help you lower your premium costs.

Every insurance policy has a coverage limit. The coverage limit is the maximum amount the insurance company will pay in the event of a claim. Coverage amounts can be just a few thousand dollars, or a few million. As you might expect, the more coverage you want, the higher the premium.

Most types of insurance come with a deductible. A **deductible** is the amount of the loss you must pay out of your own pocket before the insurance company begins to reimburse you. Deductibles can be as low as $100 and run up to $1,000 or more. The higher the deductible is, the lower your premium.

You can also think of your deductible as "self-insurance," or the amount you're willing to pay before you want an insurance company to pick up any additional losses. For example, assume you choose a $250 deductible for your car. Any losses that are less than $250 you have to pay; any claims in excess of $250 would be paid by the insurance company. So if you had a $400 repair bill from a minor auto accident, you would pay $250 and the insurance company would pay $150.

Another way to save money on almost any type of insurance is to think "conservative." Insurance companies try to minimize their risks; so the more precautions you take to lower your own risk, the less it will cost to have the company insure you.

You may want to check with a few insurance companies in your area to determine things you can do to lower your rates. Most insurance companies do research and track their data on accidents so they can reduce the possibilities of loss. A classic example is driving a four-door rather than a two-door car. Insurance companies know from experience that two-door cars tend to be involved in more wrecks and attract more thieves than four-door cars. For a home, insurance companies reward homeowners with lower premiums for adding safety features, such as smoke alarms and deadbolt locks.

"Another way to lower your insurance costs is to shop around annually for lower rates."

Another way to lower your insurance costs is to shop around annually for lower rates. The insurance industry changes, legislation changes, and your circumstances change. Any of these can lead to lower premiums.

Auto Insurance

If you drive a car you need auto insurance. An auto policy protects you in a variety of ways, including the following:

Types of Coverage

- ✔ **Liability coverage.** Liability pays for bodily injury to other people and damage to property. If you injure someone in an accident and they sue you, liability coverage pays the legal bills. If your car damages another car, liability pays to have the other car repaired.
- ✔ **Medical payments.** While liability pays other people, medical payments coverage protects you, your family members, and anyone riding with you in your car. Medical payments cover your medical expenses, such as hospital bills, doctor fees, etc.
- ✔ **Uninsured motorist.** While every driver should carry coverage, some try to get by without it. If an uninsured motorist injures you or damages your car, you turn to your own insurance company for help. But if you don't have enough coverage on your policy to pay your bills, uninsured motorist coverage will help out. In effect, it's like carrying additional coverage on yourself for insurance policies that other drivers should have for themselves.
- ✔ **Underinsured motorist.** Like uninsured motorist, you effectively own a policy on yourself that protects you in case another motorist doesn't have enough coverage.
- ✔ **Collision.** Collision coverage pays to repair your car if it's damaged in an accident by colliding with another vehicle or an object, such as a tree. A deductible applies to collision payments, so you pay first and then the insurance company covers the cost of repairs above your deductible.
- ✔ **Other than collision.** This coverage protects you from everything except a collision, such as damage caused by theft, hail, flood, vandalism, etc.

Should you drop collision?

If you're driving an older vehicle, you might be able to lower your insurance premium by eliminating the collision coverage on your car. You can do a simple analysis by comparing the cost of collision, which is listed as a line item on your auto policy, and the size of your deductible to the market value of your car. For example, assume you drive a car that's worth $1,000, and your insurance policy has a $500 deductible, and collision coverage costs you $100 per year. If you have an accident that totals your car, you'd get a check for a maximum of $500 from the insurance company. In effect, you're paying $100 per year to get a one-time payment of $500 in case of a drastic accident. Is that a good benefit for the cost? Probably not, but the answer really depends on your circumstances and your choices.

Coverage Amounts

Now that you know about the basic types of auto insurance coverage, it's important to decide how much of each you need. Every state sets minimum coverage amounts as required by law, but they are often too low to really protect you against the risk of a big financial loss.

Table 6.1 lists some suggested minimum coverage amounts. You can get a professional opinion on how much you need by talking with an experienced insurance agent.

Figure 6.1

Suggested Minimum Coverage Amounts for Auto Policies

Coverage Type	Suggested Minimum Coverage
Liability	$250,000 per person; $500,000 per accident
Medical Payments	$5,000 per person
Uninsured/Underinsured Motorist	$250,000 per person; $500,000 per accident

Shopping for Auto Policies

You can buy auto insurance coverage through several different sources. The traditional way is to meet with an insurance agent, who can explain how the policy works and what it does and doesn't cover. Another option is to obtain coverage over the phone, usually by calling a toll-free number. A relatively new choice is buying coverage over the Internet.

Many factors affect the cost of a policy. As you already know, a higher deductible will lower your premium. For auto policies, typical deductibles include $250, $500 or $1,000. In addition to the deductible, here are some additional variables that can raise or lower your premium.

- **Age.** The younger you are, the higher the premium. Statistically, young people have higher percentages of accidents than other drivers. Rates fall as you age and gain experience and skill in driving.
- **Gender.** Males under the age of 25 have significantly higher accident rates than females under age 25. So male drivers pay higher premiums than females.
- **Marital status.** Single people have more accidents than married couples, so single people pay higher premiums.
- **Type of car.** Sports cars tend to be involved in more accidents than family cars, and thefts are higher among sports cars, as well. Accordingly, premiums are higher for sports cars. Features of the car can also affect the premium. Safety devices, such as airbags, antitheft equipment, and antilock brakes often lower a car's insurance costs.

Assignment 6.1

APPLY → TAKE CONTROL → LEARN

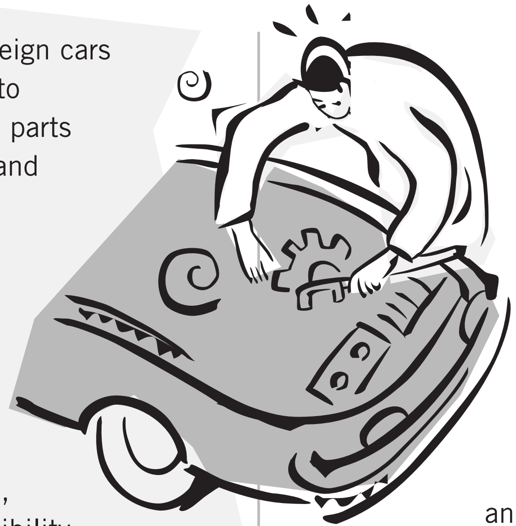
How Well Are You Covered?

Using the chart below for one car, fill in the coverage amounts for yourself, if you drive, or for an adult family member if you don't drive. You can find all of this information on the auto insurance policy. Then contact at least two more insurance companies to find out what they would charge for the same coverage. You can also use this chart to shop around if you want to increase coverage for different categories.

Comparing the Cost of Automobile Insurance

Type of Coverage	Limits	Current Company	New Company	New Company
Liability				
Bodily Injury	$ per person $ per accident			
Property Damage	$ per accident			
Medical Payments	$ per person			
Uninsured and Underinsured Motorists	$ per person $ per accident			
Damage to Your Car				
Collision	$ deductible			
Other than Collision	$ deductible			
Annual Total Premium				

- **Cost of repairs.** Foreign cars typically cost more to repair, since foreign parts cost more to make and ship. So domestic brands tend to have lower repair costs, which means lower premiums as well.
- **Mileage.** The more a car is driven, the greater the possibility of being involved in an accident. So the less you drive, the lower the premium.
- **Location.** The odds of an accident occurring are statistically greater in a highly populated city compared to a small town in a rural area. Residents of towns with small populations pay lower premiums.
- **Law enforcement.** If you have speeding tickets, your premiums will be higher than if you are a "safe" driver. Insurers associate high speeds with more accidents, and thus more claims. Drivers who obey traffic laws have lower premiums.
- **Driving record.** Drivers without accidents have lower premiums than drivers with multiple accidents. Insurance companies think that a driver with a history of accidents is more likely to be involved in future accidents.



Future Insurance Needs

As you get older, your life will change in many ways. You may switch jobs or careers. You may get married and start a family. You may acquire vast amounts of wealth, or live simply and get by with just enough to stay happy. Whatever your situation, you'll probably need some additional kinds of insurance protection.

Health Insurance

Health insurance pays the medical bills in case you, or your family members, become sick or injured. Routine medical expenses easily cost hundreds of dollars, and more serious problems can cost thousands of dollars. Health insurance is one employee benefit that is a must-have.

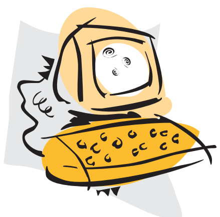
Most health insurance plans will cover you as a "dependent" of an adult family member until you reach age 19. At that point, you need to find your own coverage. It's usually cheaper if you can join a "group policy," which is what many employers offer their employees. You can, however, purchase an individual policy for yourself or your family, but usually at a much greater cost than a group policy.

"Health insurance is one employee benefit that is a must-have."

By the way, if you're going to college, many policies will continue to cover you as long as you're a full-time student, up to age 23. At that point, you're off the adult family member's health insurance policy and on your own.

Property Insurance

Property insurance protects your material possessions—your stuff—such as clothes, a stereo, a TV, appliances, furniture, a bike, computer equipment and so forth. Your material goods can be damaged in a variety of ways, including fire, flood or theft.



When you own a home, homeowners insurance also protects the house itself against damage from these problems. What if you're a renter? You can still protect your possessions with a renter's policy. It only covers your goods and not the building you rent. Usually a landlord will have insurance that protects the physical structure of an apartment, but not the renter's goods inside it.

Life Insurance

Life insurance protects people who depend on you financially in the event of your untimely death. While you are single and no one is dependent on you, you probably don't need life insurance. If you marry, and your spouse works and could get by financially without you, you still may not need life insurance.

"Anytime someone else depends on your income to help pay the bills, you need life insurance."

But anytime someone else depends on your income to help pay the bills, you need life insurance. For example, assume you are married and have children. If you die unexpectedly, your children will have financial needs, such as paying for food and clothing. Perhaps you're single but provide financial support to an adult family member. If you pass away, that family member will still have financial needs in the future.

Life insurance comes in two basic forms. "Term" life insurance offers pure protection, while "whole life" offers protection and builds up a savings account. Term is more affordable and will often meet your life insurance needs quite well for a period of many years, especially as a young person.

"You're statistically more likely to need disability insurance during your working life than life insurance to cover your unexpected death."

Disability Insurance

Disability insurance essentially pays your income from a job if you are sick or physically unable to work for long periods of time. If you have an extended leave of absence from work, employers generally don't pay you, regardless of your reason for being out. In the meantime, you still have living expenses, like food, gas, utilities and rent. How do you pay those bills if you can't work?

That's when disability insurance comes in. This insurance typically pays you 60% to 70% of your full-time wage. The insurance companies don't pay 100%, because then there would be no financial incentive to go back to work.

There are two main types of disability insurance. Short-term disability covers you for periods of up to two years. Long-term disability typically covers you for periods of one year all the way up to retirement, which could be decades.

You're statistically more likely to need disability insurance during your working life than life insurance to cover your unexpected death. Many employers offer disability as an employee benefit, and it is worthwhile to sign up for it if you can.

Liability Insurance

We mentioned earlier in the auto insurance section that liability coverage protects you in case of a lawsuit related to an auto accident. But you can also be sued in other circumstances. That's when liability insurance protects you from costly legal fees and multi-thousand dollar settlements in court cases.

Most insurers offer liability insurance as an enhancement of coverage for a homeowner's policy, called an "umbrella" policy. An umbrella policy is designed to protect you in almost all areas of your life. It provides additional liability coverage for a homeowner's policy and may also cover auto policies.

When do you need an umbrella policy? In general, if you own a house and drive a car, you should have an umbrella policy. Coverage of this type is very cheap; a policy with a $1 million limit might cost about $200 per year. That's a lot of coverage for your dollar.

Your Insurance Plan

By now, you should have a broad overview of the types of insurance available to you, as well as what kind of protection each type of policy offers. Many of these policies may not be of use to you until your circumstances change, such as getting married and starting a family. But you at least know what to look for when the need arises.

Oftentimes the cheapest place to get insurance coverage is through an employer. So when you're in the job market, it pays to think ahead and look at all the benefits an employer offers, including insurance coverage for potential future needs.

Assignment 6.2

My Family Insurance Plan

Using the chart below as a model, create one of your own showing basic insurance information for your family. Include as many different types of policies as possible: life, disability, auto, property, and health.

Type of Policy	Premium	Deductible (if any)	Coverage Limit(s)
Example: Auto	$450	$250	$200,000

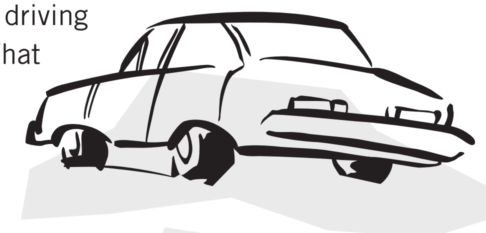
What You've Learned in Unit Six

- you have a choice in how you handle financial risk in your life;
- simple strategies to lower insurance costs;
- the basic types of auto insurance coverage; and,
- how different types of insurance will protect you from risk as your circumstances change over time.

Action Steps

"The Car of Your Dreams"

Using the Internet, shop for the car of your dreams. Find the exact make, model, year, and features you really want. Once you have that information, use the Internet to find out how much it costs to insure the car of your dreams. Keep an eye out for ways to lower your insurance costs. Does the engine size make a difference in the premium? What about safety features? What cost difference does a clean driving record make compared to one with tickets and/or accidents? What happens to the premium if you choose the exact same car but it's one year older?



Car of your dreams	Difference with engine size?	Safety features?	Driving record	**Older car**
	☐ yes ☐ no	☐ yes ☐ no	Difference___	☐ up ☐ down