TYPES OF INSURANCE

Advanced Level
WHY IS IT IMPORTANT TO HAVE INSURANCE?

**Risk** - chance of loss from an event that cannot be entirely controlled

**Emergency savings** - at least six months of expenses set aside to cover costs of unexpected expenses

**Insurance** – a financial product purchased by many people facing a similar risk to protect against the risk of larger losses

What are examples of unexpected events that may result in a financial loss?
INSURANCE POLICY

**Policy** - A contract between the insurance company and the insured that states the exact terms of the policy

**Coverage** - The risks covered and amount of money paid for losses under an insurance policy

**Policyholder** - Person who owns the insurance policy

**Premium** - Money paid to purchase the policy

Experts say that buying insurance is buying financial security. Do you think this is true? Why or why not?
AN ILLUSTRATION OF HOW INSURANCE WORKS

Suppose there are 100 people in a health insurance group.

If each person pays $100 into a “pool” they will collectively have $10,000 to cover the medical costs of the person who gets sick.

With a 1% chance that any one of them could get sick and require $10,000 in medical care.

So, everyone gives up $100, but nobody loses more than $100.

But, no one knows who will get sick.

99 people do not collect anything, but they gain peace of mind and important protection against a large loss.

Insurance shifts the risk of big loss from the individual to the insurance company.
THE BENEFITS OF INSURANCE

- Payments received from an insurance policy can far exceed the premiums paid.
- Provides financial security and peace of mind.

Why is the best outcome to have insurance but never collect on it?
THE INSURANCE PROCESS

Event occurs resulting in loss

If so, policyholder pays a deductible

Policyholder makes claim to insurance organization

Insurance organization determines if event is covered by policy

Remaining amount owed is paid by co-insurance (if applicable)

Claim – a formal request to an insurance company asking for a payment when the policyholder has an accident, illness or injury

Deductible – the out-of-pocket money paid by the policyholder before an insurance company will cover the remaining costs attributed to the loss

Co-insurance – requires the insured individual to pay a fixed percentage of the loss after the deductible has been paid
LOUISE’S ACCIDENT

Louise has a health insurance policy with a $500 deductible and 20% co-insurance.

Louise is in an accident resulting in a $5,000 medical procedure that is covered by insurance.

Louise pays the first $500 of any covered medical care plus 20% of the remaining costs.

Louise pays $500 + 20% of the remaining $4,500 for a total of $1,400.

The insurance company pays $3,600.

Even with insurance Louise still needs funds to pay the deductible and co-insurance.

What would Louise’s options have been if she did not have insurance?

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YOU DO THE MATH!

Carlos was involved in an automobile accident that resulted in $3,788 worth of damage to his car. How much does Carlos pay and how much does the insurance organization pay?

Carlos has a property and liability insurance policy with a $500 deductible and 0% co-insurance.

How much does Carlos pay? $500

How much does his insurance organization pay? $3,288
Janet wants to make sure she has the best health insurance policy. She shopped around and received multiple quotes. **What are the pros and cons of each policy?**

<table>
<thead>
<tr>
<th></th>
<th>Current Policy</th>
<th>New Policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium amount/month</td>
<td>$300</td>
<td>$200</td>
</tr>
<tr>
<td>Deductible amount</td>
<td>$200</td>
<td>$2000</td>
</tr>
<tr>
<td>Co-insurance amount</td>
<td>20% owed by policyholder, 80% owed by insurance organization</td>
<td>0% owed by policyholder, 100% owed by insurance organization</td>
</tr>
</tbody>
</table>
WHY DO INSURANCE POLICIES INCLUDE DEDUCTIBLES AND CO-INSURANCE?

Reduce the problem of moral hazard

- When the act of insuring an event increases the likelihood it will occur
- Deductibles and co-insurance place some of the loss on the policyholder

For example...

- Not locking a car or parking it in a theft-prone area in hopes it will be stolen and automobile insurance will pay for a new vehicle

Dollars paid from an insurance policy are not intended to make a person better off than before the loss happened
In most cases, individuals acquire insurance from a combination of sources:

- **Employer**
  - Health, disability, and occasionally life insurance
  - Special programs for those who qualify and during catastrophes

- **Individual**
  - Long-term care, property and liability insurance

- **Government**

If an employer does not provide insurance, it may be acquired individually.
EMPLOYER PROVIDED INSURANCE

Employee benefits - products or services that add extra value for employees beyond earned wages

- Insurance premiums paid by...
  - Employer
  - Employee
  - Payroll deduction

- In-kind income – the donation of a product or service in place of cash

• Policies may be available to the employee’s family members (usually for additional fees)
• No income taxes are paid on the in-kind income
GOVERNMENT PROGRAMS

- Provide basic insurance as a part of the social safety net to protect citizens from economic hardship
  - Social Security, Medicare, Medicaid
- Many programs require a work history and employer provided participation to be eligible
  - Unemployment insurance, worker’s compensation
- Can address specific catastrophes
  - Hurricane Sandy
HEALTH INSURANCE

Health insurance - provides money to pay for health care

If dollars are limited, health insurance is extremely important to protect against high medical bills

- Hospital bills
- Medical procedures
- Doctors’ visits
- Mental health treatment
- Vision care
- Preventative care
- Dental care
- Prescription drugs

Government
Employer

Risks Covered

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WHAT IF A PERSON CANNOT WORK OR LIVE INDEPENDENTLY?

**Disability insurance**
- Payment to replace earnings during times when workers cannot work due to illness or injury
- Provided by employers, individuals, and/or government

**Long-term care insurance**
- Payment for extended nursing care when a person cannot live independently (but doesn’t need to be hospitalized)
- Provided by individuals

**Why are both disability and long-term care insurance important?**
PROPERTY & LIABILITY INSURANCE

Two parts

Property insurance - payment to insured person if his/her property is damaged or destroyed by an accident

Pays for loss to insured person

Liability insurance - payment to others if a member of the insured household accidently causes harm to other people or property

Pays for injury or loss to others

Provided by individuals
TYPES OF PROPERTY & LIABILITY INSURANCE

Automobile insurance - payment for liability and property insurance on a vehicle

Homeowners insurance - payment to cover liability losses and damage/loss of home structure and its contents

Renters insurance - payment for damage/loss of property in a rental unit in addition to liability losses

If a person drives an automobile, automobile liability insurance is required by law.
LIFE INSURANCE

Life insurance - payment to beneficiaries who were named by the insured person

Beneficiary - someone who receives money if an insured person dies

Dependent - someone who relies on someone else for income and care

Provided by employers and/or individuals

May cover paid and unpaid work formerly done by the individual

Household production - unpaid work, such as child care or meal preparation

When would it be necessary to purchase life insurance?
IN REVIEW...

Insurance is an important part of a financial plan.

Insurance is not intended to make an individual better off than before the event.

Insurance may be acquired from multiple sources.

Even with insurance, an individual should still have funds to pay the deductible and co-insurance.

There are several types of insurance for specific purposes.
WHAT COVERS THIS RISK?

You are having a baby and need medical care

Health Insurance
WHAT COVERS THIS RISK?

You are unable to work for six months and need help paying your expenses while you’re out of work

Disability Insurance
WHAT COVERS THIS RISK?

You are elderly and need assistance from medical professionals to continue living at home

Long-term Care Insurance
WHAT COVERS THIS RISK?

Your home is destroyed by a tornado and you need to rebuild

Property Insurance
Specifically Homeowners
WHAT COVERS THIS RISK?

The car you are driving causes an accident that injures someone else

Liability Insurance
Specifically Automobile
WHAT COVERS THIS RISK?

A sudden death of a family member results in loss of income

Life Insurance