Types of Insurance

Advanced Level

Protecting Your Well Being Through Insurance

Even the most careful people experience unexpected events in life that cause financial loss. Being in a car accident, losing a home in a fire, or managing unexpected medical bills can have an enormous negative effect on your financial well being. These unfortunate events can happen to anyone because life is full of risk.

Risk is the chance of loss from an event that cannot be entirely controlled. When you wear your seatbelt while in a car you reduce your risk of injury and loss, but accidents can't be eliminated entirely. You can reduce your financial risk by putting a plan in place to protect yourself from major financial loss. Planning for loss is an essential step in helping you achieve financial security.

Having **emergency savings** is one of the first resources to put in place to help you manage unexpected losses. Building an emergency fund *equal to at least six months of expenses* will help you to handle smaller unpredicted expenses, such as repairing or replacing the tires on your car.

To protect yourself against the risk of larger losses, you can purchase **insurance**. Insurance is a financial product (called an insurance contract or policy) purchased from an insurance company by many people facing a similar risk. An insurance **policy** is a contract between the insurance company and the insured (you). It states the exact terms of the policy including what risks are covered and how much will be paid for any losses. If you incur an unexpected loss that is covered by an insurance policy, the insurance company will make a payment to the **policyholder** (that would be you) to pay for *some or all* of the resulting loss.

Here is an illustration of how insurance works.

Suppose there are 100 people in a health insurance group

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

But, no one knows who will get sick

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

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

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

Insurance shifts the risk of big loss from the individual to the insurance company.

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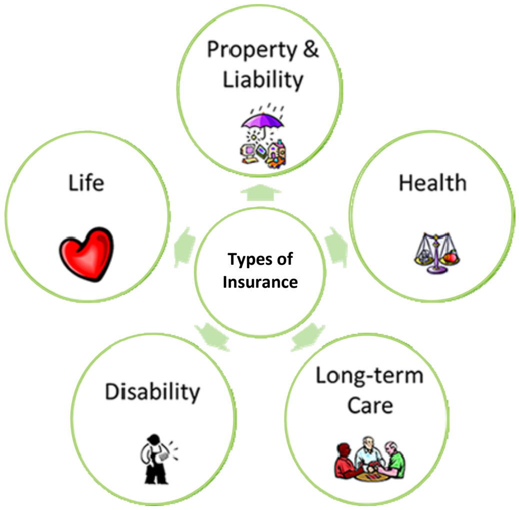
When selecting an insurance policy shop thoroughly, ask many questions and compare features to determine which policy and coverage is best for you. In the event of loss, the **payments** you receive from an insurance policy to cover your loss can <u>far exceed</u> the policy's **premiums.** A **premium** is the money you pay to an insurance company to purchase your policy.

Imagine the cost of replacing a home that is destroyed by fire or natural disaster, and it is easy to see that purchasing insurance protection can be the difference between financial well-being and financial disaster. Insurance can provide financial security and peace of mind by protecting you against large and devastating losses. Some people think that if they do not get more out of their insurance policies in payments than they contributed, the insurance was not worth it. This is a misguided notion. The best outcome is to have the insurance in case something goes wrong but to never collect on the policy because nothing went wrong.



To be well protected, important types of insurance include:

The Insurance Process

If you are an insurance policyholder and have an accident, illness or injury you must submit a **claim** to the insurance company. A **claim** is a formal request to an insurance company asking for a payment based on your insurance policy terms and conditions. Once you submit your claim the insurance company will review it making sure your request for payment is valid. When that process is complete, the insurance company will issue payment for your loss.

A common characteristic of insurance policies is that the policyholder pays a share of the dollar loss. Most insurance policies have a **deductible** which is the out-of-pocket money you pay before an insurance company will cover the remaining costs attributed to your loss. Let's say you have an auto insurance policy that has a **$200 deductible**. In the event you file a claim due to an accident, you'll pay the first $200 (your deductible) to cover your share of the loss. Similarly, health insurance policies often have a contract feature called **co-insurance** (or commonly referred to as a co-pay). This feature requires the insured individual to pay a fixed percentage of the loss after the deductible has been paid**.**

Would you rather have a higher premium or deductible? Why?

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

this means

Louise pays the first $500 of any covered medical care <u>plus</u> 20% of the remaining costs

what if...

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

then

Louise pays $500 + 20% of the remaining $4,500 for a total of $1,400. The insurance company pays $3,600

Even with insurance coverage, do you still think having an emergency savings account is a smart financial plan in case you have to cover the out of pocket costs yourself?

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Insurance policies typically include deductibles and co-insurance for a good reason. These features of an insurance contract reduce the problem of "**moral hazard**." Moral hazard occurs when the act of insuring an event increases the likelihood that the event will happen. Insurance companies cannot stay in business for long if insurance contracts actually encourage losses. A basic principle of insurance is that the dollars paid from an insurance policy should never make a person better off than before the loss happened. Because deductibles, copayments and other features of a typical insurance contract place some of the loss back on the policyholder, they encourage careful behavior to avoid the loss.

Are you or your family covered by insurance? If so, do you know what type? Have you ever file a claim against a loss?

What is an example of a moral hazard?

Sources of Insurance

In most cases, individuals acquire insurance from a combination of sources.

Purchased by the Individual

There is a wide assortment of insurance and financial products available to you through insurance providers. Individuals typically purchase both property and liability insurance policies directly from an insurance provider. Long-term care insurance and life insurance are generally sold directly to you although many employers also offer some life insurance coverage as part of the employee's benefit package.

Provided by Employers

Through your **employee benefits,** your employer may provide health, disability and occasionally life insurance options. Your contribution (payment) for these types of premiums is made through a payroll deduction. Your employer might also make these policies available to members of your family (dependents and/or spouses) resulting in a larger payroll deduction to pay for the family coverage. Regardless of the type of coverage you opt into, your employer typically pays a large share of the premium. This contribution is considered an **in-kind contribution** (the donation of a product or service in place of cash) and is not subject to income taxes. Employment-based health insurance typically costs less than if you were to buy the exact same coverage on your own directly from an insurance company.

Provided by Government Programs

Government programs also provide insurance as part of the social safety net to protect citizens from economic hardship. Some examples of major programs that cover risks individuals and families might face include:

- Social Security
- Medicare,
- Medicaid, and other programs.

Some programs such as unemployment insurance and worker's compensation require a work history and employer participation before you can be eligible to apply for benefits.

Government insurance programs also can address specific catastrophes, such as the aid provided to victims after Hurricane Sandy hit the Eastern Seaboard in 2012.

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Types of Insurance

Type of Insurance	Examples of Risks Covered (depending upon the policy purchased)	Provided by	Notes
Health • Provides money to pay for health care for illness, injury, or, in some cases, preventive care.	Doctor visits, hospital bills, therapies, prescription drugs, mental health treatment, other expenses associated with health issues. May include dental and vision care	Employer, individual, and/or government	If you're only able to purchase one type of insurance because your financial resources are limited, consider the importance of choosing health insurance. It is extremely important to protect yourself against risk of not having the financial resources to pay your medical bills.
Disability • Provides payment to replace earnings during times when workers cannot work due to illness or injury.	Provides income when a person cannot work due to illness or injury from any cause. Disability insurance coverage varies in the definition of disability and in the amount and timing of payments to the insured.	Employer, individual, and/or government	The higher the disability payments, the more the insurance premiums will cost you.
Long-term care • Provides payment for extended nursing care due to accidents, illness, or old age.	Long-term nursing home care, assisted living costs, skilled nursing services, assistance in getting meals or in accomplished everyday tasks of living	Individual	Needed when a person is not sick enough to be in a hospital, but cannot live independently.
Property insurance has two parts: **Property** • Provides payment to the insured person if his or her property is damaged or destroyed by an accident covered by the insurance policy. **Liability** • Provides payment to others if a member of the insured household accidently causes harm to other people or property.	There are several types of property insurance including: **Automobile insurance** • Provides payments for both liability and property insurance on a vehicle. **Homeowners insurance** • Provides payment to cover liability losses as well as damage and loss of the home structure and its contents. **Renters insurance** • Provides payment to renters to cover the damage and loss of property in a rental unit in addition to liability losses.	Individual	Property insurance policies (including renter's insurance) have many options. Some policies cover the "real" costs associated with replacing personal belongings, structures or vehicles. These types of policies cost more in premium payments than policies that replace your property at a depreciated (garage sale) value. If a person drives an automobile then that person is required by law to carry automobile liability insurance.
Life • Provides payment to **beneficiaries** (someone who receives money if an insured person dies).	Provides a single payment or a series of payments to beneficiaries who were named by the insured person.	Employer and/or individual	Life insurance is important to individuals who have **dependents** (someone who relies on someone else for income and care). A policy can replace the wages of the deceased and/or the **household production** the deceased was responsible for within the home. Unpaid **household production** could include the childcare, meal preparation and other domestic tasks.

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