

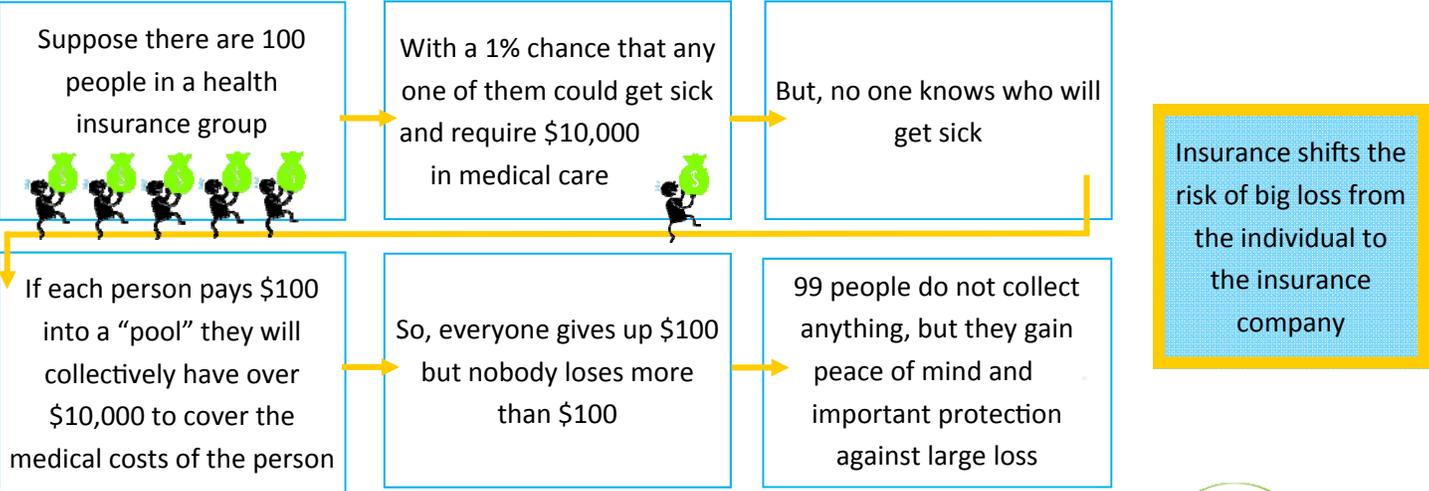
Types of Insurance

“Take Charge of Your Finances” Advanced Level

Receiving Money From Insurance

Even the most careful people experience events, like wrecking a car, that cause financial losses. Unexpected losses happen because life is full of risk. **Risk** is the chance of loss from an event that cannot be entirely controlled. Wearing a seatbelt when driving a car can reduce the risk of injury and loss, but accidents can't be eliminated entirely. Each of us face the risk of an accident or loss every day. No individual can achieve financial security without a plan in place to handle risk and unexpected losses.

One of the first resources used to manage unexpected losses is **emergency savings**. Having funds equal to at least six months of expenses in an emergency savings account will handle the smaller unpredicted expenses, such as fixing or replacing a broken refrigerator. But, to protect against the risk of larger losses, individuals can purchase **insurance**. Insurance is a financial product (called an insurance contract or policy) purchased from an insurance organization by many people facing a similar risk. The insurance **policy** is a contract which specifies what risks are covered and how much will be paid for the losses. The risks covered and amount of money paid for the loss is known as the **coverage** and varies drastically between policies. If the covered event happens, the insurance company will make a payment to the **policyholder** to pay for some or all of the resulting loss. Here is an illustration of how insurance works.

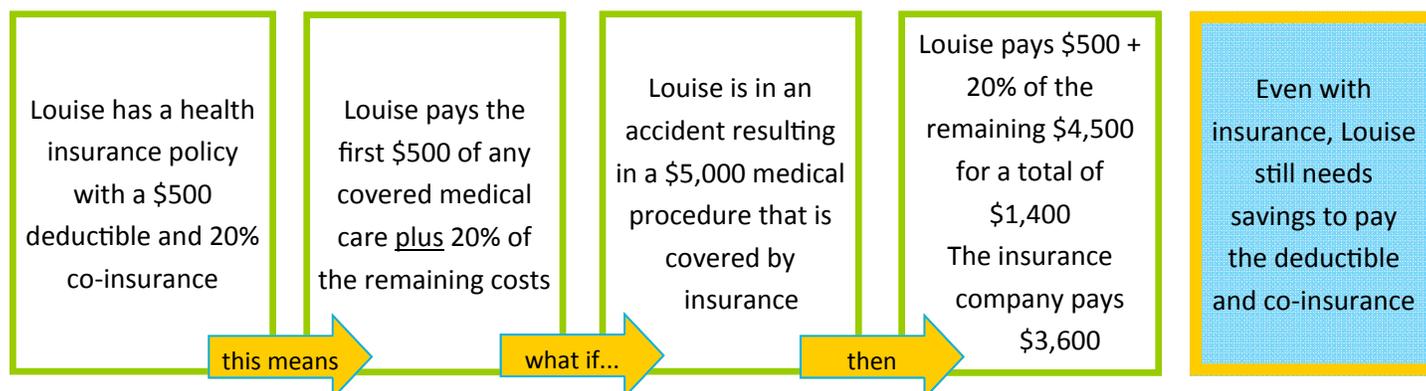


When selecting an insurance policy, consumers should shop thoroughly, asking many questions and comparing features, to determine which policy is the best for them. The payments received from an insurance policy can far exceed the **premiums** paid (money paid to the insurance organization to purchase the policy). Imagine the cost of replacing a home destroyed by fire or natural disaster and it is easy to see that having insurance protection can make the difference between financial well-being and financial disaster. By protecting against large and even catastrophic losses, insurance provides financial security and peace of mind. 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 to have include:



The Insurance Process

When the policyholder has an accident, illness, or injury and needs the insurance money, the policyholder must submit a **claim** in order to get the insurance payment. Most insurance policies have a **deductible**, which is a dollar amount that is paid by the insured person. For example, an auto insurance policy might have a \$200 deductible, meaning that the insured pays the first \$200 of a covered loss. Another common characteristic of some insurance policies, especially health insurance, is that the dollar amount of the loss is shared between the insured and the insurance company. This contract feature is called **co-insurance** and requires the insured individual to pay a fixed percentage of the loss after the deductible has been paid. For example:



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.

What is a type of insurance you or your family has used?



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

Insurance companies offer a wide range of insurance and other financial products for sale directly to individuals. Most individuals purchase property and liability insurance directly from insurance companies. Long-term care insurance and life insurance is also generally sold directly to individuals, although many employers also offer some life insurance coverage as part of their benefits package for employees.

Provided by Employers

Employers may provide health, disability, and (occasionally) life insurance through **employee benefits**. Usually with employment-based insurance, the employee makes a contribution to the premium as a payroll deduction. The employer will often make the policies available to all members of the family for the employee, but the employee will pay more for family coverage. Either way, the employer typically pays a large proportion of the premiums. Employment-based health insurance typically costs less for a given level of insurance coverage than would be the case if an individual tried to buy the same policy directly from an insurance company. Further, the employer’s contribution to paying the insurance premium is valuable to the employee because no income taxes are paid on the **in-kind income** (the provision of a product or service rather than cash).

Provided by Government Programs

Government programs may also provide basic insurance as part of the social safety net to protect citizens from economic hardship. Some examples of major programs that cover the risks that individuals and families face include Social Security, Medicare, Medicaid, and other programs. Many programs, such as unemployment insurance, worker's compensation, and Social Security require a work history and employer participation before an individual can be eligible to apply for benefits. Government insurance programs also can address specific catastrophes, such as the aid provided for victims after Hurricane Katrina hit New Orleans in 2005.

Types of Insurance

Type of Insurance	Examples of Risks Covered (depending upon the policy purchased)	Provided by	Notes
Health <ul style="list-style-type: none"> 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 dollars are limited and an individual may only purchase one type of insurance, health insurance is extremely important to protect against high medical bills which could ruin credit and cause enormous stress.
Disability <ul style="list-style-type: none"> 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 more generous the disability payments, the more the insurance premiums.
Long-term care <ul style="list-style-type: none"> 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 <ul style="list-style-type: none"> Provides payment <u>to the insured person</u> if his or her property is damaged or destroyed by an accident covered by the insurance policy. Liability <ul style="list-style-type: none"> Provides payment <u>to others</u> if a member of the insured household accidentally causes harm to other people or property. 	There are several types of property insurance including: Automobile insurance <ul style="list-style-type: none"> Provides payments for both liability and property insurance on a vehicle. Homeowners insurance <ul style="list-style-type: none"> Provides payment to cover liability losses as well as damage and loss of the home structure and its contents. Renters insurance <ul style="list-style-type: none"> 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 have many options available. Many cover the cost of replacing of belongings, structures or vehicle rather than the "garage sale" (depreciated) value. However, usually more coverage results in higher premiums. If a person drives an automobile, automobile liability insurance is required by law.
Life <ul style="list-style-type: none"> 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	Important for individuals who have dependents (someone who relies on someone else for money income and care). A policy can cover the paid work done by an individual and the unpaid household production , such as child care or meal preparation, that is done by the insured person. Both paid work and unpaid work are valuable to households.