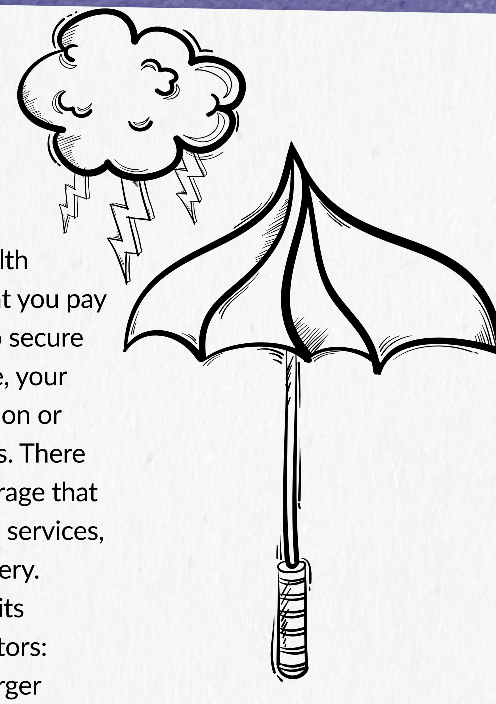
CHAPTER 5: Insurance Protection



Did You Know?

Some 45% of American consumers are concerned they will burden dependents if they die prematurely, and 58% are concerned about paying for medical expenses.[5]

Insurance of all kinds is important in protecting people from the financial impact of illness, injury, property loss, and even death. Learning about the different types of insurance will help you manage your financial risk through purchasing and utilizing insurance policies that best meet your financial needs and goals.

Insurance Terminology

To understand various types of insurance, you need to know some key terms:

- *Claim:* a policyholder's official notification to the insurance company requesting payment of an amount due for a covered loss
- *Deductible:* a dollar amount a policyholder pays before the insurer starts to make payments for a covered loss
- *Insurance:* promised payment for specific future losses should they occur in exchange for a payment called a premium
- *Insurance Policy:* a written contract between an insurer and a customer (the policyholder) describing the term of the insurance, what is covered, the cost of the premium, and the deductible amount
- *Insurer:* a company that pays to compensate the policyholder for losses or damages as described in an insurance policy as long as the premium is paid
- *Policyholder:* the owner(s) of an insurance policy
- *Premium:* the periodic payment for an insurance policy

Health Insurance

At one time or another, all of us need medical care, and it can be very expensive. A typical office visit to a doctor can cost anywhere from $80 to $220. More serious care, including x-rays, emergency room visits, hospital stays, medical equipment, and even medication can cost in the thousands. **Health insurance** provides coverage for these costs.

You have likely been covered under your parents' policy, but will some day need your own health insurance. Policies vary widely. Most health insurance requires that you pay a monthly premium to secure **coverage**. In exchange, your insurer will pay a portion or all of your medical bills. There may be limits on coverage that exclude some medical services, such as cosmetic surgery. There may also be limits on your choice of doctors: some policies pay a larger proportion of covered costs for **in-network** healthcare, which is provided by physicians and facilities whose fees are set by contract, than for **out-of-network** care, which is provided by physicians and facilities who set their own fees.

Premiums can also vary widely, in part based on the range of **benefits** you receive. Some, but not all, health insurance policies cover costs of vision care and dentistry. In other cases, you will need to purchase this coverage separately. These benefits, restrictions, and costs are all described in the policy you receive when you sign up.

Most health insurance policies require that you pay a portion of your healthcare costs. Some policies require a copayment, or **co-pay**, which is usually a flat fee for services. For example, you might pay a $25 co-pay each time you go to the doctor's office, or a $10 co-pay when you pick up a prescription at the pharmacy. The insurance company pays the remaining cost of the office visit and the prescription.

Another common feature of most health insurance policies is a **deductible**. This is usually a set amount you must pay before your coverage "kicks in" and can range from several hundred to several thousand dollars, depending on your policy. In addition, many insurance companies now require policyholders to pay **coinsurance**, which sets a percentage you must pay for medical services after you have paid your deductible. For example, suppose you have a $3,000 deductible and 20% coinsurance. Your coverage "kicks in" after you have paid $3,000 for medical services, but at that point your coinsurance also "kicks in," requiring you to pay 20% of all future medical costs.

[5]LIMRA 2016 Insurance Barometer Survey: http://advisor.simplicitymarketing.com/wp-content/uploads/2017/01/2016-Insurance-Barometer.pdf

Luckily, most health insurance policies also have an **out-of-pocket maximum**, which sets a limit on how much you must pay on your own. Co-pays, deductibles, coinsurance, and other out-of-pocket costs all count against this maximum, which can be several thousand dollars. Once you reach the maximum, however, the insurer pays all your covered costs.

Many people obtain health insurance through their employers as a benefit. In most cases, the employer pays some or the entire insurance premium, and the employee pays the remaining costs associated with the policy, such a co-pays and deductibles. Some employers also provide **Health Reimbursement Accounts (HRA)**, which are employer-funded accounts that employees can use to pay uncovered medical costs.

When people leave a job that provided them with health insurance, they can usually maintain coverage for as much as 36 months through **COBRA**. Under this federal law, ex-employees continue to receive the benefits of their former employer's group health insurance policy, but must pay all monthly premiums as well as administrative fees.

Individuals can of course purchase health insurance on their own, but the cost is usually much higher than for a group policy such as those offered by employers. For this reason, uninsured individuals sometimes purchase "catastrophic" health insurance, which typically has low monthly premiums and very high deductibles. This kind of health insurance provides financial protection against major injuries and illnesses while the policyholder pays out-of-pocket for most routine medical treatment.

In recent years, more and more people are obtaining health insurance through the **Marketplace** at www.healthcare.gov, a federal website created to help implement the Affordable Care Act. Individuals, families, and small businesses can all use the Marketplace to compare the costs and benefits of different healthcare policies available in their state. Those with limited income can also apply for subsidies designed to make health insurance more affordable. For those with very limited income, the federal government provides low-cost or free healthcare coverage through **Medicaid** and the **Children's Health Insurance Program (CHIP)**. For older Americans, affordable health insurance is provided by **Medicare**.

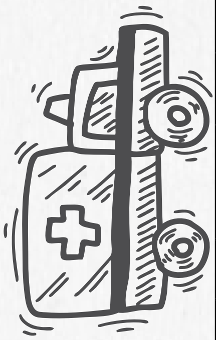
The federal government also helps people pay healthcare costs through tax policy. Employers can offer their employees **Flexible Spending Accounts (FSA)**, which are tax-deferred savings accounts that can be used to pay medical expenses not covered by an insurance policy, including deductibles, co-pays, and coinsurance. The law sets a limit on how much an employee can set aside in an FSA ($2,650 in 2018) and allows only $500 to carry over in the account from one year to the next — anything more is forfeited, so careful spending and record-keeping is essential.

Tax law also allows individuals enrolled in a **high-deductible health (HDHP)** plan to set up their own tax-deferred **Health Savings Accounts (HSA)**. There are limits on how much can be deposited to an HSA each year ($3,450 for an individual in 2018) but the entire amount can be carried over from year to year, allowing taxpayers to accumulate substantial funds to pay for high deductibles and other out-of-pocket medical costs. In addition, HSA funds can be invested, similar to an IRA, providing an opportunity to increase one's healthcare savings even more.

Activity 1

COMPARING HEALTH PLANS

Many companies offer their employees a choice of health care plans that vary in upfront costs and coverage. One may have a higher premium but a lower deductible, while another has a lower premium but less coverage overall, or even coverage only for certain types of medical care. Each employee has to weigh their own needs against the options presented by each plan and choose the one that minimizes their costs while maximizing their coverage. Risk needs to be considered, as well — you may be healthy today, but what are the chances of illness or hospitalization in the future? Practice selecting the best health plan by reading through the two plans outlined in this chart. Then answer the questions below.



	PLAN A	PLAN B
Monthly Premium	Single: $70.44 Family: $472.61	Single: $209.26 Family: $945.98
Deductible	Single: $1,500 Family: $3,000	• In-Network: $0 • Out-of-Network: $500 Single/$1,000 Family
Health Reimbursement Account (HRA)	Company reimburses the first half of your deductible, so you will only be responsible for the second half	Not available
Coinsurance (what you pay)	$0	• In-Network: $0 • Out-of-Network: 20%
Out-of-Pocket Maximum	• In-Network: $5,000 Single/$10,000 Family • Out-of-Network: $10,000 Single/$20,000 Family	Single: $5,000 Family: $10,000
Preventive Care — child well visits, 1 routine annual exam per year	In-Network covered 100%, no deductible	In-Network covered 100%
Specialist Care	In-Network covered 100% once deductible is met	In-Network covered 100%
Pharmacy	In-Network: $20 copay	In-Network: 20% copay
Emergency Room Visits	In-Network: $20 copay	In-Network: 20% copay
Out-of-Network Coverage for all categories	70% (you pay 30%)	80% (you pay 20%)

Scenario 1: You are single and in relatively good health.

1. You don't take any regular medications, and besides your routine annual check-ups, rarely visit the doctor. Which plan would you choose? Why?

   ____

   ____

   ____

2. You take medication that costs $28 per month without insurance. How much would you expect to pay over the course of one year under each plan?
   - Plan A: $_________ • Plan B: $_________
3. Imagine you fall ill and have $4,000 in medical bills this year for in-network, non-emergency room medical services. Approximately how much could you expect to pay for healthcare this year under each plan? (Remember to include your premiums.)
   - Plan A: $_________ • Plan B: $_________

Scenario 2: Imagine that you are married and have 2 children, and will be including both your spouse and your kids in your healthcare plan.

4. How much will the premium for each plan cost you per year?
   - Plan A: $_________ • Plan B: $_________
5. Last year, your spouse needed surgery that would have cost $30,000 if it were not covered by insurance. How much would you have paid for this surgery under each plan if the medical providers were all in-network?
   - Plan A: $_________ • Plan B: $_________
6. Your child has a medical condition that requires weekly visits to a specialist who is out-of-network and charges $230 per visit. In addition, your child needs 4 medications that cost a total of $1,000 per month at an in-network pharmacy (if purchased without insurance). What would be your annual costs under each plan? Remember, your out-of-pocket payments to the specialist count toward your deductible.
   - Plan A: $_________ • Plan B: $_________

Career Link

ACTUARY

Actuaries are concerned with risk — looking at the likelihood of bad events happening, quantifying the cost of those events, and setting up financial models to protect clients at a reasonable price. While risk is a factor in all industries, no other industry handles the financial impact of risk more than the insurance industry.

Actuaries have traditionally specialized in life, health, property, and casualty insurance, where they work on developing, pricing, and managing insurance products. They are involved in defining and creating pension and retirement plans. Some are finding roles as financial planning advisors. Actuaries must have a bachelor's degree, typically in fields like math or finance, and must pass a series of exams to be certified in the field. These jobs consistently rank as being among the best in America.

INSURANCE UNDERWRITER

As an insurance underwriter, you would review applications for insurance policies. It would be your job to understand the amount of risk, or the chance that the applicant would file an insurance claim, associated with each application. Insurance underwriters typically have a bachelor's degree in business or math, and some knowledge of basic accounting principles. They also possess strong interpersonal and communications skills, as the work involves working with other people in a variety of ways.

INSURANCE AGENT

Your job as an insurance agent would include meeting with potential clients to determine their insurance needs. You could be a captive agent, working for one insurance company and only selling that company's products, or you could be an independent insurance agent, or broker, representing several companies. In either case, you could select the policy that is best suited for your client. You would then help your client fill out an insurance application, which you would forward to an underwriter. After the company issued the policy, you would deliver it to the client and review it to make sure the customer fully understood the coverage.

There are a number of different types of insurance that people purchase throughout their lives to protect themselves and their property from loss, theft, damage, and accidents. These include auto insurance, property insurance like renter's and homeowner's, specialized insurance for boats, motorcycles, and jewelry, etc.

Auto Insurance

Nearly every state requires drivers to have **auto insurance.** An automobile accident can be financially devastating if it involves serious injuries and/or damage to the vehicles involved. By carrying auto insurance, drivers protect themselves and others from bearing the burden of unexpected costs due to an accident, vandalism, or fire.

If you are a driver, you are probably covered under your family's auto insurance policy. Before long, however, you will need to shop for your own auto insurance.

There are several major types of auto insurance summarized for you in the chart below. Study the chart to familiarize yourself with the various components of an auto insurance policy, noting which coverage types are required and which are optional.

The factors that affect the price you will pay for auto insurance include:

- Make and model year of your vehicle: newer and luxury cars usually cost more to insure
- Where you live: costs are usually higher in areas with high crime rates, high accident rates, and limited parking

TYPES OF AUTO INSURANCE

TYPE OF COVERAGE	KEY CHARACTERISTICS
Bodily Injury and Property Damage Liability	• Required in most states (48) • Pays for damage you cause including bodily injuries, property damage, and legal bills resulting from lawsuits related to the damages • Listed on policies in the form of three numbers such as 50/100/25: the first number represents the bodily injury coverage for each individual in thousands of dollars; the second number represents the maximum amount that will be paid for bodily injury per accident in thousands of dollars; the third number represents the maximum amount that will be paid for property damage per accident in thousands of dollars • Even though you have insurance, you can be sued for additional funds if the costs of an accident exceed the maximum that the insurance company has agreed to pay
Personal Injury Protection	• Required in very few states • Pays for medical expenses, funeral expenses, and lost wages for you and any passengers in your vehicle
Collision	• Not required in any state • Pays for repairs to your vehicle if you have an accident that is your fault • Pays a percentage of the car's value if it is totally destroyed
Comprehensive	• Not required in any state • Pays for damage to your vehicle, no matter what causes it: vandalism, theft, fire, a natural disaster, etc. • Expensive, and people who have it usually choose to have a high deductible to keep the cost lower
Uninsured / Underinsured Motorist	• Required in many states • Pays for medical bills and property damage if you are in an accident with someone who doesn't have enough/any insurance or if you are the victim of a hit and run
Miscellaneous Coverage	• Not required in any state • Extra features like roadside assistance, towing, or the cost of a rental car in the event of an accident • This type of coverage adds cost to a policy, but is convenient if you are in an accident or have mechanical difficulties

- Coverage selected: more types of coverage and higher levels of coverage cost more
- Deductible: as with health insurance, the deductible is the amount you must pay before your insurance coverage "kicks in;" choosing a higher deductible will generally decrease your monthly premium payment but means you pay more out of pocket in the event of an accident
- Driving record: a history of safe driving with no accidents or tickets can lower rates
- Driver's age: younger drivers pose a statistically higher risk to the insurance company, because of a higher rate of accidents, so their insurance costs are higher
- Claims history: making several claims in a short time period could raise your costs
- Payment history: low credit scores and missed payments make you seem like a bigger risk, raising your rates

As a young driver, your premium will typically be higher because drivers ages 16-24 are involved in more accidents than more experienced drivers. To help lower the cost of auto insurance premiums, some insurance companies offer young drivers discounts for taking certified driver's education courses or maintaining good grades in school.

Activity 2

AUTO INSURANCE

Automobile liability insurance is often described using three numbers, such as 50/100/25. These numbers refer to the amount of liability insurance coverage. For example, 50/100/25 coverage would pay up to $50,000 for bodily injury to a single individual, $100,000 total for bodily injury to all parties involved in an accident, and $25,000 of property damage.

	MONTHLY PREMIUM		
Coverage Amount	**Rate A**	**Rate B**	**Rate C**
50/100/25	$553.00	$617.00	$451.00
100/200/50	$1,036.00	$1,174.00	$830.00
150/300/75	$1,363.00	$1,566.00	$1,133.00

1. Which set of rates would you choose if you had a very inexpensive car? ______________
2. Which set of rates would you expect if you had a safe driving record, good credit, and lived in a low-crime area? ______________
3. What if your car were fairly expensive and you lived in an area with frequent traffic accidents — which set of rates would you expect? ______________
4. What's the total annual difference in cost between the least expensive set of rates and the most expensive set for the highest level of coverage? When do you think it would be worth getting the extra coverage? What steps could you take to ensure you get the lowest rates?

Homeowner's and Renter's Insurance

The most valuable asset owned by most people is their home. Since homes cost so much money, it is important that they are insured in the event of fire, theft, or other unexpected events. Mortgage lenders require homeowner's insurance until the home is paid for in full. Even after you own your home, maintaining **homeowner's insurance** is important to protect you from financial loss.

Homeowner's insurance prices vary based on several factors, including the age of the home, what the house is made of, and the home's proximity to a fire station. The deductible amount also affects the insurance premium. Choosing a higher deductible decreases the premium, but increases your out-of-pocket costs in the event of a loss. Discounts are another way to lower your premium. Insurers often offer a discount if the home has specific safety features such as alarm systems and working smoke detectors. You may also receive a discount for bundling, which is when you purchase several types of insurance, usually homeowner's and auto, from the same agent, broker, or company.

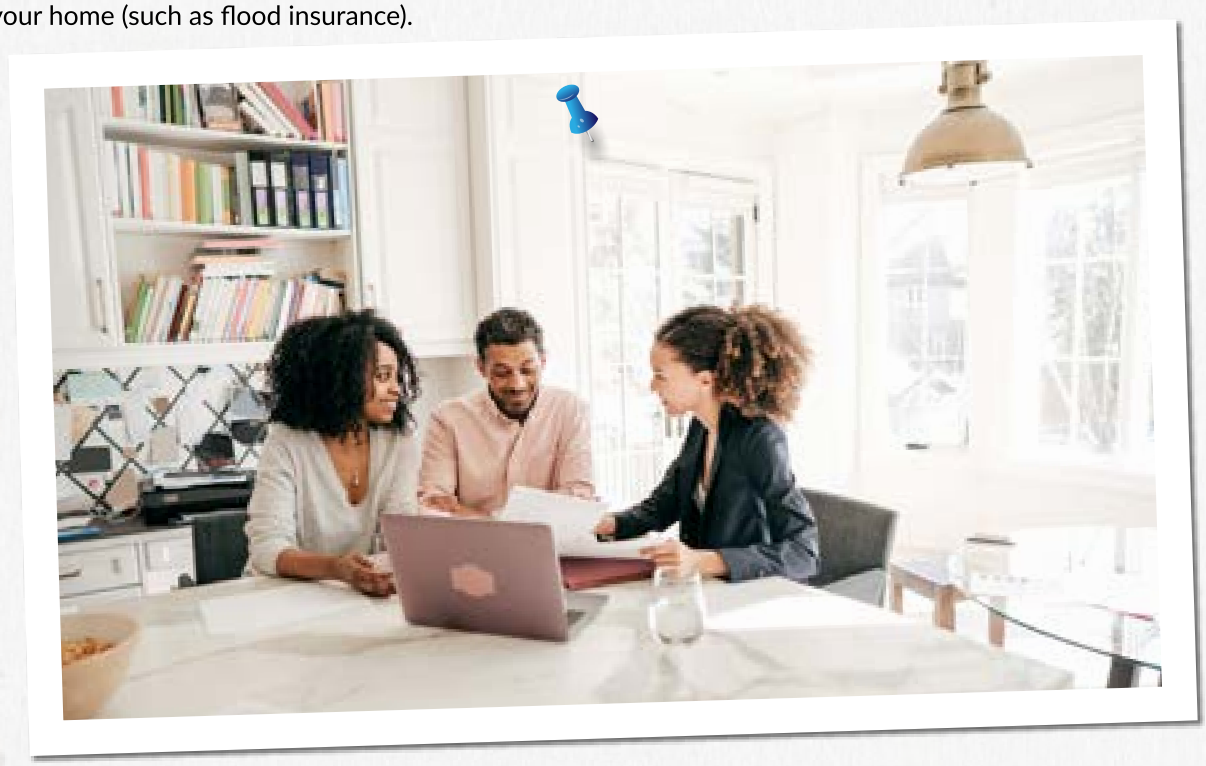
When selecting insurance coverage, it is important to know how much your home is worth, what it would cost to rebuild it if it were destroyed, the value of your home's contents, and specific coverage necessary because of the location of your home (such as flood insurance).

If you are renting a home, townhouse, or apartment, you should consider having **renter's insurance** on your personal property in the event of a fire, theft, or some other event. Renter's insurance will pay for losses incurred while you are living in a rented residence by providing you with a cash payment to replace the items that have been lost or the damages incurred. Renter's insurance can be purchased inexpensively and, like most other policies, has a deductible that must be met before a claim is paid. Many leasing companies require their tenants to purchase renter's insurance before they are approved for the lease.

Both homeowner's and renter's insurance policies typically provide protection if personal property kept within your residence is lost or stolen. They also often provide coverage for certain medical and liability risks, such as "slip and fall" types of injuries in your home, as well as claims against you for libel or slander.

Other Insurance Types

There are many types of insurance not covered in this chapter — dental, vision, mortgage, title, boat, travel, and pet, among them, as well as specialized insurances for businesses operating in various industries (e.g., worker's compensation, special liabilities for childcare centers and schools, etc.). As you plan your future, it is important to consider the need and costs for insurance protection.



Life Insurance

Young people often disregard **life insurance**, but nearly everyone needs it. The reasons for purchasing life insurance are as varied as the people who buy it. Ask yourself, "If I died tomorrow, would it be a financial hardship on any of the people I care about?" If the answer is yes, then you probably need life insurance. Some specific reasons include:

- To replace lost income to support one's family. For example, if a parent dies, life insurance provides money to pay expenses and support the family.
- To pay the cost of final expenses such as funeral and burial costs, debts, medical bills, taxes, and so on.
- To provide one's heirs with an inheritance.
- Students, or their parents, may buy life insurance to cover the cost of repaying student loans.
- Many employers offer life insurance as one of the benefits of working for the company. Amounts differ from employer to employer, and sometimes the employee can choose the value of coverage.

How to Purchase Life Insurance

When purchasing life insurance, you must designate a **beneficiary**; ideally, you will name a primary beneficiary AND a secondary beneficiary. By appointing a secondary beneficiary, you eliminate the risk of losing the insurance payout in the event that the primary beneficiary also dies. For example, married people will typically name their spouses as primary beneficiary and their children as secondary beneficiaries. You can also name your **estate** as the beneficiary.

When you purchase life insurance, the insurance company typically requires a medical exam and review of family history. This exam helps the company determine the **risk** associated with issuing a policy to you. Risk can vary due to family characteristics (such as a history of illness), your personal characteristics (age), or your lifestyle choices (smoking). Actuaries use sophisticated techniques to measure risk.

Insurance companies are not required to insure everyone who applies, nor are they required to charge the same premium to everyone they insure. If an insurance company completes a physical examination and determines you have a high mortality risk (such as if a terminal disease is found, for example), they can reject your application and deny you coverage. If you are in good health, fairly young, and have a healthy lifestyle, then you can be insured for a relatively small premium. On the other hand, if you have health issues, an unhealthy lifestyle, are elderly, participate in dangerous activities, or hold a high-risk job, the cost of the insurance policy may be higher. The insurance company considers all of this before they issue a policy and determine the premium they will charge for it.

Many people are unsure about how much life insurance they should purchase. For guidance, visit the Life and Health Insurance Foundation for Education website at www.lifehappens.org. As you will soon see, the answer truly varies based on each person's circumstances and needs.

When selecting life insurance, consumers have several options available to them. This chart highlights the various types of life insurance that are available.

LIFE INSURANCE OPTIONS

	Term Life	Whole Life	Universal Life	Variable Life
KEY CHARACTERISTICS	• Least expensive form of life insurance • Covers you for a set period of time, known as a "term" (for example, 10 years) • Requires renewal, usually at a higher rate, at the end of the term • The cost tends to rise at each renewal • Pays if you die within the period of time selected • You can select the amount of coverage you want at the start of each term	• The premium you pay always stays the same • The value of the policy increases over time because you build cash value that is tax-deferred • You are not allowed to select the investments; the insurance company controls how the money is invested • You cannot change the amount of coverage you have after the initial selection	• You can adjust the amount of coverage you have • You can adjust the amount you pay for your premium • The value of the policy increases over time because you build tax-deferred cash value • The insurance company guarantees a certain rate of return on your money • You cannot decide how the money is invested • If you lower the amount you pay for your premium for too long, then the coverage could lapse and you would no longer have the policy	• You can select the investment options you want • You are not taxed on the earnings until you redeem the policy • You can use the interest earned on the investments to pay the premiums • If you select bad investments, you could lose money on the policy

Activity 3

PLANNING FOR PROTECTION

You are just starting your first real job, as a temp office worker, and need to get insurance. You have an insurance line item in your budget of $2,000 per year. Using the chart below, conduct research about the cost of health, auto, homeowner's/renter's, and life insurance. Assume that, as a temp, you will have to pay for health and life insurance yourself.

Use your findings to make decisions about the types of insurance coverage you will be able to afford, knowing that they are all important. Your goal should be to prioritize the types of insurance you need and then to find pricing that will enable you to purchase what you need. After you fill in the chart, answer the questions below and be prepared to discuss your findings with classmates. Start your research with these websites:

- **Life and Health Insurance Foundation for Education:** www.lifehappens.org
- **Insurance Information Institute:** www.iii.org

RESEARCH FINDINGS

Type of Insurance	Coverage	Deductible	Approximate Cost
Health	$	$	$
Auto	$	$	$
Homeowner/ Renter	$	$	$
Life	$	$	$

1. Based on your $2,000 annual budget, what types of insurance did you elect to purchase? Why?

2. What financial risks are you protecting against by selecting these types of insurance?

3. What financial risks do you run by not having the remaining types of insurance?

4. Of the four types of insurance you researched, which do you think is most important for you at the start of your working life? Why?

5. How might this change after five or ten years? Why?

6. What questions do you still have about insurance?