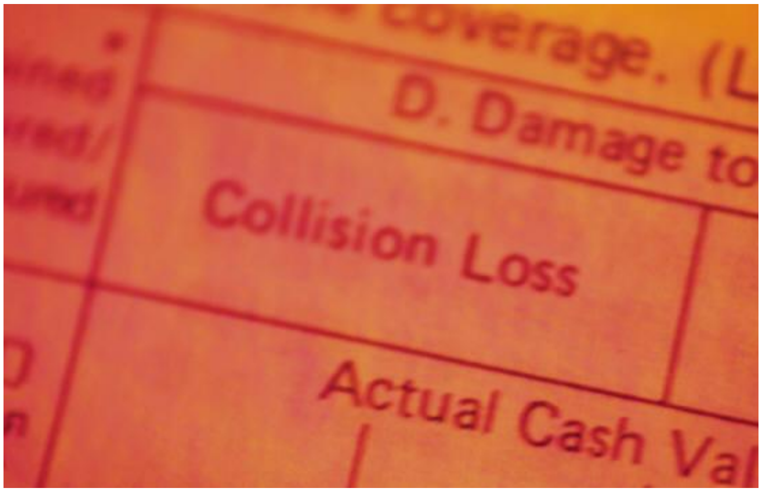
Standard 11: **The student will describe and explain how various types of insurance can be used to manage risk.**

Using Insurance to Manage Risk

Priority Academic Student Skills
Personal Financial Literacy
Objective 11.3: Examine appropriate amounts of insurance and how insurance deductibles work.



Lesson Objectives

⇒ Examine how deductibles affect insurance premiums.
⇒ Determine how out-of-pocket expenses impact the cost of using insurance.
⇒ Identify ways to save money on insurance premiums.
⇒ Demonstrate the ability to select appropriate amounts of insurance in selected situations.

Maggie knew it was a bad storm, but she did not realize a tree had fallen on her car and broken the windshield. She took it to a local repair shop to get an estimate.

Maggie has a $500 deductible, and it will cost $700 to put in a new windshield and repair the paint scratches.

Lily injured her knee running track, and the school trainer sent her to see the doctor. He says she needs surgery to repair the ligament. He tells her the estimated cost is $5,000 for outpatient surgery. She has a $500 deductible and 80/20 coinsurance with a $5,000 cap. But, her policy pays 100% of all hospital costs.

Should Maggie and Lily use their insurance to cover their costs?

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Personal Financial Literacy Vocabulary

Coinsurance: The percentage of the costs of medical services paid by the patient.

Copayment: An amount of money that the member or insured pays directly to a provider at the time services are rendered.

Deductible: The dollar amount or percentage of a loss that is not insured, as specified in an insurance policy.

PRESENTATION
The slide presentation for this lesson outlines the content in this section. You may want to use it with your students, or print off the slides to use as lecture notes.

Introduction

Making good choices about insurance is like being wrapped in a protective blanket. Insurance provides protection against catastrophic losses that could have long-term impact on a family's financial future. While insurance companies pay most of the costs when there is a loss, almost all policies have some type of deductible or other out-of-pocket expenses. Learning how to manage those additional expenses is part of understanding the role of using insurance to manage risk.

Lesson

Most insurance policies have some kind of deductible and out-of-pocket expenses which you are responsible to pay if you need to use your insurance plan. A **deductible** is the amount you must pay before the insurance company will begin paying for your losses. Suppose your car is damaged in a hail storm and it will cost $2,000 to have it repaired. If you have an insurance policy with a $1,000 deductible, you will pay $1,000 and the insurance company will pay the other $1,000 to have it repaired.

While a $100 deductible may sound better, you will pay much more in premiums for that type of coverage. So, you must decide if you want a lower deductible and higher monthly premiums, or a higher deductible and lower monthly premiums. Generally, the higher deductible and lower premiums is a better financial choice because the money you save in premiums can be used to offset the cost of the higher deductible, especially when put into an emergency fund.

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Deductibles, however, are just one type of out-of-pocket expenses you have when using insurance. For example, most health insurance policies have a **coinsurance** clause, which means you and the insurance company will share the cost of your medical expenses. Most health insurance plans pay 80% of the total charges once you pay the deductible, leaving you to pay the remaining 20%. Some plans will pay 100% of hospital charges, but not all—making it important for you to read your policy closely to understand what the company will and will not pay. Your premiums and copayments do not count toward your deductible.

In most cases, the insurance policies have a "stop loss point" or cap on coinsurance to limit your liability. The maximum amount varies from policy to policy.

Most health insurance policies also pay something called "reasonable and customary charges." Basically, this clause means that insurance companies realize that medical costs vary from one location to another and they may not be willing to pay the highest charges. Insurance companies will negotiate a set fee with physicians who agree to accept payment from the company. Under this arrangement, not all charges are covered—leaving you responsible to make any additional payments to cover those charges.

Another kind of out-of-pocket expense is called a **copayment**. A copay is the set amount you pay when you go to the doctor or to the pharmacy. Different insurance plans will have different prices for copayments, and they are often printed on your health insurance card. The purpose of a copay is a requirement to share the cost of your health care and discourage you from abusing your insurance coverage. If you paid nothing, you would have a greater incentive to go to the doctor even when it was not necessary. Unfortunately, copays can often total hundreds of dollars each month if you have several health ailments or chronic health problems. In these cases, many patients begin to pick and choose which medications they will purchase, which may create additional problems. Most copayments run between $25 and $35.

Example

Stewie had an accident on his skateboard. His hospital bill is $40,250. Based on his insurance policy information below, how much will Stewie have to pay?

Deductible:	$250
Coinsurance:	80/20
Cap on Coinsurance:	$2,000
Your Answer:	____________________

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Using the above information, you can compute how much Stewie will owe—in addition to his monthly insurance premium.

$40,250 - $250 = $40,000

20% of $40,000 is $8,000, which is more than his cap on coinsurance.

Because Stewie has a $2,000 cap on his coinsurance, he only pays $2,000, plus the $250 deductible. He will pay a total of $2,250 for his hospital bill and the insurance company will pay the rest.

Insurance Fundamentals

Not everyone who purchases insurance will need to make a claim. In fact, if they did, the insurance company would probably go out of business. The more likely an insurance company believes you are to make a claim (higher risk), the more they charge you for the insurance (higher premiums). The concept of risk explains why people with health problems tend to pay higher premiums for life and health insurance, and teenagers tend to pay higher rates for automobile insurance.

Insurance is based on the principle of probability. Insurance companies measure the probability you will need to make a claim. Then, they decide how much they will charge you for the policy. Your insurance choices are also based on probability. You decide how likely you are to need insurance, using that probability to weigh the costs and benefits of purchasing specific types of insurance. Your final decision includes how much risk you want to retain and how much risk you want to transfer to the insurance company.

To illustrate how this works, insurance companies will consider the following risk factors when setting your insurance premium.

- **Your driving record** – a clean record can save you a substantial amount on your premium. Most insurance companies use point systems for tickets and past accidents – the more points you have, the higher your premiums will be.

- **The type of car you drive**, sticker price, repair costs, and safety records affects your rate.

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- **Theft** – some models are frequently stolen, creating a greater risk for the insurance company and higher premiums for you. **Tip: It is a good idea to check insurance rates *before* you purchase a car.**

- **Your age** – younger drivers generally pay higher car insurance rates because of accident statistics.

- **Where you live**, if your car is kept in a garage, and how many miles you drive in a year affects your insurance rate. People who live in large cities with heavy traffic usually pay higher rates.

- **Credit report score** – this is a widespread insurance industry practice. An excellent credit rating, according to insurance research, makes you an attractive and low-risk client. Lower premiums are your reward.

You can reduce your premiums by reducing one or more of the above risk factors. Read the following situations and make suggestions for how each person can reduce their insurance premiums. Put your answers in the boxes below.

1. Christy likes to drive a little fast, generally just 10-15 miles over speed limit. Because she has received three speeding tickets, her insurance rates have increased. What can Christy do to lower her premiums?

2. Lacy turns 16 next month. She has been saving to buy a brand new convertible sports car since she was 12 years old. When she talked to her insurance agent about the coverage she needs on her new car, she could not believe how expensive it would be. What are Lacy's options?

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3. Bryan got a credit card when he went to the mall to buy new clothes for the spring dance. However, he sometimes forgets to make his payments and has paid several late fees. As a result, his car insurance premiums have increased. What should Bryan do?

4. Zhen likes to smoke and goes through about a pack of cigarettes a day. He is going to college next fall and wants to get a health insurance policy, but is surprised that his premiums will be increased because of his habit. What should Zhen do?

5. Think about your own situation. What are some things you can do to reduce your insurance premiums now or in the near future?

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Saving Money on Insurance

Insurance premiums can consume a large part of your budget if you are not careful. It is estimated that the average family in the United States spends almost $4,000 a year on insurance payments.

Following are several suggestions to help you maximize the money you spend on insurance.

- Consider paying for small amounts of damage out of your pocket instead of filing a claim with your insurance company. The number and frequency of claims filed has a big impact on your premiums.

- Examine the possibility of increasing your deductible. A higher deductible will decrease your premiums. If you increase your deductible from $500 to $1,000, your rates will drop significantly. **Tip: Be sure you have the additional $500 in savings in case you need to use it.**

- Nonsmokers pay less for most types of insurance than smokers because smokers are considered higher risk.

- Consider cancelling your collision insurance if your car is very old or worth less than $1,000. Most insurance experts advise you to cancel your collision when your car is worth about the same as your deductible. Do NOT, however, cancel your auto liability insurance. It is required by law and is your protection if someone is injured in an accident that is your fault.

- Take a driver's safety course approved by your insurance company to qualify for an auto insurance discount.

- Maintain a good credit history. Your premiums are directly tied to your credit rating.

- Avoid insurance that covers only one type of risk (cancer, credit life, flight, etc.); these policies often duplicate your existing policies and are certainly more expensive.

- Shop around. Talking with different insurance agents may take little time, but it could save you hundreds of dollars each year.

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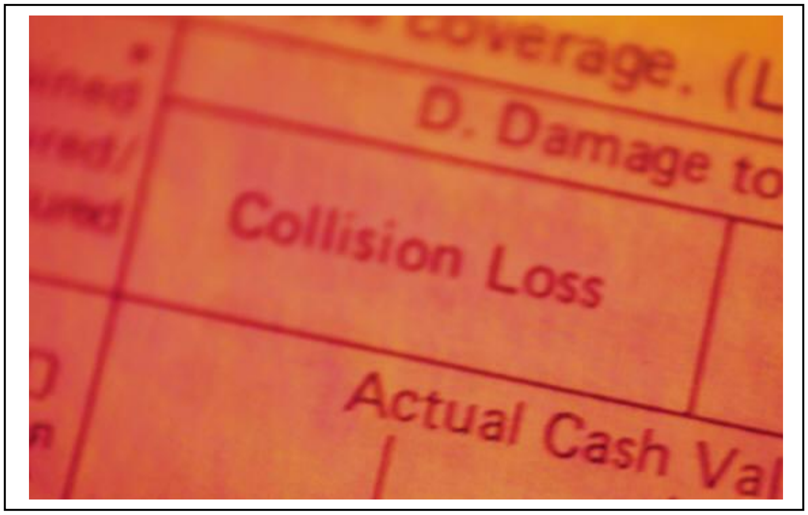
Conclusion

In addition to having a clean driving record and excellent credit rating, comparison shopping, discounts, and high deductibles can further lower your insurance premium. If you are careful, you may be able to find something quite reasonable. Just remember — not purchasing the insurance could be an expensive mistake!



If Maggie has enough money in savings, she would be better off to pay for the damage without filing a claim with her insurance company. By the time she pays her deductible, insurance would only pay $200. ($700 - $500 = $200).

Chances are the insurance company will raise her premiums, especially if she has filed other claims recently. It is probably less expensive to pay for the windshield and to save her insurance for a more expensive claim in the future.

Lily, however, should contact her insurance company to get approved for surgery. With her deductible and co-insurance responsibility, her total cost for the surgery is $780. That leaves $4,220 for her insurance company to pay ($5,000 - $780 = $4,220).

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Name: ____________________________ Class Period: ___________________________

Using Insurance to Manage Risk
Review Lesson 11.3

Answer the following questions and give the completed lesson to your teacher to review.

1. List three things you can do to save money on insurance.

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2. Explain the difference between coinsurance and copayments.

3. Identify three factors that influence insurance premiums.

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