OKLAHOMA STATE DEPARTMENT OF EDUCATION
CHAMPION EXCELLENCE

Using Insurance to Manage Risk

Standard 11

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

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.

Personal Financial Literacy Vocabulary

Co-insurance: The percentage of the costs of medical services paid by the patient.

Co-payment: 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.

Probability: The likelihood of something happening; the extent to which an event is likely to occur.

Introduction

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. She has a $500 deductible on her policy, 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.

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

Lesson

Making good choices about insurance can provide you with protection against catastrophic losses that could have long-term impact on your finances. While it is an additional expense to pay, it is an important tool to help manage your risk. A good insurance plan will pay most of the costs you have when you suffer some kind of loss, but almost all policies have some type of deductible or other out-of-pocket expenses to off-set the total cost. Learning how to deal with those additional expenses is part of understanding the role of using insurance to manage your risk.

A deductible is the amount you pay before the insurance company begins 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 pays 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 choice because the money you save in premiums can be used to offset the cost of the higher deductible, especially when you save it in your emergency savings account.

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.

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. Therefore, they 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 for 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 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.

For example, suppose Stewie had an accident on his skateboard that injured his back. After surgery and a few days in the hospital, his 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

REMINDER

Insurance rates are based on the principle of probability, not possibility.

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

Only a small percentage of those who have insurance need to make a claim at one time. Insurance based their premiums on how likely you are to be one of those people making a claim. The more likely you are to make a claim, the higher risk they view you. And, the higher the risk of filing a claim, the more they charge you for premiums. The opposite is also true. Lower risk policyholders have lower premiums because the company does not expect them to file as many claims as those who are higher risk. The concept of risk explain why people who are older may pay higher health insurance rates than those who are younger, and it explains why young adults pay higher auto insurance premiums than more experienced drivers.

Insurance rates are based on the principle of probability, not possibility. Probability is how likely you are to do something while possibility is whether or not you are able to do it. 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 automobile insurance premium.

- Your driving record. A clean driving record, meaning no tickets or accidents, can save you a substantial amount on your premium. Most insurance companies use a point system for tickets and past accidents; the more points you have, the higher your premiums.

- The type of car you drive. Sticker price, potential repair costs, the vehicle's safety record, the number of extras added onto the base, and other factors are also important. Those with favorable ratings, lower prices, and few add ons tend to have lower premiums than those with less favorable ratings, higher prices, and more add ons.

- Theft. Some models of vehicles are more frequently stolen than others, 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 they tend to have more accidents than more experienced drivers.

- Where you live. If you live in a low crime neighborhood, your car is kept in the garage, and you only drive a few miles each year, you will tend to pay lower insurance premiums than people who live in high crime areas, keep their cars outside, and live in a more congested area. People who live in large cities with heavy traffic usually pay higher rates than those who live in smaller communities.

- Your credit score. If you have an excellent credit rating, you will be classified as a low-risk client with lower insurance premiums than someone who has a low credit score. The insurance industry views credit scores as a means of measuring how responsible a person tends to be.

Saving Money on Insurance

Insurance premiums can consume a large part of your budget. 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 your insurance coverage while minimizing the cost or your premiums:

- 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, keeping only the liability. Most insurance experts advise you to cancel your comprehensive coverage 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.

- Get more than one policy from the same agent or company. "Bundling" your insurance coverage tends to reduce your overall payment.

- Ask if you qualify for any additional discounts. Insurance companies offer reduced rates for students with good grades or those working in certain professions.

Conclusion

In addition to having a clean driving record and excellent credit rating, you may want to explore other ways to save money on your insurance premiums. Comparison shopping, discounts, and high deductibles can further lower your insurance premium. If you are spend a little time understanding your coverage and exploring your options, you may be able to find less expensive coverage. However, be sure the company is reliable and providing the services you need. Sometimes, paying a little more is better than finding the cheapest price. Whatever you decide, just remember that failing to purchase insurance could be an expensive mistake!

FINAL NOTE: If Maggie has enough money in savings, she would probably 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).

Some insurance companies may also increase her premiums, especially if she has filed other claims recently. Others may not count it against her because it was an act of nature rather than something she caused.

However, most companies will note that she filed a claim, making it more difficult to change companies in the near future. She may also want to visit with her agent for advice before filing her claim. Overall, it is probably better to pay for the windshield and save her insurance for a more expensive claim in the future.

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

This lesson was written and created by Oklahoma educators in partnership with

Oklahoma CEE Council on Economic Education

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.

2. Explain the difference between co-insurance, co-payments, and deductibles.

3. Determine which of the following is co-insurance, co-payment, or deductible.

   a. ____________ Debbie goes to the doctor for a flu shot. She pays the doctor $30 for the visit and her insurance company pays the doctor $80.

   b. ____________ Juan breaks his ankle sliding into second base during a softball game. His hospital bill is $3,000. He is required to pay 20 percent and his insurance company will pay 80 percent of his bill.

   c. ____________ The paint on Jasmine's car is damaged during a hailstorm. It will cost $1900 to have it repaired and repainted. She will pay $500 and her insurance will pay $1,400.

4. Identify three factors that influence auto insurance premiums.

Name: ______________________________ Class Period: _____________________________

Using Insurance to Manage Risk Activity Lesson 11.3

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

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.

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?

3. Bryan has had a credit card since he started working during his sophomore year in high school. He loves to use to buy clothes and lunch for his buddies. 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?

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