## Module 3

## Managing Risk

Learning Objectives

* Describe the purpose of insurance
* Identify assets that are commonly insured
* Compare the types of insurance available for certain assets
* Explain the factors that determine insurance costs

Life is full of risks. You can try to avoid them or reduce their likelihood and consequences, but you cannot eliminate them. You can, however, pay someone to share them. That is the idea behind insurance.

Insurance can be purchased for your property and your home, your health, your employment, and your life. In each case, you weigh the cost of the consequence of a detrimental event that may never actually happen against the cost of insuring against it. Deciding what and how to insure is really a process of deciding what the costs of loss would be and how willing you are to pay to protect yourself against those costs.

## Property Insurance

**Property** includes assets such as your home if you are a homeowner or your furnishings if you rent. It also includes assets such as your vehicle or other items you own that have value (e.g., jewelry, precious art, clothing, etc.). Property insurance is ownership insurance: it typically covers loss of use, loss of value, and liability for any use of your property that causes damage to others or others’ property.

Loss of use and value can occur from hazards such as fire or weather disasters, from deliberate destruction such as vandalism or theft, or from accidents like a fender bender. When replacement or repair is needed to restore usefulness and value, that cost should be considered in assessing risk. For example, if your laptop’s hard drive crashes, you not only have to bear the cost of replacing or repairing it, but also the cost of being without your laptop for however long that takes. Insuring your laptop shares that risk (and those costs) with the insurer.

**Liability** is the risk that use of your property will injure someone or something else. Ownership implies control of, and therefore responsibility for, property use. For example, you are liable for your dog’s attack on a pedestrian and for your fallen tree’s damage to a neighbor’s fence. You also are liable for damage a friend causes while driving your car with your permission and for injury to your invited guests who trip over your lawn ornament, fall off your deck, or leave your party drunk.

**Homeowner’s insurance** insures both the structure and the personal possessions that make the house your home. **Renter’s insurance** protects your possessions even if you are not the owner of your dwelling. You may not think you need insurance until you are the homeowner, but even when you don’t need to insure against possible damage or liability for your dwelling, you can still insure your possessions. Even if your furniture came from your aunt’s house or a yard sale, it could cost a lot to replace.

If you own and drive a car, you must have **auto insurance**. Your car accident may affect not only you and your car, but also the health and property of others. A car accident often involves a second party, and so legal and financial responsibility must be assigned and covered by both parties. Auto insurance policies cover two types of consequences: bodily injury and property damage. Each encompasses three types of financial losses.

A diagram of types of insurance coverage



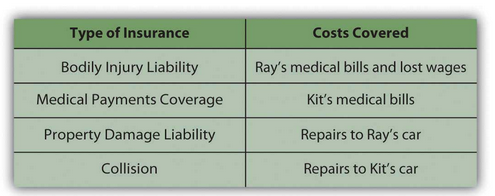
*Figure 1: Automobile Insurance Coverage*

**Bodily injury liability** refers to the financial losses of people in the other car that are injured in an accident you cause, including their medical expenses, loss of income, and your legal fees. Injuries to people in your car or to yourself are covered by **medical payments** coverage. **Uninsured motorist protection** covers your injuries if the accident is caused by someone with insufficient insurance or by an unidentified driver.

**Property damage liability** covers the costs to other people’s property from damage that you cause, while **collision** covers the costs of damage to your own property. To reduce their risk, the lenders financing your car loan will require that you carry adequate collision coverage. **Comprehensive physical damage** covers your losses from anything other than a collision, such as theft, weather damage, acts of nature, or hitting an animal.

Auto insurance coverage is limited, depending on the policy. The limits are typically stated in numbers representing thousands of dollars. For example, 100/300/50 means that $100,000 is the limit on the payment to one person in an accident; $300,000 is the limit on the amount paid in total (for all people) per accident; and $50,000 is the limit on the amount of property damage liability that can be paid out.

Here’s an example of how it all works. Kit is driving home one night from a late shift at the convenience store where he works. Sleepy, he drifts into the other lane of the two-lane road and hits an oncoming car driven by Ray. Both Kit and Ray are injured, and both cars are damaged. Figure 2 shows how Kit’s insurance will cover the costs.



As with any insurance, the cost of having an insurer assume risk is related to the expected amount of loss and the likelihood of experiencing that loss. Insurance companies will consider various factors to determine your insurance **premium** (the amount you pay for insurance. This could be a monthly, semi-annual, or annual payment). The table below describes some of the factors that insurance companies deem relevant to determine risk. Some factors may only be considered for a particular insurance type. For example, the age of the insured is relevant to auto insurance but is unlikely to affect rental insurance premiums.

|  |  |  |  |
| --- | --- | --- | --- |
| Insured | Property | Auto | Coverage |
| * Employment * Marital status * Criminal record * Credit history * Insurance claim history * Driving record * Age * Education level * Gender | * Age * Size of home * Location of home * Proximity to fire/police services * Building materials * Number of occupants * Heating system * Alarm systems or other safety systems | * Make and model * Age * Safety features, such as air bags * Security devices * Rate of theft * Annual miles driven * Driving and parking locations | * Actual cash value of covered property * Replacement cost * Extra coverages the insured wants |

*Figure 2. Factors that Determine Insurance Premiums*

Insurance premiums vary widely, so you should always shop around. In addition to premiums, you should consider the insurer’s reliability in addressing a claim. You can check your insurer’s reputation by the record of complaints against it, filed with your state’s agency of banking and insurance, or with your state’s attorney general’s office.

## Health Insurance

There are many kinds of coverage and plans for health insurance. As health care costs rise, insurers face the choice between lower profits (or, indeed, losses) or charging higher premiums. As an alternative to increases in premiums, insurers add the following “cost offsets”:

* Deductibles—an amount payable by the insured before any expenses are assumed by the insurer.
* Co-pays—partial payment for certain costs—for example, for physician’s visits or prescriptions.
* Coinsurance—shared payments of expenses by insured and insurer.

Each of these payment features represents responsibilities of the insured, that is, your out-of-pocket costs. The more costs you shoulder, the less risk to the insurance provider, and so the less you pay for the insurance policy. Making you responsible for initial costs also discourages you from “overusing health care,” or seeking health care more than is necessary, or from submitting frivolous health care claims.

Costs vary with coverage, coverage limits, and offsets, and they vary widely between insurers. You should be well informed as to the specifics of your coverage, and you should compare rates before you buy. Dental and vision plans are usually offered as separate add-ons. Although health insurance is always advised, the costs versus potential benefits of dental and vision insurance should be carefully considered.

## Income Insurance

As you have learned, assets such as a home or car should be protected from the risk of a loss of value, because assets store wealth, so a loss of value is a loss of wealth.

Your health is also valuable, and the costs of repairing it in case of accident or illness are significant enough that it also requires insurance coverage. In addition, however, you may have an accident or illness that leaves you permanently impaired or even dead. In either case, your ability to earn income will be restricted or gone. Thus, your income should be insured, especially if you have dependents who would bear the consequences of losing your income. Disability insurance and life insurance are ways of insuring your income against some limitations.

### Disability insurance

Disability insurance is designed to insure your income should you survive an injury or illness impaired. The definition of “disability” is a variable feature of most policies. Some define it as being unable to pursue your regular work, while others define it more strictly as being unable to pursue any line of work. Some plans pay partial benefits if you return to work part-time, and some do not. As always, you should understand the limits of your plan’s coverage.

The costs of disability insurance are determined by the features and/or conditions of the plan, including the following:

Waiting period

Amount of benefits

Duration of benefits

Cause of disability

Payments for loss of vision, hearing, speech, or use of limbs

Inflation-adjusted benefits

Guaranteed renewal or noncancelable clause

In general, the greater the number of these features or conditions that apply, the higher your premium.

All plans have a waiting period from the time of disability to the collection of benefits. Most are between 30 and 90 days, but some are as long as 180 days. The longer the waiting period is, generally, the lower the premium.

### Life insurance

**Life insurance** is a way of ensuring that your income will continue after your death. If you have a spouse, children, parents, or siblings who are dependent on your income or care, your death would create new financial burdens for them. To avoid that, you can insure your dependents against your loss, at least financially.

There are many kinds of life insurance policies. Before purchasing one, you should determine what it is you want the insurance to accomplish for your survivors. What do you want it to do?

* Pay off the mortgage?
* Put your kids through college?
* Provide income so that your spouse can be home with the kids and not be forced out into the workplace?
* Provide alternative care for your elderly parents or dependent siblings?
* Cover the costs of your medical expenses and funeral?
* Avoid estate taxes?

These are uses of life insurance. Your goals for your life insurance will determine how much benefit you need and what kind of policy you need. Weighed against that are its costs—the amount of premium that you pay and how that fits into your current budget.

#### Term insurance

**Term insurance** is insurance for a limited time period, usually ten, twenty, or thirty years. After that period, the coverage stops. It is used to cover financial needs for a limited time period—for example, to cover the balance due on a mortgage, or education costs. Premiums are lower for term insurance because the coverage is limited. The premium is based on the amount of coverage and the length of the time period covered.

Term insurance is a more affordable way to insure against a specific risk for a specific time. It is pure insurance, in that it provides risk shifting for a period of time, but it does not also provide a way to save or invest.

#### Whole life insurance

**Whole life insurance** is permanent insurance. That is, you pay a specified premium until you die, at which time your specified benefit is paid to your beneficiary. The amount of the premium is determined by the amount of your benefit and your age and life expectancy when the policy is purchased.

Unlike term insurance, where your premiums simply pay for your coverage or risk shifting, a whole life insurance policy has a cash surrender value or cash value that is the value you would receive if you canceled the policy before you die. You can “cash out” the policy and receive that cash value before you die. In that way, the whole life policy is also an investment vehicle; your premiums are a way of saving and investing, using the insurance company as your investment manager. Whole life premiums are higher than term life premiums because you are paying not only to shift risk, but also for investment management. Whole life premiums can be 10-20 times greater than those of term insurance.

Consumer advocate Clark Howard (Howard, 2024) cautions that, except for a few very wealthy individuals, term life insurance is the recommended method for insuring your income. This is because whole life insurance combines *investment* strategies with income insurance. The fees and commissions related to the investment component of whole life insurance policies can be exorbitant. For most individuals and families, life insurance should simply insure income; investments are available in other, more effective, and less expensive ways. Dana George (2024) offers this advice:

One word of warning here: Never buy a policy because a very polite but slick agent talks you into it. You can be assured that the harder you're sold on an insurance product, the more commission the agent is set to earn if you make the purchase (para. 11).

## Quiz Questions

1. Match the following terms with the type of coverage it describes for auto insurance

|  |  |
| --- | --- |
| bodily injury liability | Injuries to yourself or people in your car for an accident you cause |
| uninsured motorist | financial losses of people in the other car that are injured in an accident you cause |
| property damage liability | Damage to your property from an accident you cause |
| comprehensive | losses from anything other than a collision, such as theft, weather damage, acts of nature, or hitting an animal. |
| medical payments | Injuries to yourself or people in your car for an accident caused by an unknown driver or underinsured driver |
| collision | Damage to others’ property from an accident you cause |

1. True or false: The goal of insurance is to save for your future. \*false
2. Which of the following are ways to insure your income? Select all that apply.
   1. property insurance
   2. auto insurance
   3. health insurance
   4. disability insurance\*
   5. life insurance\*

## Module 3 Assignment

1. Read through the State Health Benefit Plan for the current year health plan choices. <https://shbp.georgia.gov/enrollment/open-enrollment> à click on “Open Enrollment” and download the pdf. Answer the following questions:
   1. The state offers plans from \_\_\_how many ­­­\_\_\_ companies.
   2. Do you live in the service area of Kaiser?
2. Compare renters' insurance companies at this site: <https://www.nerdwallet.com/article/insurance/renters-insurance-ga-georgia>. Select one company that you could imagine using. Name the company and explain why you chose it.

## References

Adaptation of Personal Finance. **Provided by**: Saylor Academy. **Located at**: <https://saylordotorg.github.io/text_personal-finance>. **License**: [*CC BY-NC-SA: Attribution-NonCommercial-ShareAlike*](https://creativecommons.org/licenses/by-nc-sa/4.0/)

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