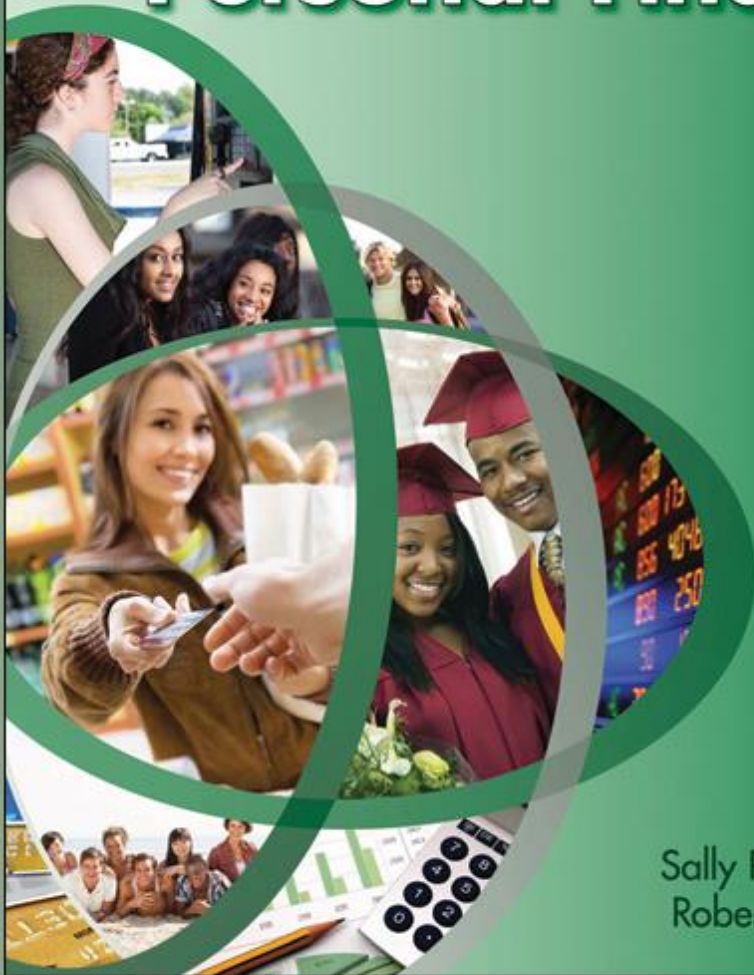


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Foundations of Personal Finance

Ninth Edition



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Chapter 8

Insurance

Section 8.1

RISK MANAGEMENT

Objectives

- Identify and explain two common types of risks.
- Discuss strategies for dealing with risk.
- Explain how insurance protects individuals from financial loss.

Terms

- risk
- pure risk
- speculative risk
- risk management
- insurance
- premium
- dependent
- policyholder

Risk

- **Risk** is a measure of the likelihood of loss or injury (some risk is predictable and some is not)
- **Pure risk** is a chance of loss but no chance of gain
 - *Personal risk*—illness or disability of self or family member
 - *Property risk*—affects our personal or real property
 - *Liability risk*—legal risks resulting from possibility of losing money or other property as a result of legal proceedings

Risk (Continued)

- **Speculative risk** has a possibility of financial loss or financial gain
 - Most speculative risks are not insurable
 - Example: purchasing stock because you think you will be able to sell it for a profit is called “speculation”

Managing Risk

- **Risk management** is the process of measuring risk and finding ways to minimize or manage loss
 - *Avoidance* means taking steps to eliminate risk (heed warnings)
 - *Reduction* is a strategy of minimizing risk that you cannot always avoid (use seatbelts, wash hands)
 - *Retention* is assessing risk and preparing financially for possible loss (self insurance)
 - *Transfer* is shifting the risk (buying insurance)

In Your Opinion

What types of risks do teenagers face?

Insurance Protection

- **Insurance** is a form of risk management that spreads individual risk among a large group of people
- **Premium** is the fee paid to an insurance company for a policy

Did You Know?

The money an insurance company collects from policyholders is invested. The earnings are used to pay insurance claims.

Buying Insurance

- A **dependent** relies on someone else for financial support (child, spouse, or elderly parent)
- A person who buys insurance is a **policyholder**
- Types of insurance to protect against financial risks includes:
 - Health
 - Disability
 - Life
 - Auto
 - Home

Review 8.1

- What is an example of speculative risk?
 - Buying stocks, real estate, gold or silver
- What is the term used to describe what a person does when they set aside money in a savings account in case of an accident, rather than purchasing insurance?
 - Self insurance

Section 8.2

HEALTH AND DISABILITY INSURANCE

Objectives

- Outline the different types of private health insurance coverage.
- Identify ways to choose an insurance plan.
- Describe types of government-sponsored health insurance programs.
- Explain the purpose of disability insurance.

Terms

- deductible
- fee-for-service plan
- coinsurance
- inpatient
- managed care plan
- copayment
- health savings account (HSA)
- exclusion
- preexisting condition

Private Health Insurance

- Participants in private insurance plans usually pay a monthly premium
- Most plans have a **deductible** amount that the individual must pay toward their medical expenses before the insurance company begins to pay
- **Fee-for-service plans** pay for covered medical services after treatment is provided

Did You Know?

Approximately 35 percent of health-care costs are paid by private plans offered by insurance companies. Many of these plans are available through employers.

Fee-for-Service Plans

- **Coinsurance** is a percentage of the service cost that patients pay (example: 20 percent)
- **Inpatient** is a person whose care requires a stay in a hospital
- Basic coverage usually includes:
 - Prescriptions
 - Hospital stays
 - Doctor's visits
 - Outpatient procedures
 - Inpatient tests

Fee-for-Service Plans (Continued)

- Major medical coverage typically covers costs of serious illnesses and high-cost procedures and injuries
- Both types of coverage are often combined into a comprehensive fee-for-service plan

Did You Know?

With many fee-for-service plans, your health care provider will bill your insurance company for you.

Managed Care Plans

- **Managed care plans** limit your choice of service providers to those who participate in the plan (except for specialist referrals outside the plan)
- **Copayment** is a flat fee the patient must pay for medical services at the time of service (for appointments or prescriptions)
- Three forms of managed care plans are
 - Health Maintenance Organizations (HMOs)
 - Preferred Provider Organizations (PPOs)
 - Point-of-Service Plans (POS)

Health Maintenance Organizations (HMOs)

- HMOs provide a list of participating physicians from which you choose a primary care doctor
- Your doctor and a referral specialist from the HMO will determine which treatments and procedures are covered
- If you go outside the plan, you pay part or all of the bill

Preferred Provider Organizations (PPOs)

- Arrange with specific doctors, hospitals, and caregivers to provide services at reduced cost to plan members
- PPOs offer more choice than HMOs
- You may go outside the plan if you are willing to pay the extra cost
- Example: the plan may pay 80 percent of the cost within the plan, and only 60 percent outside the plan

Point-of-Service (POS)

- POS plans connect you with a primary care doctor who is your “point of service”
 - Supervises your care
 - Makes referrals to participating or nonparticipating specialists
- POS plans provide the freedom of a PPO with the lower cost of an HMO

Health Savings Account (HSA)

- **HSA** is a tax-advantaged savings account for people with high deductible health plans (HDHPs)
- Patients pay a high deductible before the insurance begins to pay, but monthly premiums are usually lower
- You can contribute pretax dollars into an HSA, and use the money to pay for health care costs; however, tax penalties apply for other uses

COBRA

- COBRA stands for **C**onsolidated **O**mnibus **B**udget **R**econciliation **A**ct
- It gives covered workers the right to continue group health-care coverage for up to 18 months after job loss
- Employers may require individuals to pay for the full cost plus a 2 percent administrative fee

Individual Plans

- Individuals may purchase health insurance on their own
- Individual plans are generally more expensive and may offer fewer benefits than group plans
- **Exclusions** refer to medical services that are not covered (such as dental or optical care)
- A **preexisting condition** is an illness or injury someone had before signing up for insurance

Coverage for Young Adults

- The *Affordable Care Act* includes provisions for children to remain on family policies until age 26
- Full-time college students can usually remain on their parents' plan
 - Many colleges offer student medical insurance for major medical expenses
 - Many campuses have their own student health clinics

Did You Know?

- Accidents are a leading cause of injury and death among young adults
- Experts recommend having major medical insurance to at least pay for hospitalization, tests, and surgery in case of serious illness or injury

Long-Term Care

- Long-term care insurance covers certain costs of care in a nursing home, assisted living facility, or at home
- Plans vary in cost and the services provided
- Premiums increase with age

Choosing a Plan

- Employer group plans usually have an enrollment period to sign up or change plans
- Shop around if you are looking for an individual plan
- Consider the services covered, the choice of health-care providers, and the costs

Choosing a Plan (Continued)

- Services may have a maximum benefit for certain types of treatment or number of days care is covered
- Plans may require preauthorization and utilization reviews for certain services
- Consider whether you wish to choose your own doctor, specialists, and hospitals
- Find out about premiums, deductible, copays

Government-Sponsored Health Insurance

- Medicare is available to eligible citizens age 65, some under age 65 with certain diseases or disabilities
 - Part A is hospital insurance
 - Part B is medical insurance
 - Part C is the Medicare Advantage Plan (private companies contract with Medicare to combine Part A and Part B)
 - Part D is prescription drug coverage, provided by private insurance companies
 - Medigap insurance is provided by private companies to cover copayments and deductibles

Government-Sponsored Health Insurance

(Continued)

- Medicaid is for eligible low-income persons and those with certain disabilities (services vary from state to state)
- Children's Health Insurance Program (CHIP) gives federal funds to states to provide health insurance for those 18 and younger when their families earn too much to qualify for Medicaid but not enough for private health insurance

Disability Insurance

- Disability insurance pays a portion of income lost when a worker is unable to work for a prolonged period due to illness or injury
 - Short-term usually requires a waiting period up to 14 days and provides coverage for up to two years
 - Long-term may have waiting period of several weeks or months and pays for a number of years or for life

Workers' Compensation Insurance

- Covers medical care and pays for a portion of lost wages for workers with work-related illnesses or injuries
- If injuries and illnesses are fatal, death benefits are provided to survivors
- Every state requires employers to provide some form of workers' compensation

Review 8.2

- What is a tax-advantaged savings account for people enrolled in high deductible health plans?
 - Health savings account (HSA)
- What is the name for the amount of money you will be required to pay before insurance pays for any services?
 - Deductible

Section 8.3

LIFE INSURANCE

Objectives

- Describe types of life insurance and endowment policies.
- Explain how to select appropriate life insurance coverage.

Terms

- beneficiary
- term life insurance
- whole life insurance
- endowment insurance

Life Insurance

- Life insurance can help provide financial security for you and your family
- A **beneficiary** is a person or organization named by the policyholder to receive assets after the policyholder's death

Term Life Insurance

- **Term life insurance** provides protection for a specific period of time
- When the term ends, so does the protection
- Policies are often renewable at higher rates
- Term coverage may be the best choice for those who really need insurance and cannot afford high premiums

Whole Life Insurance

- **Whole life insurance** provides basic lifetime protection so long as premiums are paid
- Also called *straight life insurance*
- Coverage builds cash value over the years that policyholder would receive if policy is surrendered before death
- You may be able to borrow against the cash value, but benefits are reduced by the amount of the loan

Limited Payment Policies

- Limited payment policies offer lifetime protection
- Premium payments are made for a stated period of time, or until you reach a certain age
- Premiums are higher and cash value builds faster than standard whole life coverage

Variable Life Insurance

- Variable life insurance premiums are fixed
- Insurance is combined with an investment feature
- The death benefit may be higher than the guarantee, depending on the investment earnings
- Disadvantage is it may not offer the best insurance or investment opportunities

Adjustable Life Insurance

- You can revise your adjustable life insurance policy as your needs change
- You may raise or lower the premiums, face value, and premium payment period
- The need to monitor coverage is a disadvantage

Universal Life Insurance

- Universal life insurance permits adjusting premiums, face value, and level of protection
- It also offers an investment feature
- It offers flexibility in the amount of premiums and the level of protection
- Earnings keep pace with market rates, and you don't pay taxes on earnings until you cash in your policy

Endowment Insurance

- **Endowment insurance** pays the face value of the policy to the beneficiaries if the insured dies before the endowment period ends
- It pays the face amount to the insured if he or she lives beyond the endowment period
- It is a combination of protection and savings
- Disadvantages are high premiums and possible tax consequences

Did You Know?

There is no one-type-fits-all life insurance. You need to carefully consider your present and future earning power and your financial responsibilities and obligations to those who depend on you.

Choosing a Plan

- The amount and type of life insurance protection depends on two key factors:
 - Amount of protection (based on lost earnings, current and future needs of survivors, burial costs and unpaid debts)
 - Types of protection (group life insurance, individual policies, guaranteed renewability, double indemnity/accidental death, convertible provisions)

Choosing a Company, Agent, and Policy

- Check the company's reputation
- Compare premiums charged by different companies for the same types of coverage
- Choose an agent who explains things clearly and handles policy revisions and claims promptly

Review 8.3

- What type of life insurance provides protection for only a specific period of time?
 - Term life insurance
- Who is named by a policyholder to receive the death benefit of an insurance policy?
 - Beneficiary

Section 8.4

HOME AND AUTO INSURANCE

Objectives

- Outline the key factors to consider when buying home insurance.
- Outline the key factors to consider when buying auto insurance.

Terms

- umbrella policy
- depreciation
- endorsement
- bodily injury liability
- property damage liability
- no-fault auto insurance

Home Insurance

- Homeowners insurance provides two basic types of coverage:
 - Property protection to insure against financial loss due to damage or loss of dwelling and personal property
 - Liability protection protects a homeowner if others are injured on the policyholder's property
- A separate umbrella policy is necessary to cover losses up to a higher amount over homeowners insurance

Did You Know?

Floods and earthquakes are not covered by property insurance. Separate coverage must be purchased to protect against loss covered by those events.

Amount of Coverage

- Find out how much it would cost to rebuild your home
- You should buy enough insurance to rebuild it if it gets completely destroyed
- An *appraisal* is an estimate of the current value of property

Amount of Coverage (Continued)

- Find out if you are insured for:
 - *Replacement cost*, which covers the cost of replacing what you lost, or
 - *Actual cash value*, which is the replacement cost minus **depreciation** (a decrease in the value of property as a result of age or wear and tear)

Cost of Home Insurance

- The cost of home insurance depends on:
 - Type and amount of coverage
 - Size of deductible
 - Risk factor where you live
 - The insurance company
 - Opportunity for discounts

Did You Know?

Your landlord's insurance policy will not cover your personal items when you rent a house or apartment.

Renters Insurance

- Renters insurance covers losses due to damage or loss of personal property and possessions
- Get a policy with liability insurance in case guests get harmed
- An endorsement on your parent's homeowners policy may cover your personal possessions while living in a dorm
- An **endorsement** is an attachment to an existing insurance policy

Auto Insurance

- **Bodily injury liability** protects you when you are responsible for an accident that results in injury or death of others
- **Property damage liability** protects you when you are responsible for an accident which damages the property of others

Auto Insurance (Continued)

- *Medical payments or personal injury protection (PIP)* covers medical expenses for you and any person injured in or by your car
- *Collision insurance* pays for damage to your car due to an auto accident or collision
- *Comprehensive physical damage insurance* pays for loss or damage to your car from fire, theft, falling objects, earthquake, flood, riot, civil commotion, and collision with a bird or animal

Auto Insurance (Continued)

- *Uninsured and underinsured motorist insurance* pays for
 - You and your passengers' injuries caused by an uninsured or hit-and-run driver
 - Covers you driving, riding, or walking
- Some auto insurance policies also include roadside assistance and rental reimbursement

Cost of Auto Insurance

The cost of auto insurance depends on:

- Driver classification
- Rating territory
- Premium discount eligibility
- Car's year, make and model
- Deductible amount
- Coverage amount

In Your Opinion

Do you think it's fair that younger, less-experienced drivers usually have to pay higher premiums than middle-aged drivers?

No-Fault Auto Insurance

- **No-fault auto insurance** eliminates the faultfinding process in settling claims
- Each policyholder makes a claim to his or her own insurance company regardless of who is at fault
- It is designed to speed up payments to accident victims and lower insurance rates by reducing court trials to determine fault
- Each state has its own insurance requirement

Review 8.4

- What is the decrease in the value of property as a result of age or wear and tear?
 - Depreciation
- What type of auto insurance coverage eliminates the faultfinding process by having each policyholder make a claim after an accident?
 - No-fault auto insurance