MANAGING FINANCIAL RISKS WITH INSURANCE

Hard Core Boot Camp
Content Session #3
LIFE IS FULL OF RISKS...MANY HAVE FINANCIAL CONSEQUENCES

- Damage to car in accident
- Loss of home and/or possessions
- Loss of income due to disability
- Loss of a household earner’s income
- Loss of a homemaker’s services
- Large medical bills for disease or injury
- A court judgment of liability for damages
FIVE WAYS TO MANAGE RISK

- Do nothing and hope for the best
- Risk avoidance
- Risk reduction
- Risk acceptance
- Risk transfer (insurance)
Risk Avoidance

- Don’t stop at a convenience store in a bad part of town after midnight

Risk Shifting

- Buy Insurance
- Self Insurance

Risk Assumption

Risk Reduction

- Wear seatbelts
- Install an alarm system
COMMON TYPES OF RISK

- **Personal Risks**
  - Loss of income or life
  - Illness and disability

- **Property Risks**
  - Losses to property
  - Caused by perils such as fire or theft

- **Liability Risks**
  - Losses caused by negligence
  - Resulting in injury or property damage to others
Insurance Policy - Contract between a person buying insurance (the insured) and an insurance company (the insurer).
Insurance consists of two basic elements:
- Reduction of risk
- Sharing of losses

Law of Large Numbers - As the number of members in a group increases, predictions about the group’s behavior become increasingly more accurate
AN INSURABLE INTEREST MUST EXIST TO BUY INSURANCE

- Insurable Interest - When a person or organization stands to suffer a financial loss from a specific risk.

- Example #1: The person that lives in an house that is insured

- Example #2: The spouse of person who is covered by life insurance
INSURANCE BASICS

- Protect against risk by paying a premium
- “Large Loss Principle” (size of loss matters)

Major “large-loss” risks:
- Loss of income due to disability
- Loss of a household earner’s income
- Destruction of one’s home (fire, flood, etc.)
- Liability losses due to a court judgment
- Large medical expenses (e.g., cancer treatment)
COMMON INSURANCE ERRORS

- Not following the “large loss principle”
- Unfamiliarity with employer-provided (and public) insurance benefits
- Lack of disability insurance
- Lack of adequate liability insurance
- Not checking credit rating of insurance companies
PARTS OF AN INSURANCE CONTRACT

- Declarations page
- Insuring Agreements
- Exclusions
- Endorsements and Riders
POLICY FEATURES THAT LIMIT COVERAGE

- Benefit coordination clauses
- Deductible
- Elimination period
- Co-payment
- Co-insurance
- Policy limit
VIDEO: DEDUCTIBLES AND COINSURANCE

http://www.youtube.com/watch?v=8lybFtOtXdc&feature=related
generally unnecessary insurance

- Credit insurance (life, disability, unemployment)
- Life insurance for children
- Cancer insurance
- “Double Indemnity” insurance riders
- Hospital indemnity policies
- Flight insurance
- Car rental collision-damage waivers
FACTORS THAT AFFECT HOMEOWNER’S INSURANCE

- Location of Home (e.g., rural vs. urban)
- Type of Structure (e.g., brick vs. wood)
- Coverage Amount and Policy type
- Home Insurance Discounts
  - Alarm system
  - Smoke detectors
  - If you insure car with the same company
- Company Differences
  - Compare costs and coverage
FACTORS THAT AFFECT AUTO INSURANCE

- **Vehicle Type**
  - Year, make, model, and theft rate

- **Rating Territory**
  - Accident, auto theft, and vandalism rates in the area where you live

- **Driver Classification**
  - Age, sex, marital status, credit history, driving record, driving habits
  - Assigned risk pool for those unable to obtain insurance

Reducing Automobile Insurance Premiums

- **Compare Companies**

- **Premium Discounts**
  - Establish and maintain a good driving record
  - Install security devices such as a car alarm
  - Multiple policies with the same company
  - Larger deductibles
Automobile liability insurance limits may be quoted as three figures:

100/300/50

$100,000
Per-person bodily injury limit specifying that $100,000 is the most that will be paid for any one person’s bodily injury liability losses from an accident.

$300,000
Per-accident bodily injury limit specifying that $300,000 is the most that will be paid for all bodily injury liability losses from an accident.

$50,000
Per-accident property damage liability limit specifying that $50,000 is the most that will be paid for all property damage liability losses from an accident.

OR

They may be quoted as a single figure:

$250,000
Per-accident limit for all liability losses specifying $250,000 as the most that will be paid in liability losses arising out of one accident.

Source: Personal Finance by Garman and Forgue, Houghton-Mifflin
HOW UMBRELLA INSURANCE POLICIES WORK

Source: *Personal Finance* by Garman and Forgue, Houghton-Mifflin

Umbrella policies generally exclude automobiles, aircraft, watercraft, and professional liability exposures unless these are included in one of the basic plans.
WHY DO PEOPLE NEED LIFE INSURANCE?

- **Income-Replacement Needs** - The financial losses resulting from premature death are lost income and employee benefits.

- **Major Expenses** - Two examples are a mortgage and children’s college expenses.

- **Final Expenses** - One-time medical and funeral expenses occurring just prior to or after a death.

- **Readjustment-Period Needs** - Allows surviving spouse/family members to pay ongoing expenses.
BUY TERM LIFE INSURANCE AND INVEST THE DIFFERENCE?

Cash-Value Policy

Premium to pay for insurance protection, sales commissions, and company expenses

$ Premium to provide for the building of cash value plus related company expenses

Term Policy

Premium to pay for insurance protection, sales commissions, and company expenses

$ Dollars not spent on life insurance and available to spend, save, or invest

Source: Personal Finance by Garman and Forgue, Houghton-Mifflin
Multiple-of-Earnings Approach is an inaccurate method
- Multiplies one’s income by some factor (e.g., 7x or 10 x) to derive a rough estimate of needed insurance

Needs Approach is a Better Method
- Considers individual factors that affect life insurance needs (personalized calculation)

Resource:
http://www.bankrate.com/calculators/insurance/life-insurance-calculator.aspx
BUYING LIFE INSURANCE

- Research insurance company ratings by major rating firms:
  - A. M. Best
  - Standard and Poor’s
  - Duff & Phelps
  - Moody’s
  - Weiss Research

- Talk to friends, colleagues, or advisors

- Online premium quote services
VIDEO: HOW DOES [HEALTH] INSURANCE WORK?

http://www.youtube.com/watch?v=nXfGeMNNbSM
## Compare Available Options

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Premier Plan</th>
<th>Standard Plan</th>
</tr>
</thead>
<tbody>
<tr>
<td>In Network Deductible</td>
<td>$500 / $1,000</td>
<td>$1,000 / $2,000</td>
</tr>
<tr>
<td>Out of Network Deductible</td>
<td>$1,000 / $2,000</td>
<td>$1,500 / $3,000</td>
</tr>
<tr>
<td>In – Network Co-Pay per Office Visit</td>
<td>$20 PCP / $40 Specialist 90% after deductible</td>
<td>$30 PCP / $50 Specialist 80% after deductible</td>
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<tr>
<td>Co-insurance</td>
<td></td>
<td></td>
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<tr>
<td>Out of Network Co-insurance</td>
<td>70% after deductible</td>
<td>60% after deductible</td>
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COMPARE AVAILABLE OPTIONS

Tier 1
- Retail: $10 Co-pay 30 Day Supply
- Mail Order: $20 Co-pay 90 Day Supply

Tier 2
- Retail: $30 Co-pay 30 Day Supply
- Mail Order: $60 Co-pay 90 Day Supply

Tier 3
- Retail: $50 Co-pay 30 Day Supply
- Mail Order: $100 Co-pay 90 Day Supply
# Health Insurance Must-Haves

A health insurance plan should:

- Offer basic coverage for hospital and doctor bills
- Provide at least 120 days’ hospital room and board in full
- Provide at least a $1 million lifetime maximum for each family member
- Pay at least 80 percent for out-of-hospital expenses after a yearly deductible of $500 per person or $1,000 per family
- Impose no unreasonable exclusions
- Limit your out-of-pocket expenses to no more than $3,000 to $5,000 a year, excluding dental, vision care, and prescription costs

Although health insurance plans vary greatly, all plans should have the same basic features. *Would you add anything to this list of must-haves?*

Source: *Personal Finance* by Garman and Forgue, Houghton-Mifflin
Health Spending Accounts (HSA)
- Money contributed to pre-tax dollar account
- Must have a high-deductible policy

Health Reimbursement Accounts (HRA)
- Also tied to high-deductible policies
- Funded solely by employer
- Unused funds carried over to next year

Flexible Spending Accounts (FSA)
- Workers contribute pre-tax dollars
- Funds managed by employer
- Unused funds forfeited at year end
WAYS TO REDUCE PERSONAL HEALTH CARE COSTS

- Eat a balanced diet
- Keep weight under control
- Avoid smoking
- Don’t drink excessively
- Get sufficient rest, relaxation, and exercise
- Drive carefully
- Protect yourself from medical ID theft
- Use free public health programs
GENERAL INSURANCE TIPS

- Insure for major losses
- Choose a highly rated insurance company
- Select the highest deductible you can afford
- Pay premiums annually or semi-annually
- Avoid duplicating coverage
- Ask about available discounts
- Follow “The Rule of Three”
CONTENT SESSION 3
ACTIVITIES