Choices and Risks

All choices involve risk. Let's consider driving a car. Everyone knows that there is always a risk of having an accident. You could cause an accident yourself or another driver could cause an accident that involves you. How can you reduce the risk of having an accident when driving? You have three choices. First, you can choose to stop driving. Ride the bus, ride a bike, or walk. Even though you are not required to drive, the no-driving alternative may seem extreme to you. Let's examine the remaining choices.

Second, you can become a safer driver. Take a course in defensive driving. Study the state road-safety manual. Pay attention in driver's education. Avoid driving during rush hours on dangerous roads and late at night. Third, you can purchase auto insurance. You can purchase insurance to protect you from financial loss for car repairs, medical costs, or lawsuits that result from an accident. You may still have a wreck, but the consequences will not be as bad as they would have been if you did not have insurance.

Your choices about driving are similar to many others. Usually your, best way of reducing risk is to take actions yourself to reduce risks. For example, to reduce health problems, eat right, get plenty of exercise, get enough sleep, avoid drugs, and so forth. Buying health insurance is another way to reduce healthcare cost risks. To reduce the chances of theft, install good locks, stop mail and newspaper deliveries when you are away, and keep areas around your house or apartment well lit. Buying homeowner's or renter's insurance is another way to reduce the risk of financial loss from theft.

Insurance	Purpose	Examples of Coverage
Auto	Provides financial protection from losses due to an auto accident or other damage to a car.	Collision: Provides for the repair or replacement of the policy owner's car damaged in an accident. Liability: Covers the cost of property damage or injuries to others caused by the policy owner. Comprehensive: Covers the cost of damage to an auto as a result of fire, theft, or storms.
Health	Provides payment for certain health-care costs.	Basic Health: Covers office visits, laboratory, hospital costs and routine care. Major Medical: Protects against large bills from catastrophic illness or injury. Dental and Vision: Covers some cost of routine exams and specific services.
Renter's	Provides financial protection in case of loss of personal possessions in a rental unit.	Reimburses policy owner for loss of possessions in a rental unit due to fire, theft, water damage.
Homeowner's	Protects against financial loss from damage to your home or its contents, as well as injury to others on the property.	Physical Damage: Reimburses for fire or water damage to house or other structures. Loss or Theft: Reimburses for personal property damaged or stolen. Liability: Protects against loss from a lawsuit for injuries to guests.
Life	Provides financial protection to dependents of policy owner when policy owner dies.	Term Life: Offers protection for a specified period of time. Whole Life: Offers protection that remains in effect during the lifetime of the insured and acquires a cash value.
Disability	Provides income over a specified period when a person is ill or unable to work.	Policy owner selects a replacement income for lost wages if an illness or accident prevents the person from working. Disability income is paid for a specified time after a waiting period.

The purpose of insurance is to spread out risks over many people. Let's consider an example. Imagine that the student council in a high school of 1,000 students wants to offer all students insurance against the theft of personal possessions from school lockers. The student council has decided to establish a locker insurance company. Suppose that students in this school have an average of $50 worth of personal stuff in each locker. Suppose further that an average of 10 in every 1,000 lockers are broken into each year. In a typical year, students in the school lose a total of $500 ($50 of stuff x 10 locker break-ins) in locker theft. If all 1,000 students wish to buy insurance, it would cost $0.50 per student ($500 loss / 1000 students).

If every student bought $.50 worth of locker insurance, they would be covered from financial damage due to locker break-ins. This is fundamentally how insurance companies work. Insurance companies charge a fee (a premium) paid by customers to provide protection against certain types of losses. The fee or premium would not only cover the losses but also the costs of operating the business and a profit.

Questions

1. All choices involve risks. Name two ways to reduce risks.

2. Explain how insurance works.

3. What is a premium?

4. What does <u>each</u> type of insurance provide?

   • Auto

   • Health

   • Renter's/Homeowner's

   • Life

   • Disability

5. In the case of auto insurance, what is the difference between collision and liability coverage?

6. In the case of health insurance, what is the difference between basic health and major medical coverage?

7. Think about three different risks that you might face over your lifetime. For each of these risks, describe ways that you could reduce your risk.