PROTECTING YOURSELF WITH INSURANCE

INSURANCE and RISK

Life Carries Risk

Risk is a situation in which some kind of loss is possible. Risk is a part of life. The loss might be

- Financial, such as a $10,000 hospital bill for a ruptured appendix
- Physical, such as an injury or a death
- Material, such as a wrecked car, a burned house, or a stolen diamond ring

Insurance protects against risk, in the sense that people who buy insurance are financially compensated in case of loss. Purchasing insurance does not remove risk. It merely provides compensation for the loss and spreads the cost of sharing the risk.

Because insurance is intangible-you do not actually see what you are getting-some people cannot bring themselves to spend money on something they cannot see and might not need. Risk is intangible, too, until you experience a loss, or survive a close call.

Risks, like life, depend on the circumstances that surround you. Although many people face similar risks, no one faces exactly the same risks. For example, although cars are fitted with airbags and seat belts to protect you in a dangerous collision, someone who is six feet tall will suffer different injuries than someone five feet tall. And, as risk changes with circumstances, your risk for various losses changes throughout your life as you take new jobs, change your marital status and number of dependents, and increase or decrease income and savings.

Dealing with Risk

There are several ways to handle risk. Take the risk-filled behavior of smoking as an example. You can choose to:

- ***Avoid risk,*** by not smoking
- ***Reduce risk,*** by limiting the number of cigarettes you smoke
- ***Ignore risk,*** by smoking three packs a day
- ***Transfer risk,*** by buying health insurance that will pay for conditions caused by smoking

Handling risk by transferring it is the underlying principle of insurance. ***Insurance transfers risk.***

How Insurance Works

Individuals who buy insurance are the **insured.** The insured agrees to transfer risk by paying certain sums of money, **premiums,** to the insuring company, the **insurer.** These premiums create a pool of money that the insurer uses to compensate the insured for losses.

An **insurance policy** is a contract designed to cover specific future losses such as theft, accident, fire, illness, or death. Each kind of specific loss the insured is protected against is called a **coverage.** People agree to pay premiums on an insurance policy and the insurer agrees to reimburse them for their loss.

When a loss occurs, the insured files a claim. A **claim** is a request to cover losses that occur from a specific event.

Who Provides Insurance?

Most insurance is provided by private, for-profit corporations. The United States government also provides some insurance, for example to military employees. Additional insurance programs are provided jointly by federal and state governments. The biggest difference between private and government-supplied insurance is the cost of the premiums. Most people who receive government insurance do not have to pay premiums.

Increasing Costs

During the past twenty years, insurance premiums for most kinds of insurance have increased dramatically. Because of the high cost of insurance, many Americans are uninsured or underinsured. Some consumer advocates blame high premiums on the insurance industry, saying it is overcharging the public. Others blame increasingly sophisticated medical technology for health insurance costs. Industry defenders blame consumers and attorneys who bring unreasonable claims to court, thus raising costs for insurance companies.

One undeniable factor in high premiums is the string of catastrophic earthquakes, hurricanes, floods, and wildfires that occurred in the late 1980s and 1990s. Insurance costs for so many widespread natural disasters caused insurance companies to raise premiums substantially, or cancel policy coverage in specific areas. If people built homes in areas prone to wildfires, for example, insurance companies would exclude wildfires from those customers' fire coverage.

THINK CRITICALLY

1. Why do people need insurance?

2. What are four ways to handle risk.

3. How can you transfer risk?

4. List four different risks you face in your life that you handle in each of the four different ways.