Insurance

Insurance helps protect your assets and wealth. Payments, called premiums, are paid to an insurance company at certain periods throughout the year. These payments can be set-up as monthly, quarterly, semi-annual, or annual payments. There are different types of insurance depending on what you want to protect. The most common types of insurance policies are for health, life, vehicles, homeowners, and renters.

Why should you consider buying insurance and how does it work?

Insurance provides a way in which consumers can transfer and share risk, but they must pay for this benefit or service. Buying insurance is not appropriate for all levels and types of risk. Buying insurance makes the most sense when the potential financial cost is great and there is a significant probability of loss over the long term. In these cases, it is wise to share and transfer risk by paying premiums for an insurance policy.

Common types of insurance:

- ✓ **Automobile** – provides financial protection to the owners, operators, and occupants of an automobile in case of accidents, theft, or damages.

- ✓ **Health** – protects against financial loss caused by the costs of illness or accident.

- ✓ **Life** – provides financial protection to a family when the insured, who is typically the major wage earner of the family, dies

- ✓ **Homeowners** – protects the homeowner from loss caused by fire, theft, and storm damage of the structure and the possessions within the structure. A liability insurance feature protects the homeowner from loss when someone is injured on the homeowner's property

- ✓ **Renters** – Protects the renter from loss or personal possessions because of such risks as fire, theft, or storm damage.

Source: National Council on Economic Education – How insurance works

- ✓ **Disability –** provides income during a specified period when a person is unable to work because of illness or an accident.

How Insurance Works

The purpose of having insurance is to spread risk to many different people. Suppose the football team at your school wanted to protect themselves from theft. Each student has football equipment assigned to them that they keep in their gym lockers. There is a total of 85 students on three different football teams at the middle school. The school decided to offer insurance to the football players in case anyone broke in and stole their equipment. The coaches estimated that each football player had an average of $50 of equipment in their lockers. If 10 lockers were broken into, that would be a $500 loss ($50 stolen equipment x 10 lockers = $500 loss).

$$\frac{\$500.00}{85 \text{ players}} = \$5.88 \text{ cost per student to insure their lockers}$$

This example gives you a rough idea of how insurance works. If all the football players bought insurance, they would be protected against any losses if their equipment was stolen from their locker. If they didn't buy insurance and someone broke into their locker, it would cost the player $50.00, whereas if they had insurance, it would cost them $5.88. Maybe 10 lockers never get broken into, but that's okay. You're only paying a small amount to guarantee that if your locker does get broken into, you won't have to pay $50 of your own money.

Basically, insurance companies charge a fee, called a premium, which is paid by customers. This premium provides protection against certain types of financial loses. The fee or premium collected from everyone covers the losses.

Let's look at this on a larger scale. Depending on the type of insurance, sometimes you need to pay a deductible. A deductible is the amount you pay for covered services before your insurance plan starts to pay. In other words, for bigger insurance plans (like car, home, and health insurance) you are required to pay a part of the fees up front. So, let's say you buy a house. Your home insurance is $1200 annually with a $500 deductible. That is a lot of money! But, let's pretend that a pipe bursts in your basement from the cold in the winter and everything is damaged. The cost to clean up everything and replace what has been damaged is around $15,000. With your home insurance, you are only going to pay roughly $1700 for that year.

Source: National Council on Economic Education – How insurance works

Some insurance is required by law in Illinois. If you own a car, you must also purchase car insurance. If you are pulled over for speeding or get into an accident and you do not have car insurance, it is a hefty penalty against you. Across the county, it is required that you buy health insurance. Usually, if you apply for a mortgage on a home, you must show proof of home insurance. On the other hand, there are insurance policies for almost anything you own or do- if you choose to pay for it.

Picking insurance can be overwhelming because they come with many choices. You have the option to cover different aspects of a purchase. You can choose just the basic or upgrade to cover more potential damage. In the case of the home insurance, if your company had a special plan to cover plumbing that you chose not to pay for, your burst pipe wouldn't be paid through insurance. Your level of risk tolerance will play a factor into your decisions.

Overall, insurance is a part of everyone's life. You will have to make many decisions about a variety of insurance plans as you get older. Remember to always shop around to make sure you get the best price and to include the cost of insurance in your future budgets.

Source: National Council on Economic Education – How insurance works