Managing Risk

LESSON DESCRIPTION AND BACKGROUND

As people begin to earn an income and acquire assets, they begin to think about how to protect what they have against the risk of financial loss. Toward this end, many people buy insurance. This lesson explains how insurance works and provides an overview of different types of insurance. The students participate in a simulation activity that allows them to use their understanding of the costs and benefits in decisions about purchasing insurance.

Lesson 10 correlates with national standards for economics and personal finance as shown in Tables 1-2 in the introductory section of the publication.

ECONOMIC AND PERSONAL FINANCE CONCEPTS

• Auto insurance

• Disability insurance

• Health insurance

• Homeowner's insurance

• Life insurance

• Renter's insurance

• Risk

OBJECTIVES

At the end of this lesson the student will be able to:

• Analyze insurance as a way of reducing **risk**.

• Explain that insurance is a way of spreading risk among people in an insurance "pool."

• Identify key types of **insurance** such as **health**, **auto**, **homeowner's**, **renter's**, **life**, and **disability**.

• Explain the costs and benefits associated with choices regarding the purchase of insurance.

TIME REQUIRED

One 45-minute class period

MATERIALS

• A copy for each student of **Exercise 10.1** and **10.2** from the *Student Workbook*

• One or two decks of cards with one suit of ace (counted as a 1) through queen (counted as a 12) for each small group to use in the Big Risk simulation. Each group should receive 12 cards in the same suit, with the king excluded from the set of cards.

ADDITIONAL RESOURCES

To download visuals, find related lessons, correlations to state standards, interactives, and more visit http://fffl.councilforeconed.org/9-12/lesson10.

PROCEDURE

1. Tell the students that the purpose of this lesson is to help them understand the concept of risk and how the purchase of insurance can help to reduce risk. Insurance is usually not regarded as a hot topic, but that may be changing. Ongoing debates about how best to provide health insurance to American families that do not currently have coverage illustrate the importance of this topic.

2. Explain that understanding insurance begins with understanding risk. Life is filled with risk. Virtually every decision involves risk—some more than others, of course. Listening to music on a CD player is quite a low-risk choice, but it is not necessarily a risk-free choice. A hearing loss could result from sustained listening to music played at a very high volume. Use the following questions to explore other possibilities of risk:

a. What are some low-risk choices that people make? *(Low-risk choices are many and varied, including, e.g., drinking pasteurized*

milk, eating a sandwich, turning on a light, making a telephone call, taking a walk— even though you could get hit by a meteorite.)

b. What are some high-risk choices that people make? *(Here, too, examples are many and varied, including motorcycling, smoking, drinking, using drugs, sport parachuting, hang gliding, and riding bucking broncos.)*

3. Give each student a copy of **Exercise 10.1** from the *Student Workbook*. Ask the students to read the exercise and answer the questions at the end. Discuss the answers with the class:

a. All choices involve at least some measure of risk. Name two ways to reduce risks. *(It is possible to reduce some risks by changing your behavior. For some risks, it may also be wise to consider purchasing insurance.)*

b. How does insurance work? *(The purpose of insurance is to spread risk over many payers. People who buy insurance form what is called a pool. The money they spend to buy insurance then can be used to compensate members of the pool who suffer losses—e.g., in an automobile accident. The underlying idea is that there will be enough money to cover the losses because relatively few members of the pool will experience a loss that needs to be covered.)*

c. What is a premium? *(The fee paid for insurance protection.)*

d. What does each type of insurance typically provide?

i. Auto: Provides financial protection to the owner, operator, and occupants of an automobile in case of accidents or damages.

ii. Health: Protects against financial loss caused by illness or accident.

iii. Renter's: Protects the renter from loss caused by damage to, or theft of, personal possessions; also protects against liability claims from guests who are injured

while visiting your rented dwelling.

iv. Homeowner's: Protects the homeowner from loss caused by damage from fire, theft, storms, and so forth; also protects against liability claims from guests who are injured while visiting your home.

v. Life: Provides, on the death of a policy holder, financial protection to beneficiaries of the policy holder.

vi. Disability: Provides income over a specified period when a person is ill and unable to work.

e. In the case of auto insurance, what is the difference between collision and liability coverage? *(Collision coverage provides for the repair or replacement of the policyholder's car if it is damaged in an accident. Liability protection covers the cost of property damage and injuries to others as a result of an accident.)*

f. You are taking a new job and have two choices of health insurance, HMO (Health Maintenance Organization) and traditional health insurance. Which one would you choose and why? *(There is really no correct answer here. Let the students explain their answers, but make sure they understand the tradeoffs between traditional health insurance – which allows consumers more choice but higher premiums – and HMOs, in which choice can be very limited, but at a lower cost.)*

4. Explain that decisions to buy insurance depend on individual judgments about the future. The general guideline is not to allow a large portion of potential loss to remain uninsured. To illustrate some of the risks associated with choosing or refusing to purchase insurance, the class will participate in a brief simulation activity. Give each student a copy of **Exercise 10.2** from the *Student Workbook*.

5. Divide the class into small groups and ask each group to read the instructions for **Exercise 10.2**. Ask the students to imagine that they have just graduated from high school. Select

one student in each group to act as somebody who will not insure any of his or her material goods or income; the rest of the group has budgeted $2,900 to purchase insurance.   The group members who are considering buying insurance can discuss with one another how they choose to allocate money to insurance purchases. This should be a group decision based on the various risks identified in **Exercise 10.2**. After the students have examined the possible risks and dollar costs of insuring various things listed, the groups should decide what insurance they wish to purchase and circle their choices. Remind the groups that they may not spend more than $2,900 and may choose to spend less. Ask the groups to identify the insurance purchased and total up the premiums.

6. Tell the class that you will now demonstrate how to play the game. Distribute one partial suit of cards (ace through queen) to each group. The cards represent the numbers 1-12: ace = 1, 2 = 2, jack = 11, queen = 12, etc. Ask a student in each group to pull a card from the deck of 12 cards. Look at the number. This number represents the item or items affected by the unexpected events during that particular year. For example, if a "6" is selected, the following insurances are affected: automobile, health, and disability (see "card" listing in each insurance box).

7. Tell the students to look at the examples of how to treat a "6" that is drawn in the Adding Up Insurance box. Show the students in each group how this box would be filled out if a "6" is drawn. Note that the first row shows the losses suffered by an uninsured student who draws a "6." The "Loss" category of the insurance boxes lists a $5,000 loss for an automobile accident, $1,200 for medical expenses, and $14,400 for lost wages from a disability. The sum ($20,600) is shown in columns 5 and 6. This player has no costs for insurance or deductibles in columns 3 and 4.

8. Tell the students that the second row in the Adding Up Insurance box shows the losses suffered by a person who purchased both automobile and disability insurance. The premiums for

this insurance ($1,900) are listed in column 3. In the fourth column, the deductible or co-pay for each insured loss should be entered. Explain that if an item is protected by insurance, the student will pay the deductible or co-payment, if applicable. Explain that a deductible is the portion of the loss that is paid by the insured when the unexpected event (that is covered by insurance) occurs. Since the disability insurance has no deductible, only the $250 for the automobile coverage is included in column 4. The fifth column includes losses that were not insured. No health insurance was purchased, so the health insurance loss of $1,200 would be placed here. The total dollar cost for the person with disability and automobile insurance for the year is noted in column 6 for the second example.

9. Explain that, when they play the game, the students will not be able to insure all items. Pulling a card from the deck will determine which items will be affected. Uninsured students will experience losses in all categories affected by pulling a card from the deck.

10. Play the game; have each row filled out for the uninsured person in the group and for the insured members of the group. The simulation represents five years. Have a student in each group pull a card five times. Shuffle the cards before choosing one for each year. At the end of the five years, the students should calculate the total amount spent for the five-year period. Discuss what the students learned. Ask:

a. For insured people: What were your losses over the period of the simulation? *(**Answers will vary.**)*

b. For uninsured people: What were your losses over the period of the simulation? *(**Answers will vary.**)*

c. Which students had fewer losses? *(**Probably students who had purchased insurance.**)*

d. Were the costs of purchasing insurance worth the benefits? *(**Probably yes. In most cases students who purchased insurance were better off than those who did not.**)*

CLOSURE

Use the following questions to review the lesson:

• How does insurance work? *(The idea of insurance is to spread a risk over many payers. People pay premiums to buy insurance from an insurance company, with the expectation that only a few people in the pool will actually experience a loss that will need to be covered by the money provided by the premiums.)*

• What is a premium? What is a deductible? *(A premium is the fee paid for insurance protection. A deductible is the amount of a loss that is paid by the insured when an insurable event occurs.)*

• What types of insurance are commonly available? *(Auto, health, renter's, homeowner's, life, disability.)*

• Is the cost of buying insurance worth the benefit? *(Accept a variety of answers. In discussion, stress the general guideline that it is not wise to let a large portion of potential loss remain uninsured.)*

ASSESSMENT

Ask groups of students to call local insurance brokers or use the Internet to find information about auto insurance. The students should find out how much it would cost them to purchase auto insurance. They will learn that answers will vary depending upon the applicant's driving record, type of car, age of car, present grades, completion of drivers' education, scope of coverage sought, and so forth. Ask the students to write a report about their findings and present the results to the class.

EXTENSION

Ask each student to interview an adult about the different types of insurance coverage she or he has. In each interview, the student should collect information about the terms of the policy or policies held by the interviewee—the scope of coverage, premiums, deductibles, co-pays, and other important considerations.