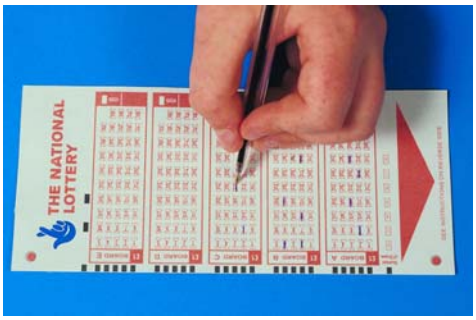
2(c) Insurance

What is insurance?

Insurance is a financial service where we pass on **risks** to an insurance company in return for a payment called a **premium**. If the risk becomes a reality, the insurance company pays us money in compensation. Insuring a risk doesn't stop events from happening but it does cover us against the loss. For example, if someone insures their car against theft and then the car is stolen, the person has still lost the car but the insurance company will pay the value so the owner can buy another car.

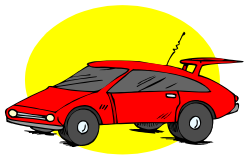
Insurance is a bit like doing the lottery but with a difference. If you do the lottery, you guess the numbers, pay your money and hope to win. The money that everyone pays goes into a pool and the lucky winners are paid out of that pool. When people insure their possessions, they pay their premiums, which go into a pool, and the unlucky ones are paid compensation out of it when something goes wrong.



Insurance companies are willing to cover you against loss on certain risks because they are able to make a profit out of doing so. By looking at past loss figures, they are able to calculate how likely a loss is to happen.

What can you insure?

You can insure almost anything as long as the insurance company can calculate the risk. Here is a list of the main types of insurance.

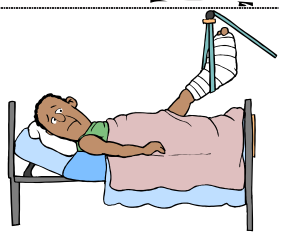
Motor insurance	You can insure your car against general damage, fire, theft and third-party liability. Third-party liability means any compensation you have to pay to a third party (someone else) if you hit them with your car. You are required by law to have third-party cover on a motor vehicle.	
House and contents insurance	You can insure the buildings and the contents of the house against a range of risks, e.g. fire, burglary, flood, aeroplane damage.	

Travel insurance

You can insure yourself against medical costs and your possessions against loss or damage while you are travelling or on holiday.

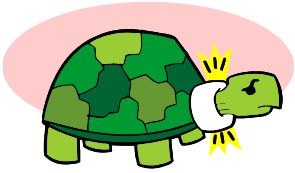
Health insurance

You can insure yourself for private health treatment so that, if you have to go into hospital, you can go to a private one. People then do not have to spend time on long waiting lists.



Pet insurance

You can insure your cat, dog, horse or any other pet against vet's expenses.



Miscellaneous cover

There are some unusual insurance policies, e.g. a school holding an outdoor event can insure against bad weather on the day; a footballer can insure his legs and a film star her face.

All of the above come under the heading of 'general insurance'.

Did you know?

An example of something you cannot insure against is the risk of losing in a bet. For example, you can't bet at a racecourse and then claim on an insurance policy if you lose.

Life assurance

This is a special type of insurance; note that it is called **assurance**. This is because you are definitely going to die one day but you don't know when. There are different types of life assurance; in each case, you pay premiums – the company invests these to make an income. Money is then paid to you or your heirs from the profits, depending on the type of policy you have.

Quotation

In this world nothing is certain but death and taxes.

Benjamin Franklin (1706-1790)

What does the law say about insurance?

There are three legal principles that you should know about insurance.

- **Indemnity**: you cannot make a profit out of insurance. If you suffer a loss, the insurance payment should put you in the same position that you were in before the risk happened. For example, if you insure a new car for £12,000, the value of the car will fall over the years that you use it. If you have an accident after three years and the car is written off (damaged beyond repair), you will receive its market value on that date and not the £12,000 you paid for it.

- **Utmost good faith**: you must tell the insurance company everything that affects the likelihood of the risk happening. For example, if you open a shop and insure your stock, you must tell the insurance company if the shop next door is selling fireworks because this makes a fire more likely. If you do not tell them and the fire happens, they will not pay you because you were not honest with them.

- **Insurable interest**: you must have an interest in someone to be able to insure their life. Married people and business partners have an insurable interest in each other but you cannot insure the life of a stranger, as you have nothing to lose from this person's death.

Calculating insurance risk

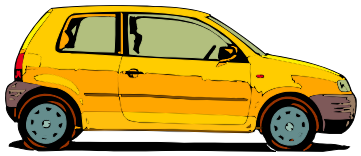
Insurance companies judge risk by studying what has happened in the past. Car insurance is a good example. A 17-year-old boy wanting to insure his own car will pay an extremely high premium which could be more than £2,000 a year. However, a 50-year-old woman who has not made any claims will pay only around £200 for her policy. These figures also depend on the size and make of car and on the area in which the car is kept.

The reason for the large difference in the premium between a young man and a middle-aged woman is not age or sex discrimination but the likelihood of a claim being made. Insurance companies can see from their statistics that far more claims are made by young men who are less experienced and more likely to take risks while driving, than by 50-year-old women, who drive more carefully. This is an overall conclusion – of course there are careful young men and risk-taking middle-aged women – but insurance companies can only go on the total figures. The more likely you are to have an accident according to the insurer's statistics, the higher your premium will be.

Compulsory insurance

There are some types of insurance that you must buy if you purchase particular products. Here are some examples:

- **Car insurance**: if you own a car, you are obliged by law to buy insurance to cover you against liability for injury and damage to third parties, i.e. other people besides yourself; these might be other drivers and pedestrians. This is known as **third-party insurance**. If you drive a car without this, you are breaking the law and will be prosecuted if you are caught. But you do not have to buy only third-party insurance and you can choose to buy motor insurance that covers more, such as damage to yourself and your car (see section below on voluntary insurance).



- **Buildings insurance** on a house: there is no law that says you have to insure your house against fire, flood, etc. However, most people buy their houses by borrowing money via a mortgage loan and the bank or building society that lends you the money will insist that you insure your buildings. The house is the **security** for the loan so it must be covered against loss or damage.

- Some travel agents nowadays insist that people who book holidays with them take out **travel insurance** for the period they are away. This will cover them against loss or damage to their property and for medical expenses if they become ill.

Voluntary insurance

Other types of insurance are voluntary – it is up to you whether you buy it or not. You have to balance the cost of the policy with the risk of loss if the insured event happens.

For example, if you have a car you can buy more than the compulsory third-party cover. You can insure your car against fire and theft and even take out a comprehensive policy, which covers your car against damage. Your decision probably depends on the value of the car – comprehensive car insurance is quite a bit more expensive and it is only worth buying it if your car is quite valuable.

Case study

Amy is going on holiday with her parents; they have bought a travel insurance policy but she thinks it's a waste of money. She tells her mother:

'£70 is very expensive and nothing's going to happen. We'll come back without any problems, just like we always do, and you'll have wasted your money. Why don't you give me the money instead if you don't want it?'

Do you agree with Amy?

Protecting your assets

We spend some of our money on physical goods, which are called **assets** – these are items that belong to us like houses, cars and TV sets. It is good to have assets as they make our lives easier and more comfortable. But there is always a threat that we might lose them or they might get damaged in some way. Because **threats** exist, we have to protect our assets.

Q

How might the following assets get lost or damaged:

- ***cash***
- ***an MP3 player***
- ***a car***
- ***a house?***

Threats

Let's put some of the possible threats to assets under different headings.

Theft

Most physical assets can be stolen.

Items you carry around with you like a mobile phone or your purse or wallet can be lost to muggers or pickpockets, or you might leave them lying around by mistake for someone else to take.

Car theft is very common and there are many cases of people who return to where they parked their car only to find it gone. This can also happen to bicycles.

It is not possible to steal a house but burglars can break in and steal the contents, e.g. electrical equipment, jewellery, etc.

Accidental damage

Some assets are more fragile than others but most things can be broken.

	You might drop your phone or MP3 player so that it doesn't work any more.
	People have accidents in their cars. The car will be expensive to repair and it might even be written off.
	Domestic items can get damaged, e.g. you might spill a tin of paint on the carpet while you are decorating.

Fire

Fire is always a threat and must be taken very seriously.

	Cars can catch fire because of electrical faults.
	A house fire causes a lot of damage to the contents and to the buildings themselves.

External threats

There are many types of threat from the weather, etc – these mainly affect houses and their contents but can also cause cars to be lost. Here are some of these external threats:

- storms and wind damage, including hurricanes and tornadoes;
- floods;
- earthquakes and tsunamis;
- landslides, subsidence and mudslides;
- damage from collision by aircraft or road vehicles.

Can you think of examples of the above external threats that you have seen on the news? They might be either in the UK or in other parts of the world. How were people and their property affected?

Threats to services

We have looked so far at the loss of physical assets but it is also possible to lose money because the delivery of a service went wrong. A good example of this is a holiday that has been booked and paid for. Here are some of the possible threats to the holiday:

- cancellation by the travel company;
- an illness that means you cannot go on holiday;
- loss or theft of suitcases and their contents while on holiday;
- personal accident or even death while on holiday.

We can say that everyone who owns any type of property runs the risk of losing it or of having it damaged because of the threats covered in the previous sections.

So what can we do about threats to property

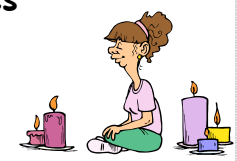
What steps can we take to safeguard our property under the following headings?

- ***Car accidents and theft***
- ***Domestic burglaries***
- ***House fires***
- ***Floods***
- ***Muggings and pickpockets***

Taking precautions is known as **risk reduction**. It can take two main forms:

(a) taking steps to prevent the risk from happening, e.g. locking your car so it doesn't get stolen;

(b) taking steps to lessen the loss if the risk does happen anyway, e.g. making buildings earthquake-proof so they don't fall down.

Car accidents	Drive more carefully and be aware of possible hazards. Stick to speed limits and comply with road markings. Buy a car with air bags.
Car theft 	Install burglar alarms and immobilisers to make it difficult for car thieves. Park cars in busy areas or in car parks with security guards. Hide valuables in the glove compartment or boot so that thieves cannot see them.
House burglaries  	Install burglar alarms, good locks on doors and windows and security lights. Don't keep valuable jewellery or a lot of cash in the house. Mark electrical equipment with a personal identity number. Don't open the door to strangers.
House fires 	Install smoke alarms upstairs and downstairs. Be careful in the kitchen, especially with chip pans. Don't smoke in the bedroom or leave candles burning when you leave a room. Keep fire extinguishers handy.
Floods 	If your house is on low-lying land, and especially if it is near a river (on a flood plain), you are more likely to be flooded. You can't stop the water from coming in but you can take some precautions such as using sandbags and putting valuable items upstairs.
Muggings and pickpockets 	Don't keep money or valuables in outside pockets but use an inside pocket or a waist belt. Don't walk in lonely streets after dark. Be aware and on guard in crowds.

Go through the list of threats on the previous page and see what other pieces of good advice you can think of.

Is it enough to take precautions?

Unfortunately, however careful you are, things still happen and you can never say you will never be the victim of one or more of the threats we have outlined. Equally, whatever you do, you can never be sure that you will not be adversely affected by an event. Is there anything else you can do to reduce the financial loss you will suffer if any of these events takes place?

What will happen in the following situations? Give reasons.

(a) Billie has just bought a new car in her own name and wants to insure it.

(b) Martin has a new girlfriend whom he loves very much and he wants to insure her life.

(c) Elijah bought a new bicycle two years ago for £200 and insured it against accidental damage, but not on a new-for-old basis. Now it has been damaged in an accident and he is claiming £200.

(d) Jean-Jacques and Marie-Claire are married and are arranging a mortgage to buy their first house. They have decided not to insure the house because the policy is expensive.

(e) Paul is on holiday in Egypt and is spending more money than he had planned. He decides to pretend that he has lost £300 and intends to claim this on his travel insurance when he gets home.

Have a look at the following cases and say whether or not you think the people concerned should buy insurance.

Should they buy insurance?	Yes/No	Reason
Siobhan has a friend who lives in Istanbul and she is planning to visit her for a month. She has booked a cheap flight and will be staying at her friend's house. Travel insurance for a month will cost her £60.		
Terry has just got a pet dog from his local Dogs' Rescue Centre. The dog is five		

years old and has been badly treated but seems healthy. Terry is wondering whether to buy pet health insurance, which will cost him £10 a month. A friend of his has just paid £15 for a week's course of antibiotics for her dog.		
Ruby is buying her first flat. She has to buy buildings insurance but is not sure whether she needs to insure the contents as well. Most of her furniture is second-hand but she has just bought a new television and DVD player. The contents policy will cost her £80 a year.		
Hugh's hobby is breeding show cats and he owns three prize-winners. He can insure them against theft, illness and death – the policy is expensive and will cost him £250 a year.		

Insuring your health and life

Apart from insuring your possessions, you can also take out insurance policies to cover healthcare and that pay out if you need medical treatment or if you die.

Health insurance

Health insurance guarantees you treatment and a hospital bed in the private sector. It is expensive, but those who can afford it pay for shorter waiting lists and a private hospital room.

Life assurance

You take out a policy against your life and the policy pays out under certain conditions, depending on the type of policy. Note that this is called **assurance** and not insurance; this is because it is **sure** that you are going to die sometime, but you don't know when. There are three main types of life assurance.

- **Whole of life assurance:** you pay a monthly premium for the rest of your life. When you die, the policy pays out an agreed sum to the people who inherit your money. Some people take out this type of policy to cover their funeral expenses or to give their next-of-kin a useful sum of money at a difficult time.
- **Term assurance:** a policy whereby you pay a premium for a specified number of years. If you die within the term, the policy pays out but if you survive, it pays nothing. (It is possible to arrange for it to pay a limited amount if you survive, but

your premium would be higher.) This is a useful type of insurance for people who borrow money to buy a house. A typical mortgage lasts for 25 years, so borrowers take out term life assurance for the same period, i.e. 25 years. If the house owner dies within this period, his or her income stops at the same time but the dependants are left to pay off the mortgage. The proceeds of the life can be used to pay off the debt. When the mortgage term has finished and the house has been paid for, the policy is no longer necessary.

- **Endowment assurance:** with an endowment policy, you pay an agreed sum every month and, when the policy matures after an agreed number of years, you receive a lump sum according to how the investment has grown. It is really a type of long-term saving but you cannot touch the money for some years after you start.

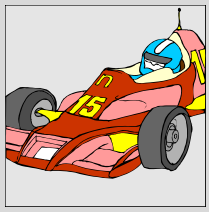
When calculating the premium someone must pay for life assurance, the insurance company takes various factors into account such as the person's:

- gender and age (women tend to live longer on average than men);
- medical history – if the person already has a life-threatening condition, this will not be included in the policy, i.e. if the person dies from this condition, the policy will not pay out;
- occupation – some jobs are more dangerous than others;
- life habits, e.g. whether they smoke or drink.

The more likely someone is to die early, the more expensive the policy. The worst case for the insurance company is someone who takes out a policy, makes only a few premium payments and dies soon after. The best case is someone who pays premiums regularly and dies after many years.

How easy do you think it will be for the following people to get a life assurance policy?

Person wanting life assurance	Easy? Y/N	Reason
 **Julie** is 30 years old. She is fit and doesn't smoke but there is a history of cancer in her family.		

 **Stan** is 75 years old. He smokes and goes down the pub three times a week. He has already had two heart attacks.		
Junior is 3 years old and is fit and healthy. His parents want to save money for his studies when he is older. 		
Pablo is a racing driver who does white-water rafting in his spare time. 		

Medical science can now do genetic tests on people to see if they are likely to develop life-threatening diseases. What effects might this advance have on life assurance?

Review questions

1. What are the main risks that can happen to a house and its contents?
2. What are the main risks that can happen to someone while on holiday?
3. What are the two main types of risk reduction?
4. How could someone reduce the risk of (a) theft from and (b) external damage to their house?
5. Because they can't entirely reduce risks, people buy a service that enables them to transfer the financial responsibility for a loss to a company. What do we call this service? What is the name of the payment made for the service?
6. Insuring a risk makes the risk less likely to happen. True/False
7. The higher the risk of someone suffering a loss, the higher the premium charged by an insurance company. True/False

8. What do you call the legal principles described below?
   (a) You can only insure something if it belongs to you.
   (b) You can't make a profit out of claiming on an insurance policy.
   (c) You must tell the truth on an insurance application form.
9. Say whether the following insurance policies are compulsory or voluntary:
   (a) comprehensive motor insurance;
   (b) health insurance on a pet horse;
   (c) travel insurance if you go by public transport to a nearly town;
   (d) buildings insurance for someone who has a mortgage loan;
   (e) third-party car insurance.
10. Why might someone buy a term life assurance policy?
11. What factors are taken into account by a life insurance company when calculating the premium on a life assurance policy?

Case study

Sally and Bob have bought an annual travel insurance policy with ABC Insurance. Here are some of the details of the policy.

- It lasts for 12 months.
- It costs £74.52 for the year.
- It covers travel within Europe only.
- It covers 42 days in any one journey and 120 days in any period of insurance.
- Sally has a medical condition, which she has declared. She is not covered if she becomes ill from this condition while she is away. Bob has no medical condition.

The policy covers the following risks:

✓	Personal possessions up to £1,500
✓	Emergency replacement of personal possessions up to £100
✓	Personal money up to £500
✓	Emergency medical expenses abroad up to £5,000,000
✓	Cancellation or cutting short of a journey up to £5,000
✓	Personal accident up to £25,000
✓	Personal liability up to £2,000,000
✓	Delayed or missed departure up to £600
✓	Loss of passport up to £250
✓	Legal assistance up to £50,000

Sally and Bob went to Russia. While they were there, they were the victims of a robbery and they lost one of their suitcases with £500 worth of possessions and £600 in cash. They reported the theft to the hotel they were staying at and the local police were informed. They were given a paper confirming the theft and they claimed against their insurance when they got home. They were compensated within two weeks and received the whole of the £500 for the suitcase and its contents and £500 of the £600 in cash. They feel pleased that they had purchased the insurance and are happy that ABC Insurance dealt with their case so quickly.

Learning activities

Internet

1. Go to the website of Direct Line insurance (www.directline.com) and choose Pet Insurance. Click on 'Get a Quote' and you will be transferred to a secure connection. You will then be asked to enter some personal details, e.g. postcode and address and your age. Type in that you are 18 or over – it doesn't matter if it's not true because you are not going to buy the insurance. Then you will be asked questions about the pet you want to insure – you can put in details of your own pet or make them up. Click on Continue and you will be given a quote, e.g. £12.86 per month.

2. Go to the website of Tesco Personal Finance (www.tescofinance.com). Choose Home Insurance and go to Frequently Asked Questions. Find the answers to the following questions.

   - What does home contents cover?
   - Is my PC covered?
   - In what cases do I need to tell you about the individual value of my contents?
   - What service does the Emergency Helpline offer?
   - What measures does Tesco Insurance take to prevent fraud?

Key points for Insurance

- ❑ Our property (e.g. houses and their contents, cars and other possessions) is always under threat of loss or damage from risks such as theft, fire, accidental damage and external events.
- ❑ We can also suffer loss when we consume services, for example when we go on holiday.
- ❑ Risk reduction means taking steps to minimise the likelihood of these risks happening and also to minimise our loss if they do occur.
- ❑ Insurance is a financial service that enables us to transfer the risk of loss to an insurance company. In return for the payment of a premium, the insurer will take on the risk and pay compensation if it happens.
- ❑ The more likely the risk is to happen, given the individual circumstances, the higher the premium will be.
- ❑ Insurance contracts are based on three principles: indemnity (you can't make a profit out of insurance), insurable interest (you must have a financial interest in

the thing or person insured) and utmost good faith (you must tell the truth to the insurer).

- The main types of insurance are: buildings and contents, motor, travel, pet and particular items.
- Some types of insurance are compulsory such as third-party car insurance and buildings insurance if you have a mortgage loan. Others are voluntary and depend on whether people prefer to pay the premiums or take the risk.
- You can take out private health insurance so that you can use private doctors and hospitals if you fall ill.
- You can insure your life. There are three types of policy: whole of life, term and endowment assurance.
- With a 'whole of life' policy, you pay premiums throughout your life and your dependants get the money when you die.
- Term assurance policies are often used to back up a mortgage or other loans so that someone's family won't have to pay back the debt if they die.
- An endowment assurance is a type of long-term savings.
- Premiums on life assurance policies are calculated according to how likely it is that the person will die young or will live to be old.