February 24, 2025

LEC 06 - Home and Automobile Insurance

Learning Objectives

1. Develop a risk management plan using insurance
2. Discuss the importance of property and liability insurance
3. Explain the insurance coverage and policy types available to homeowners and renters
4. Analyze factors that influence the amount of coverage and cost of home insurance
5. Identify the important types of automobile insurance coverages
6. Evaluate factors that affect the cost of automobile insurance

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What is Insurance?

- Insurance is protection against possible financial loss
- An insurance company, or insurer, is a risk-sharing firm that that assume the financial responsibility for losses
- People purchase a policy and pay the premium
- Insured is a person covered by an insurance policy

Types of Risks

- Risk is the change or uncertainty of loss
- Peril is the causes of a possible loss, such as a fire
- Hazard is something that increases of likelihood of a loss
- Most common risks are classified as personal risks, property risks, and liability risks
- Pure risk is a risk in which there is only a chance of loss
    - Insurable, accidental, unintentional, nature of risk can be predicted
- Speculative risk is the chance of loss or gain and is uninsurable, such as starting a small business or gambling

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Risk Management Methods

1. Risk avoidance means to avoid the chance of loss altogether
2. Risk reduction means to reduce the chances of a loss occurring or reducing the adverse effects of losses that do occur
3. Risk assumption means taking on the responsibility for the loss or injury
4. Risk shifting means to transfer the cost of the loss onto the insurance company

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Homeowners Insurance Coverages

- Coverage for a place of residence and its associated financial risks

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- Physical damage to property and the loss of use
- Buildings and other structures
  - Ex. Pool house, guest house, shed
- Additional living expenses
  - Ex. Living in a hotel while home is being repaired
- Personal property/articles
  - Ex. Jewellery
  - Personal property endorsement
  - Household inventory

Types of Coverages

Actual Cash Value (ACV)

- Two different ways of calculating payouts
  - Payment received is calculated based on the cost of the item minus depreciation
  - Payment received is calculated based on the cost of the item minus depreciation using the straight line method

Replacement Value

- You receive the full cost of repairing or replacing a damaged or lost item, depreciation is not considered.
- Typically costs more due to better protection and higher cost to the insurance company

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Example

Most home insurance policies cover jewellery and silverware for a limited amount unless items are covered with additional insurance via an umbrella plan. If $\$10,000$ worth of jewellery and $\$4,500$ worth of silverware was stolen from a family, what amount of the claim would not be covered by the insurance if the standard amount of coverage is $\$2,500$ for jewellery and $\$3,500$ for silverware. How can they make sure they are covered correctly for the full amount?

- For jewellery, the insurance would not cover $\$7,500$. For silverware, the insurance would not cover $\$1,000$. Therefore, in total the family would not be covered for $\$8,500$
- To ensure the family is coverely correctly for the full amount, the family should purchase additional insurance for a higher premium

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Example

What amount would a person with actual cash value coverage receive for a two year old furniture destroyed by a fire? The furniture cost $\$3,500$ originally but would cost $\$6,000$ to replace today and has an estimated life of 5 years.
* Assume actual cost method

$$= 3500 - \frac{3500}{5} \cdot 2 = \$2,100$$

Example

What amount would it cost an insurance company to replace a family's personal property that cost $\$35,000$? The replacement costs for the items have increased by 8% in total since initially purchased

$$= 35000 \cdot 1.08 = \$37,800$$

Deductibles

- Deductible is your share of any claim
    - Fixed amount indicated on your policy
    - Often $100, $250, $500, $1000, your insurance company will subtract that amount from your claim
- The higher your deductible, the lower your premium since the insurance company is responsible for less of your loss
- People are generally more careful if the cost of being careless is higher
- Fewer small claims means less administrative costs for insurer

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Example

For each of the following situations, what amount would the insurance company pay?

a) Wind damage of $\$2,000$, the insured has $\$500$ deductible
$$= 2000 - 500 = \$1,500$$
b) Theft of an entertainment system worth $\$2,300$, the insured has a $\$1,000$ deductible
$$= 2300 - 1000 = \$1,300$$

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c) Vandalism that does $\$375$ of damage to a home, the insured has a $\$500$ deductible

$$= 375 - 500 = 0 \ (Capped \ at \ 0)$$

Home Insurance Cost Factors

Factors That Affect Home Insurance Costs

- Location of residence
- Type and age of the structure
- Amount of coverage and deductibles
- Replacement value
- Electricity, heating type, plumbing, age of roof
- Other factors like alarms and pools

Reducing Home Insurance Costs

- Discounts like an alarm system, smoke detector, insuring your car with the same company
- Company differences
    - Compare costs and coverage
    - Customer satisfaction is important

Automobile Insurance Coverages

- All provinces and territories require mandatory automobile insurance
- Covers risks associated with owing, operating, or using a vehicle
    - Liability to others for injury, death, or property damage
    - Injury, death to yourself, or your passengers
    - Damage to your vehicle

Risk	**Insurance Coverage**
Injury to or death of yourself or your passengers	Accident benefits
Damage to your vehicle	Physical damage insurance, such as comprehensive or collision coverage
Liability to others for injury, death, or property damage	Third-party liability coverage

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Automobile Insurance Costs

Factors That Affect Automobile Insurance Costs

- Where you live
    - Urban areas have a higher probability of accidents and car burglaries, which would likely increase the amount of your premium
- Make and style of car
    - The type of car your drive generally does not affect the premium for third-party liability insurance, but it does affect the cost of coverage for physical damage to your car
    - Insurance companies rate vehicles according to their safety record and cost to repair or replace them
- Use of vehicle
- Rating territory
- Driver classification
- Assigned risk pool for people who are considered high risk drivers

Reducing Automobile Insurance Premiums

- Find out how much it will cost to insure a car before you buy it
- Compare companies
- Increase your deductibles
- Look for discounts
    - Establish and maintain a good driving record
    - Install security devices such as a car alarm
    - If you have more than one vehicle insure them both with the same company

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Example

Fionna is looking at saving some money on her car insurance. She drives a Nissan Murano worth $\$45,000$. If she increases her deductible from $\$500$ to $\$1,000$ her annual savings on her premium could be 9%. If her annual premium is $\$3,000$ how many years would she have to be incident free in order to justify the higher deductible (assume no interest for simplicity). Is it worth it? Now what if her car was a Pontiac Vibe worth only $\$3,500$?

- Discount would be $3000 \cdot 0.09 = \$270$
- She would need to be incident free for 2 years then the savings will exceed the increase in deductible
- It is worth it depending on if she is claim free for 2 years

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- It is probably not worth it if the car is only valued at $\$3,500$, so it is likely better to assume the risk

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Example

Lennox currently is paying $\$300$ a month for his car insurance. His insurance agent recommends he install a devicce that monitors his driving and sends the info to his insurer. He can potentially save up to 30% if his monitored reports are good. How much can Lennox potentially save in two years for his vacation fund if he can earn 6% APR compounded monthly in an investment?

- $300 \cdot 30\% = \$90$ saved each month
- $= FV(6\%/12,\ 24,\ -90,\ 0,\ 0) \Rightarrow \$2,289$
- Therefore, he can save a maximum of $\$2,289$ in two years