Formal Insurance Education - Who Really Needs It?

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When families and individuals start planning their budget, what will they most likely be spending the greatest percentage of their income on? Their home? Cars? Vacations? No, it is insurance. Whether it is health, homeowners, life, disability, automobile, boat, camper, professional liability or an annuity, the costs are rising and the consumer remains uninformed. Where does everyone get this information? College? High School? The Internet? The truth is, that most people get their only information from their agent despite the fact that the agents make their livelihood from insurance sales. After more than 25 years of teaching a basic insurance course (Insurance and Risk) it still holds true that students receive their "formal" insurance education from their parents and their insurance agents. Where did their parents get their information? In nearly all cases, from their parents or from their agents. This is very clear from the "IQ" (Insurance Quotient) test given at the beginning of class each year. Even with very basic questions on homeowners, automobile and life insurance, they still show their ignorance of these very basic types of insurance coverages. Thus, our paper looks at the issues for all insurance consumers in trying to understand their rights, benefits, claims and how the insurance industry, high school faculty and college programs as a whole, must do a better job to formally educate everyone if their policyholders are to make reasonable decisions in purchasing their "necessary" coverages.

INTRODUCTION

Insurance is a necessary evil to help maintain economic stability for our families, our businesses and even our country. It also provides a feeling of security by knowing that if an accident or loss does occur, there will be monies available to help make the victim whole again. But billions of dollars (United States alone in 2004 with $429.0 billion in the property/casualty area and $531.3 billion in the life/health area) (Insurance Industry at a Glance) are spent each year on premiums with little or no understanding of what you are buying when you purchase a policy of insurance, even for the very basic types such as life, health, homeowners and automobile (recognizing that many other types such as liability, business and a multitude of others, but those are a beyond the scope of this paper).

For instance, with the rise of health insurance costs, many employers are no longer providing fully-paid health insurance as a benefit, leaving the costs to the employee to cover themselves and their families. A startling statistic shows that in 2000 the average cost of health insurance for a single person was at $2,655.00 per year and for family coverage $6,772.00 per year (Branscome, 2005). While these numbers are dramatic, in the past five years, such premiums have done nothing but increase thereby putting additional pressures for families and individuals to come up with the required resources to provide for their health insurance needs. In fact, it is estimated that "by 2006, the average family health insurance premiums will exceed $14,500.00, or at approximately five times faster than the inflation rate."(Health Insurance Cost) (As an anecdotal example, at Northwest, the employee's health insurance premiums are completely paid, but family coverage for 2005 is $828.00 per month, or $9,936.00 per year, just to obtain the basic coverages available and does not include dental, vision, or disability insurance for the family members.) Graphically, this means that the average health insurance premium for a family policy represents "21% of the national median household income in 2004, of $42,409.00." (Health Insurance Cost)

Health insurance, of course, is not the only "basic" coverage that has increased in costs. From 1995-1999, the national average for homeowner's insurance premiums rose 17% and from 2000-2003 another 24.1% (OII Backgrounder: Homeowners Insurance Outlook), for an increase of over 40% in only eight years, far exceeding the general consumer price inflation. With the value of land and homes in general on the rise, this trend will certainly continue.

Not to be forgotten is automobile insurance which, again on average, has increased in the United States, which just for liability coverage (the source did not state in what specific amounts), rose from $668.00 per year in 1995 to an estimated $870.00 per year in 2005, an increase of 23.4%. (Hot Topics and Issues Updates – Automobile Insurance Overview)

CLASSROOM CASE STUDY

Each year, Dr. McLaughlin gives an IQ (Insurance Quotient) test to his introductory Insurance and Risk students to "test" their beginning understanding of some basic insurance concepts. Each of these students, numbering approximately 20-30 per course, is of junior or senior status, nearly all of whom are finance majors. The questions are over automobile, homeowners, and life insurance, which are coverages that many of the students have at that age.

Here is a sample of the questions asked:

Automobile

1. You are traveling down the road heading back to school from a weekend getaway. Suddenly, a deer runs out in front of you and there is no time to avoid the collision. You hit the deer causing $4,000.00 worth of damage to your vehicle. What type of coverage do you need to pay for the repairs to your vehicle?
   (*Comprehensive - 23% Collision - 77%)
2. You are going to Wal-Mart to buy some "necessities of life." A person on your left has a stop sign at the intersection you are approaching. Unfortunately, you are the only one to see the stop sign and the other person runs the stop sign, slamming into your car doing $5,000.00 worth of damage, but at least you have no physical injuries. When the police arrive, you find out that the careless driver does not have any automobile insurance. You

check your policy when you get home and see that you have "uninsured motorist coverage" for $25,000.00. Are you covered for your loss?
(Yes - 91% *No - 9%)

Homeowners

1. You have a home that you just purchased five years ago. You bought the home for $100,000 and insured the home at that time for $100,000.00. The value of the home has now increased to $125,000.00, so your insurance coverage has decreased to 80% of the replacement value. During last night's thunderstorm, you had $10,000.00 worth of damage to your home's roof and siding caused by some hail. (Assume you have a policy that covers hail damage and the home is depreciated 25%.)
   Your insurance company will pay you:
   ($7,500.00 - 9% $8,000.00 - 82% *$10,000 - 9%)
2. You are so proud of your new home that you just purchased for $200,000.00. It sits down by the river and provides a very scenic view off of your deck of the river floating slowly by the dock you had built for the boat you want to purchase. You contact your insurance agent and ask him for "full coverage" on your home, its contents and even the dock. Three weeks later it begins to rain and will not quit. The river begins to rise and continues until it is out-of-control. When you return to your home, you find that the water has been in your home, causing serious damages and your dock has been swept away. With "full coverage" under your HO-3 policy are you covered?
   (Yes - 14% *No - 86%)

Life Insurance

1. You are getting married in a couple of weeks and decide that the life insurance you have through your employment, which is equal to your salary, may not be enough protection for your new spouse. You call your agent and tell him an additional $100,000 of coverage is needed and you want a policy with a savings plan with it for future retirement plans, but want it at the least cost possible because of your budget. Your agent suggests a term insurance policy plus investing the difference in some mutual funds because of the lower premium cost, even though the policy itself does not have a savings plan, to fit your request. Is this true?
   (*Yes - 36% No - 64%)
2. You are just married and you want to make sure you contact your insurance agent to name your spouse as the primary beneficiary on your life insurance policy. As you grow older, you have two children, but fail to name them as contingent beneficiaries on your policy. One your fortieth birthday you are coming home with your spouse after an evening out and a car hits you head on, killing you and your spouse. Your life insurance proceeds will automatically be paid to your children equally by the insurance company per the policy conditions and provisions.
   (True - 55% *False - 45%)

In looking further into the "Why" students answer the way they did in this exercise, it is even more revealing about their lack of basic insurance coverages. Some of the percentages, on the surface, would tend to show some pretty basic understanding of these concepts, but before putting the correct answers up, they were asked to explain their choices. Here are the “majority” answers for both the correct and incorrect responses.

Automobile

Question One - Comprehensive (correct)

“I’ve had it happen before”

“I thought it was a trick question about having a ‘collision with a deer’

Question One - Collision

“You buy collision coverage to fix your car in case of any type of collision, i.e., a car, light pole or even a deer.”

Question Two - Yes

“That’s why you buy uninsured motorist coverage in the first place. When it’s their fault they fix your car if the other guy is uninsured.”

Question Two - No (correct)

“I’m not sure why exactly, but it seems too obvious to say yes.”

Homeowners

Question One - $7,500.00

“Depreciation only allows you to collect what you really lost. The loss is $10,000, but you can only collect $7,500.00"

Question One - $8,000.00

“It only makes sense that you take the amount of your loss times the percentage of coverage, even if it has depreciated, you’re paying for 80% coverage so you get what you’re paying for.”

Question One - $10,000.00 (correct)

“You have $100,000.00 worth of coverage so you should be able to collect up to $100,000.00 on any loss.”

(No one knew about the 80% average clause for partial losses.)

Question Two - Yes

“Full coverage means you are covered for everything unless a space ship falls on your house or something weird like that.”

Question Two - No (correct)

“My family had it happen and you are not covered without flood insurance.”

“You have to buy it extra, it is not part of your regular policy.”

Life Insurance

Question One - Yes (correct)

“I just heard that term insurance was the cheapest. If you invest the difference, I guess you could consider that as a savings plan.”

“My brother sells life insurance and that’s what he tells people to buy.”

Question One - No

“You need some kind of cash value insurance to do this, according to the guy that came to see me.”

“I didn’t know if you could get a retirement savings plan with term insurance, which is what the policy holder was talking about.”

Question Two - True
"It has to go somewhere, so it only seems reasonable it should go to his children."
"I think the law says that if you don't name someone in the policy to get the money it goes to your family."
Question Two - False (correct)
"I agree it goes to the kids, but I don't think it goes automatically."
"I think it goes into a person's estate and the family has to fight over it. That's what my father had to do when his parents died."

Clearly, even from these very basic concepts related to the common types of insurance, which all persons should obtain, we are "missing the boat" in educating America on insurance. But why is insurance so misunderstood? We believe it is because, despite the tremendous budgetary costs associated with obtaining even the "basic" insurance coverages, people are misinformed, uninformed and too uneducated to even ask simple questions about what they are receiving in exchange for their premium dollar.

EDUCATION

So where do we get our information about the insurance coverages that we purchase? Nearly 100% of the students after the "IQ" test, relate that they get their insurance information from three sources - their parents, their agents and on the Internet, in that order. Certainly that begs the next question, where did their parents get their information? Regarding the choice of insurance agents, students consistently agree that they do their "homework" when making a "major" consumer purchase such as an automobile, entertainment center, clothes, even where to take a "special date." They will read Consumer Reports, talk to friends, shop for weeks to make an informed decision based upon their "needs analysis" and budget. However, when it comes to purchasing insurance they are content to rely on the advice of the very person who makes their livelihood by selling you their product and one which is mostly mysterious to the consumer. Obviously, insurance commission structures can certainly "influence" the specific product the agent advocates to the consumer.

How do we as a society improve on this dismal situation? Clearly education is the key. There are Internet resources such as the "Insurance Survival Kit" that tells consumers "when it comes to insurance, there are two main areas where most people need assistance; the first involves purchasing decisions and the second involves claims."[7] (Preview Insurance Survival Kits) Is that not the basis of all insurance education needs? Can you trust everything they have told you, and who is behind the information? But while the Internet "offers the promise of easy-to-access information and convenience, there is still a need to make web sites easier to use, enhance consumer privacy protections and improve the accuracy of the information they offer. For now this technology is still in its adolescence, nothing can substitute for consumer vigilance, research and common sense" (Buying Health Insurance Online – Tips for Consumers) when evaluating and comparing insurance plans. We totally agree!

CONCLUSION

We have attempted to show how important insurance education is based upon the ever increasing costs to all Americans and how even educated persons can be nearly totally uninformed about the products, needs of the person, coverages available, terminology and claims associated with the ever more complex insurance industry. Insurance education in our society is a MUST. Students are currently not getting sufficient information in our schools at any level. Resources are often out-dated and too complicated for the "average" or even an educated person to understand. We believe that this situation can still be overcome by the insurance industry taking the mystery, fear and confusion out of informing the populace on insurance issues and that our educational system, even in elementary schools, begin educating all students, not just finance or business ones, of the basics of insurance coverages and terminology associated therewith. Insurance Education - Really, Who Needs It - **EVERYONE**!

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