When you have completed this chapter, you will be able to:

**Section 13.1**
- Identify types of risks and risk management methods.
- Explain how an insurance program can help manage risks.
- Describe the importance of property and liability insurance.

**Section 13.2**
- Identify the types of insurance coverage and policies available to homeowners and renters.
- Analyze the factors that influence the amount of coverage and cost of home insurance.

**Section 13.3**
- Identify the important types of motor vehicle insurance coverage.
- Explain factors that affect the cost of motor vehicle insurance.

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**Reading Strategies**

To get the most out of your reading:

**Predict** what you will learn in this chapter.

**Relate** what you read to your own life.

**Question** what you are reading to be sure you understand.

**React** to what you have read.
In the Real World . . .

Josh Peterson just got his driver’s license and bought a used car. According to state law, he was required to obtain auto insurance. Josh was alarmed by how much auto insurance cost—it was almost as much as his car payments. A month later, Josh became involved in his first traffic accident. Although no one was hurt and the damage to the cars was minimal, he was shocked to learn how much repairs cost. He was thankful he had auto insurance. Because Josh caused the accident, his auto insurance premiums would increase. His mother said they could shop around for an auto insurer with a better rate, but they would have to pay the higher rate for now.

As You Read  Consider why it is important to have insurance for protection.

Insurance Rates

Q: My brother is 17 and has an excellent driving record. Why are his motor vehicle insurance rates higher than rates for females in his same age group?

A: Insurance rates are based on an analysis of accident statistics for all types of drivers. Since young men have a higher incidence of being involved in accidents than young women have, insurance rates for young men are more expensive. Some insurance companies offer discounts for young adults covered on a parent’s policy.

Ask Yourself  What can you do to ensure that your insurance rate stays as low as possible?

Go to finance07.glencoe.com to complete the Standard & Poor’s Financial Focus activity.
**Insurance and Risk Management**

**What Is Insurance?**

**Why is it important to have insurance?**

Insurance is protection against possible financial loss. Since you cannot predict the future, you never know when something bad might happen to you or your property. Insurance allows you to be prepared for the worst. It provides protection against many risks, such as unexpected property loss, illness, and injury. Although many kinds of insurance exist, they all have several characteristics in common. For example, they give you peace of mind, and they protect you from financial loss when trouble strikes.

An insurance company, or insurer, is a risk-sharing business that agrees to pay for losses that may happen to someone it insures. A person joins the risk-sharing group by purchasing a contract known as a **policy**. The purchaser of the policy is called a policyholder. Under the policy, the insurance company agrees to take on the risk of the policyholder. In return, the policyholder pays the company a **premium**, which is a fee for insurance. The protection provided by the terms of an insurance policy is known as **coverage**, and the person protected by the policy is known as the **insured**.

**Types of Risks**

**What are the most common types of risks?**

Risk, peril, and hazard are important terms in insurance. In everyday use, these terms have almost the same meanings. In the insurance business, however, each word has a distinct and special meaning.

**Risk** is the chance of loss or injury. You face risks every day. For example, if you cross the street, there is some danger that a motor vehicle might hit you. If you own property, there is risk that it will be lost, stolen, damaged, or destroyed.

In the insurance business, risk refers to the fact that no one can predict trouble. This means that an insurance company is taking a chance every time it issues a policy. Insurance companies frequently refer to the insured person or property as the **risk**.
Peril is anything that may possibly cause a loss. It is the reason that someone takes out insurance. People buy policies for protection against a wide range of perils, including fire, windstorms, explosions, robbery, and accidents.

Hazard is anything that increases the likelihood of loss through peril. For example, defective electrical wiring in a house is a hazard that increases the chance that a fire will start.

The most common risks are personal risks, property risks, and liability risks. Personal risks involve loss of income or life due to illness, disability, old age, or unemployment. Property risks include losses to property caused by perils, such as fire or theft, and hazards. Liability risks involve losses caused by negligence that leads to injury or property damage. Negligence is the failure to take ordinary or reasonable care to prevent accidents from happening. If a homeowner does not clear the ice from the front steps of her house, for example, he or she creates a liability risk because visitors could fall on the ice.

Personal risks, property risks, and liability risks are types of pure, or insurable, risk. The insurance company will have to pay only if some event that the insurance covers actually happens. Pure risks are accidental and unintentional. Although no one can predict whether a pure risk will occur, it is possible to predict how much it will cost if it does.

A speculative risk is a risk that carries a chance of either loss or gain. Starting a small business that may or may not succeed is an example of speculative risk. Speculative risks are not insurable.

Risk-Management Methods

**Why is risk management important?**

Risk management is an organized plan for protecting yourself, your family, and your property. It helps reduce financial losses caused by destructive events. Risk management is a long-range planning process. Your risk-management needs will change at various points in your life. If you understand how to manage risks, you can provide better protection for yourself and your family. Figure 13.1 on page 415 summarizes various risks and effective ways of managing them.

Most people think of risk management as buying insurance. However, insurance is not the only way of dealing with risk.

**Risk Avoidance**

You can avoid the risk of a traffic accident by not driving to work. A car manufacturer can avoid the risk of product failure by not introducing new cars. These are both examples of risk avoidance. They are ways to avoid risks, but they involve serious trade-offs. You might have to give up your job if you cannot get there by driving a car. The car manufacturer might lose business to competitors who take the risk of producing exciting new cars.
In some cases, though, risk avoidance is practical. For example, by taking precautions in high-crime areas, you might avoid the risk of being robbed. By installing a security system in your car, you might avoid the risk of having it stolen.

**Risk Reduction**

You cannot avoid risks completely. However, you can decrease the likelihood that they will cause you harm. For example, you can reduce the risk of injury in a car accident by wearing a seat belt. You can reduce the risk of developing lung cancer by not smoking. By installing fire extinguishers in your home, you can reduce the damage that could be caused by a fire. In addition, you can lower your risk of illness by eating properly and exercising regularly.

**Risk Assumption**

Risk assumption means taking on responsibility for the negative results of a risk. It makes sense to assume a risk if you know that the possible loss will be small. It also makes sense when you have taken all the precautions you can to avoid or reduce the risk.

When insurance coverage for a particular item is expensive, it may not be worth insuring. For instance, older cars are generally worth less than new cars. So even if an accident happens and the car is wrecked, you may be better off financially by not paying for the insurance coverage since the car was not worth much anyway.

Self-insurance is another option for risk assumption. By setting up your own special fund, perhaps from savings, you can cover the cost of loss. Self-insurance does not eliminate risks, but it does provide a way of covering losses as an alternative to an insurance policy. Some people self-insure because they cannot obtain insurance from an insurance company.

**Risk Shifting**

The most common method of dealing with risk is to shift it, which means to transfer it to an insurance company. In exchange for the fee you pay, the insurance company agrees to pay for your losses.

Most types of insurance policies include deductibles. Deductibles are a combination of risk assumption and risk shifting. A **deductible** is the set amount that the policyholder must pay per loss on an insurance policy. For example, if a falling tree damages your car, you may have to pay $200 toward the repairs. Your insurance company will pay the rest.
Planning an Insurance Program

What factors will affect your insurance goals?

Your personal insurance program should change along with your needs and goals. For example, Kirk and Luanne are a young married couple. The following four steps outline how they will plan their insurance program to meet their needs and goals.

STEP 1: Set Insurance Goals

Kirk and Luanne’s main goal should be to minimize personal, property, and liability risks. They also need to decide how they will cover costs resulting from a potential loss. Income, age, family size, lifestyle, experience, and responsibilities are important factors in determining the goals they set. The insurance that they buy must reflect those goals.

Kirk and Luanne should try to come up with a basic risk-management plan that achieves the following goals:

- Reduces possible loss of income caused by premature death, illness, accident, or unemployment
- Reduces possible loss of property caused by perils, such as fire or theft, or hazards
- Reduces possible loss of income, savings, and property caused by personal negligence

Figure 13.1 Risks and Risk Management Strategies

<table>
<thead>
<tr>
<th>Personal Events</th>
<th>Risks</th>
<th>Financial Impact</th>
<th>Strategies for Reducing Financial Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disability</td>
<td>Loss</td>
<td>• Loss of income</td>
<td>• Savings and investments</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Increased expenses</td>
<td>• Disability insurance</td>
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<tr>
<td>Death</td>
<td>Loss</td>
<td>• Loss of income</td>
<td>• Life insurance</td>
</tr>
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<td></td>
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<td></td>
<td>• Estate planning</td>
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<tr>
<td>Property Loss</td>
<td>Catastrophic storm damage to property</td>
<td>• Property repair and upkeep</td>
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<td></td>
<td>• Repair or replacement</td>
<td>• Motor vehicle insurance</td>
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<td></td>
<td>• Cost of theft</td>
<td>• Homeowners insurance</td>
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<tr>
<td>Liability</td>
<td>Claims and settlement costs</td>
<td>• Flood or earthquake insurance</td>
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<tr>
<td></td>
<td>• Lawsuits and legal expenses</td>
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<td></td>
<td>• Loss of personal assets and</td>
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<td></td>
<td>income</td>
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Risky Business

Risk management strategies help reduce the financial impact of various risks. Can you think of other strategies that would apply to the risks mentioned in the chart?
Step 2: Develop a Plan

Planning is a way of taking control of your life instead of just letting life happen to you. Kirk and Luanne need to determine what risks they face and what risks they can afford to take. They also have to determine what resources can help them reduce the damage that could be caused by serious risks.

Furthermore, they need to know what kind of insurance is available. The cost of different kinds of insurance and the way the costs vary among companies will be key factors in their plan. Finally, this couple needs to research the record of reliability of different insurance companies.

Kirk and Luanne must ask four questions as they develop their risk-management plan:

1. What do they need to insure?
2. For how much should they insure it?
3. What kind of insurance should they buy?
4. Which insurance company should they choose?

Step 3: Put Your Plan into Action

After they have developed their plan, Kirk and Luanne need to follow through by putting it into action. During this process they might discover that they do not have enough insurance protection. If that is the case, they could purchase additional coverage or change the kind of coverage they have. Another alternative would be to adjust their budget to cover the cost of additional insurance. Finally, Kirk and Luanne might expand their savings or investment programs and use those funds in the case of an emergency.

The best risk-management plans will be flexible enough to allow Kirk and Luanne to respond to changing life situations. Their goal should be to create an insurance program that can grow or shrink as their protection needs change.

Step 4: Review Your Results

You should take time to review a risk-management plan every two or three years, or whenever family circumstances change.

For example, Kirk and Luanne have been satisfied with the coverage provided by their insurance policies. However, when the couple bought a house six months ago, it was time for them to review their insurance plan. With the new house, the risks became much greater. After all, what would happen if a fire destroyed part of their home?

The needs of a couple who rent an apartment differ from the needs of a couple who own a house. Both couples face similar risks, but their financial responsibilities differ greatly. When you are developing or reviewing a risk-management plan, ask yourself if you are providing the financial resources you will need to protect yourself, your family, if you have one, and your property.
Why is it important to include property and liability insurance in a financial plan?

Major natural disasters have caused catastrophic amounts of property loss in the United States and other parts of the world. In 2004, the damage caused by Hurricane Charley resulted in $6.8 billion in insurance claims in the state of Florida alone. Insurance claims are requests for payment to cover financial losses. Without the money they received from their insurance, the people affected by the hurricane may not have been able to make repairs to their homes.

Most people spend a great deal of money on their houses, vehicles, furniture, clothing, and other personal property. Therefore, protecting these items from loss is extremely important. Each year homeowners and renters in the United States lose billions of dollars from more than 3 million burglaries, 500,000 fires, and 200,000 cases of damage from other perils. The cost of injuries and property damage caused by vehicles is also enormous. By including property and liability insurance in your financial plan, you can help protect yourself from such financial loss.

Think of the price you pay for insurance as an investment in the protection of your most valuable possessions. Although the cost of such insurance may seem high, the financial losses against which it protects could be much higher.

There are two main types of risks related to your home and your car or other vehicle. One is the risk of damage to or loss of your property. The second type of risk involves your responsibility for injuries to other people or damage to their property.

Property Damage or Loss

Property owners face two basic types of risks. The first is physical damage caused by perils such as fire, wind, and flooding. These perils can damage or destroy your property. For example, a windstorm might cause a large tree branch to smash the windshield of your car. As a result, you would have to find another way to get around while it was being repaired.

The second type of risk that property owners face is loss or damage caused by criminal behavior, such as robbery, burglary, vandalism, and arson. Insurance can help you protect yourself from loss of or damage to your property.
Liability

Liability is legal responsibility for the financial cost of another person’s losses or injuries. You can be judged legally responsible even if the injury or damage was not your fault. For example, suppose that Terry falls and gets hurt while playing in her friend Lisa’s yard. Terry’s family may be able to sue Lisa’s parents even though Lisa’s parents did nothing wrong. Similarly, suppose that Sanjay accidentally damages a valuable painting while helping Ed move some of his furniture. Ed may take legal action against Sanjay to pay for the cost of the painting.

Usually, if you are found liable (or legally responsible) in a situation, it is because negligence on your part caused the mishap. Examples of such negligence include letting young children swim in a pool without supervision or cluttering a staircase with things that could cause someone to slip and fall, and become injured.

Section 13.1 Assessment

QUICK CHECK
1. What are the three main types of insurable risks?
2. How can developing an insurance program help you manage risk?
3. Why are property and liability insurance necessary to protect a homeowner from financial loss?

THINK CRITICALLY
4. “Insurance is a waste of money. If and when you suffer a financial loss because of an accident or some other event, you can pay for it from your savings account.” Do you agree or disagree with this statement? Explain your position.

USE COMMUNICATION SKILLS
5. My Favorite Things Make a list of your most valuable possessions. Consider new and used items that may have collectible value. Also consider how much it would cost to replace your valuable possessions.

Write About It Write a paragraph discussing the personal and financial consequences of having the items on your list lost, stolen, damaged, or destroyed. Also explain the effect of having the items insured in the event of loss.

SOLVE MONEY PROBLEMS
6. Paying for Insurance Protection Hans has recently purchased a fully restored 1957 Chevy. The car cost $35,000, but for Hans, the price was worth it. The best price he can find for insurance is $2,500 per year. He is thinking about cutting corners on his insurance coverage to save money. However, he knows he would be taking a risk by doing so.

Calculate Help Hans solve his problem by comparing the cost of his insurance with the cost of his vehicle. Is it worth the insurance expense to protect his prized vehicle, or is it too much to spend to insure what is, after all, just a car?
Home and Property Insurance

Homeowners Insurance Coverage
What does a homeowners insurance policy cover?

Insuring your residence and its contents is absolutely necessary to protect your investment. **Homeowners insurance** is coverage that provides protection for your residence and its associated financial risks, such as damage to personal property and injuries to others.

A homeowners policy provides coverage for the following:

- The home, building, or any other structures on the property
- Additional living expenses
- Personal property
- Personal liability and related coverages
- Specialized coverages

Buildings and Other Structures

The main purpose of homeowners insurance is to protect you against financial loss in case your home is damaged or destroyed. Detached structures on your property, such as a garage and tool shed, are also covered under a homeowners insurance policy. In fact, the insurance coverage even includes trees, shrubs, and other plants, which are landscaping.

Additional Living Expenses

If a fire or other event damages your home, additional living expense coverage pays for you to stay somewhere else. For example, you may need to stay in a motel or rent an apartment while your home is being repaired or rebuilt. These extra living expenses will be paid for by your insurance. Some policies limit additional living expense coverage to 10 to 20 percent of the home’s total coverage amount. They may also limit the payment period to a maximum of six to nine months. Other policies may pay additional living expenses for up to a year.
**Personal Property**

Household belongings, such as furniture, appliances, and clothing, are covered by the personal property portion of a homeowners insurance policy up to a portion of the insured value of the home. That portion is usually 55, 70, or 75 percent. For example, a home insured for $80,000 might have $56,000 (70 percent) worth of coverage for household belongings.

Personal property coverage typically includes limits for the theft of certain items, such as $1,000 for jewelry. It also provides protection against the loss or damage of articles that you take with you when you are away from home. For example, items you take on vacation or use at school are usually covered up to the policy limit. Personal property coverage even extends to property that you rent, such as a rug cleaner, while it is in your possession.

Most homeowners policies also include optional coverage for personal computers, including stored data, up to a certain limit. Your insurance agent can determine whether the computer equipment is covered against data loss as well as damage from spilled drinks or power surges.

**Household Inventories** If something does happen to your personal property, you must prove how much it was worth and that it belonged to you. To make the process easier, you can create a household inventory. A household inventory is a list or other documentation of personal belongings, with purchase dates and cost information. You can get a form for an inventory from an insurance agent. **Figure 13.2** provides a list of items you might include if you decide to compile your own household inventory. For items of special value, you should have receipts, serial numbers, brand names, model names, and proof of value.

In addition, keep a video recording or photographs of your home and its contents with your inventory list. Make sure that closet and storage area doors are photographed open. On the backs of the photographs, indicate the date and the value of the objects pictured. Update your inventory, photos, and related documents on a regular basis. Keep a copy of each document in a secure location, such as a safe-deposit box.

**Additional Property Insurance** If you own valuable items, such as expensive musical instruments, or need added protection for computers and related equipment, you can purchase a personal property floater. A **personal property floater** is additional property insurance that covers the damage or loss of a specific item of high value. The insurance company will require a detailed description of the item and its worth. You will also need to have the item appraised, or evaluated, by an expert from time to time to make sure that its value has not changed. In addition, keep photographs of valuable items as well as descriptions, receipts, and appraisals.

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**As You Read RELATE**

Do you own something you think should be insured separately from your parents’ homeowners insurance?
Personal Liability and Related Coverages

Every day people face the risk of financial loss due to injuries to other people or their property. For example, a guest could fall on a patch of ice on the steps to your home and break his arm. A spark from the barbecue in your backyard could start a fire that damages a neighbor’s roof, or your son or daughter could accidentally break an antique lamp while playing at a neighbor’s house.

In these situations, you could be held responsible for paying for the damage. The personal liability portion of a homeowners policy protects you and members of your family if others, except regular employees, sue you for injuries they suffer or for damage to their property. This coverage includes the cost of legal defense.
Amounts of Coverage Most homeowners policies provide basic personal liability coverage of $100,000, but often that is not enough. An umbrella policy, also called a personal catastrophe policy, supplements basic personal liability coverage. This added protection covers all kinds of personal injury claims. For example, an umbrella policy will cover you if someone sues you for saying or writing something negative or untrue, damaging his or her reputation.

Extended liability policies are useful for wealthy people and for businesses. The policies are sold in amounts of $1 million or more. If you are a business owner, you may need other types of liability coverage as well.

Medical payments coverage pays the costs of minor accidental injuries to visitors on your property. It also covers minor injuries caused by you, members of your family, or even your pets, away from home. Settlements under medical payments coverage are made without determining who was at fault. This makes it fast and easy for the insurance company to process small claims, generally up to $5,000. If the injury is more serious, the personal liability portion of the homeowners policy covers it. Medical payments coverage does not cover injury to you or the other people who live in your home.

If you or a family member should accidentally damage another person’s property, the supplementary coverage of homeowners insurance will pay for it. This protection is usually limited to $500 or $1,000. Again, payments are made regardless of fault. If the damage is more expensive, however, it is handled under the personal liability coverage.

▲ ADDITIONAL PROTECTION
The purchase of a valuable item such as a high-quality musical instrument is a major investment. Why would a person who buys an expensive piano get a personal property floater for it?
Specialized Coverages

Homeowners insurance usually does not cover losses from floods and earthquakes. If you lived in an area that had frequent floods or earthquakes, you would need to purchase special coverage. In some places the National Flood Insurance Program, run by the federal government, makes flood insurance available. This protection is separate from a homeowners policy. An insurance agent or the Federal Emergency Management Agency (FEMA) of the Federal Insurance Administration can give you additional information about this coverage.

Standard and Poor’s publishes the globally recognized S&P 500® financial index. It also gathers financial statistics, information, and news, and analyzes this data for international businesses, governments, and individuals to help them guide their financial decisions.

GERMANY

Sometimes called the “Motherland of the Automotive Industry,” Germany is one of the world’s leading car manufacturers. From the luxurious Mercedes-Benz to the sleek and sporty Porsche to the unique and practical Volkswagen Beetle, Germans design cars that turn heads. In fact, the German-made Volkswagen Beetle has been called the “most popular vehicle of all time.”

The German economy has experienced ups and downs, but car manufacturing has remained one of its cornerstones. The industry pulls in over $90 million in sales within the country and over $145 billion from other countries. The United States, with its fondness for status cars, is Germany’s number one foreign market.

**Think Globally**

Automobile insurance is higher for someone who owns a sports car such as a Porsche. Why?
You may be able to get earthquake or flood insurance as an endorsement (addition of coverage) to a homeowners policy or through a state-run insurance program. The most serious earthquakes occur in the Pacific Coast region. However, earthquakes can happen in other regions, too. If you purchase a home in an area that has a high risk of earthquakes or floods, you may have to buy insurance for those risks.

**Renters Insurance**

**Why is it important for a renter to get renters insurance?**

For people who rent, home insurance coverages include personal property protection, additional living expenses coverage, and personal liability and related coverages. Renters insurance does not provide coverage on the building or other structures.

The most important part of renters insurance is the protection it provides for personal property. Many renters believe that they are covered under their landlords’ policies. However, that is true only when the landlord is liable for damage. For example, if bad wiring causes a fire and damages a tenant’s property, the tenant may be able to collect money from the landlord. Renters insurance is relatively inexpensive and provides protection similar to homeowners insurance.

**Home Insurance Policy Forms**

**What coverage is offered by each type of policy form?**

Home insurance policies are available in several forms. The forms provide different combinations of coverage. Some forms are not available in all areas.

The basic form (HO-1) protects against perils such as fire, lightning, windstorms, hail, volcanic eruptions, explosions, smoke, theft, vandalism, glass breakage, and riots. The broad form (HO-2) covers an even wider range of perils, including falling objects and damage from ice, snow, or sleet.

The special form (HO-3) covers all basic- and broad-form risks, plus any other risks except those specifically excluded from the policy. Common exclusions are flood, earthquake, war, and nuclear accidents. Personal property is covered for the risks listed in the policy.

The tenants’ form (HO-4) protects the personal property of renters against the risks listed in the policy. It does not include coverage on the building or other structures.

The comprehensive form (HO-5) expands the coverage of the HO-3. The HO-5 includes endorsements for replacement-cost coverage on contents and guaranteed replacement-cost coverage on buildings.

Condominium owners insurance (HO-6) protects personal property and any additions or improvements made to the living unit. These might include bookshelves, electrical fixtures, wallpaper, or carpeting. The condominium association purchases insurance on the building and other structures.
Manufactured housing units and mobile homes usually qualify for insurance coverage with conventional policies. However, some mobile homes may need special policies with higher rates that are dependent on the home’s location and the way it is attached to the ground. Mobile home insurance is quite expensive: A $50,000 mobile home can cost as much to insure as a $150,000 house.

Though some risks are not covered by home insurance (see Figure 13.3), home insurance policies do include coverage for additional costs:

- Credit card fraud, check forgery, and counterfeit money
- Removal of damaged property
- Emergency removal of property to protect it from damage
- Temporary repairs after a loss to prevent further damage
- Fire department charges in areas with such fees

How Much Coverage Do You Need?
What is the actual cash value method?

You can get the best insurance value by choosing the right amount of coverage and knowing the factors that affect insurance costs. Your insurance should be based on the amount of money you would need to rebuild or repair your house, not the amount you paid for it. As construction costs rise, you should increase the amount of coverage. In fact, today most insurance policies automatically increase coverage each year as construction costs rise.

Figure 13.3 Not Everything Is Covered

Certain personal property is not covered by homeowners insurance:

- Items insured separately, such as jewelry, furs, boats, or expensive electronic equipment
- Animals or fish
- Motorized vehicles not licensed for road use, except those used for home maintenance
- Sound devices used in motor vehicles, such as radios and CD players
- Aircraft and parts
- Property belonging to tenants
- Property contained in a rental apartment
- Property rented by the homeowner to other people
- Business property

Coverage Exclusions

Separate coverage may be available for personal property that is not covered by a homeowners insurance policy.

Give an example of another type of policy that would cover one of the items listed here.
In the past, many homeowners’ policies insured a building for only 80 percent of the replacement value. If the building were destroyed, the homeowner would have to pay for part of the cost of replacing it, which could be expensive. Today most companies recommend full coverage.

If you are borrowing money to buy a home, the lender will require that you have property insurance. The amount of insurance on your home determines the coverage on your personal belongings. Coverage for personal belongings is usually between 55 and 75 percent of the amount of insurance you have on your home.

Insurance companies base claim settlements on one of two methods. Under the **actual cash value** method, the payment you receive is based on the replacement cost of an item minus depreciation. Depreciation is the loss of value of an item as it gets older. This means you would receive less for a five-year-old bicycle than what you originally paid for it.

Under the **replacement value** method for settling claims, you receive the full cost of repairing or replacing an item. Depreciation is not considered. Many companies limit the replacement cost to 400 percent of the item’s actual cash value. Replacement value coverage is more expensive than actual cash value coverage.

### Home Insurance Cost Factors

**Why do the location and type of construction of your home affect your home insurance costs?**

The cost of your home insurance will depend on several factors, such as the location of the home and the type of structure and construction materials used. The amount of coverage and type of policy you choose will also affect the cost of your home insurance. Furthermore, different insurance companies offer different rates.
Location of Home

The location of your home affects your insurance rates. Insurance companies offer lower rates to people whose homes are close to a water supply or fire hydrant—or are located in an area that has a good fire department. Rates are higher in areas where crime is common. People living in regions that experience severe weather, such as tornadoes and hurricanes, may pay more for insurance.

Type of Structure

The type of structure and its construction influence the price of insurance coverage. A brick house, for example, will usually cost less to insure than a similar structure made of wood. However, earthquake coverage is more expensive for a brick house than for a wooden dwelling because a wooden house is more likely to survive an earthquake. Also, an older house may be more expensive to restore to its original condition. That means that it will cost more to insure.

Price, Coverage Amount, Policy Type

The purchase price of a house directly affects how much you pay for insurance. Therefore, it costs more to insure a $300,000 home than a $100,000 home. Also, the type of policy you choose and the amount of coverage you select affect the amount of premium you pay.
The deductible amount listed on the policy also affects the cost of insurance. If you increase the amount of the deductible, the premium will be lower because the company will pay out less in claims. The most common deductible amount is $250. Raising the deductible from $250 to $500 or $1,000 can reduce the premium you pay by 15 percent or more.

**Home Insurance Discounts**

Most companies offer discounts if a homeowner takes action to reduce risks to a home. Your premium may be lower if you have smoke detectors or a fire extinguisher. If your home has dead-bolt locks and alarm systems, which make it harder for thieves to get in, insurance costs may be lower.

**Company Differences**

A homeowner can save up to 25 percent on homeowners insurance by comparing rates from several companies. Some insurance agents work for only one company. Others are independent agents who represent several different companies.
Do not select a company on the basis of price alone. Also consider service and coverage. Not all companies settle claims in the same way.

For example, suppose that all of the homes on Evergreen Terrace are hit on one side by large hailstones. They all have the same kind of siding. Unfortunately, the homeowners discover that this type of siding is no longer available. So all the siding on all the houses will need to be replaced. Some insurance companies will pay to replace all the siding. Others will pay only to replace the damaged parts.

State insurance commissions and consumer organizations can give you information about different insurance companies. Consumer Reports, a magazine that provides unbiased information on a variety of goods and services, rates insurance companies on a regular basis.

Section 13.2 Assessment

QUICK CHECK
1. What are six home insurance policy forms and their coverages?
2. What type of coverage does a personal property floater provide?
3. How can the location of a home affect insurance costs?

THINK CRITICALLY
4. Describe at least two situations in which personal liability coverage might be required.

USE MATH SKILLS
5. Insurance Coverage  Homeowners insurance covers your personal possessions up to a percentage of the insured value of your home. When Carolina’s house burned down, she lost household items worth a total of $25,000. Her house was insured for $80,000, and her homeowners policy provided coverage for personal belongings up to 55 percent of the insured value of the house.

Calculate  Determine how much insurance coverage Carolina’s policy provides for her personal possessions and whether she will receive payment for all the items destroyed in the fire.

SOLVE MONEY PROBLEMS
6. Analyzing Insurance Costs  Kara and Adam Gottlieb are in the process of buying their first home. After months of shopping, they have narrowed down their choices to two. One is an older house near a river, where flooding occurs occasionally. The other is a newer house that is located farther from the river. They need to know how much homeowners insurance will cost for each house before making a final decision.

Analyze  Given this information, make your best educated guess about which house would be less expensive to insure.
Motor Vehicle Insurance

Motor vehicle accidents cost more than $150 billion in lost wages and medical bills every year. They can destroy people’s lives physically, financially, and emotionally. Buying insurance cannot eliminate the pain and suffering that vehicle accidents cause. However, insurance can reduce the financial impact.

Every state in the United States has a financial responsibility law, which is a law that requires a driver to prove he or she can pay for damage or injury caused by an automobile accident if he or she is at fault. As of 2003, more than 45 states had laws requiring people to carry motor vehicle insurance. When injuries and property damage occur in an accident, the driver(s) is required to file a report with the state. In the remaining states, most people buy motor vehicle insurance by choice. Very few people have the money they would need to meet the financial responsibility requirements on their own.

The coverage provided by motor vehicle insurance falls into two categories: protection for bodily injury and protection for property damage. (See Figure 13.4.)

Motor Vehicle Bodily Injury Coverages

Who is covered by bodily injury liability insurance?

Most of the money that motor vehicle insurance companies pay out in claims goes for legal expenses, medical expenses, and other costs that arise when someone is injured. The main types of bodily injury coverages are:

- Bodily injury liability
- Medical payments
- Uninsured motorist’s protection

Bodily Injury Liability

Bodily injury liability is insurance that covers physical injuries caused by a vehicle accident for which you are responsible. If pedestrians, people in other vehicles, or passengers in your vehicle are injured or killed, bodily injury liability coverage pays for expenses related to the crash.
Liability coverage is usually expressed by three numbers, such as 100/300/50. These amounts represent thousands of dollars of coverage. The first two numbers refer to bodily injury coverage. In the 100/300/50 example, $100,000 is the maximum amount that the insurance company will pay for the injuries of any one person in any one accident. The second number, $300,000, is the maximum amount the company will pay for all injured parties (two or more) in any one accident. The third number, $50,000, indicates the limit for payment for damage to the property of others. (See Figure 13.5.)
Medical Payments Coverage

Medical payments coverage is insurance for medical expenses of anyone injured in your vehicle, including you. This coverage also provides medical benefits for you and members of your family while riding in another person’s vehicle or if any of you are hit by a vehicle.

Uninsured Motorist’s Protection

Unfortunately, you cannot assume that everyone who is driving has auto insurance. You can guard yourself and your passengers against the risk of getting into an accident with someone who has no insurance by having uninsured motorist’s protection.

Uninsured motorist’s protection is insurance that covers you and your family members if you are involved in an accident with an uninsured or hit-and-run driver. In most states it does not cover damage to the vehicle itself. Penalties for driving without insurance vary by state, but they generally include stiff fines and the suspension of driving privileges.

Motor Vehicle Property Damage Coverages

What does comprehensive physical insurance cover?

One afternoon, during a summer storm, Carrie was driving home from her job as a hostess at a pancake house. The rain was torrential, and she could not see very well. As a result, she did not realize that the car in front of her had stopped to make a left turn, and she hit the car. The crash totaled Carrie’s new car. Fortunately, she had purchased insurance with property damage coverage. Property damage coverage protects you from financial loss if you damage someone else’s property or if your vehicle is damaged. It includes property damage liability, collision, and comprehensive physical damage.

Property Damage Liability

Property damage liability is motor vehicle insurance that applies when you damage the property of others. In addition, it protects you when you are driving another person’s vehicle with the owner’s permission. Although the damaged property is usually another car, the coverage also extends to buildings and to equipment such as street signs and telephone poles.

Collision

Collision insurance is insurance that covers damage to your vehicle when it is involved in an accident. You collect money no matter who is at fault. However, the amount that you can collect is limited to the actual cash value of your vehicle at the time of the accident. So keep a record of your car’s condition and value.
Comprehensive Physical Damage

Comprehensive physical damage insurance protects you if your vehicle is damaged in a non-accident situation. It covers your vehicle against risks such as fire, theft, falling objects, vandalism, hail, floods, tornadoes, earthquakes, and avalanches.

No-Fault Insurance

Why are some states adopting the no-fault system?

To reduce the time and cost of settling vehicle injury cases, some states are trying a number of alternatives, including the no-fault system. The *no-fault system* is an arrangement whereby drivers who are involved in accidents collect money from their own insurance companies. It does not matter who caused the accident. Each company pays the insured up to the limits of his or her coverage. No-fault systems and coverages vary by state.

Other Coverages

When is wage loss insurance required?

Several other kinds of motor vehicle insurance are available. For example, rental reimbursement coverage pays for a rental car if your vehicle is stolen or is being repaired. Wage-loss insurance pays for any salary or income you might have lost due to being injured in a vehicle accident. States that have adopted a no-fault insurance system usually require auto owners to carry wage-loss insurance. It is available by choice in other states.

Emergency road service coverage pays for mechanical assistance in the event that your vehicle breaks down. This can be helpful on long trips or during bad weather. If necessary, you can get your vehicle towed to a service station. However, once your vehicle arrives at the repair shop, you are responsible for paying the bill. If you belong to an automobile club, your membership may include towing coverage. If that is the case, paying for emergency road service coverage could be a waste of money.

Motor Vehicle Insurance Costs

Why is bodily injury liability coverage of 100/300 recommended?

Motor vehicle insurance is not cheap. The average household spends more than $1,000 for motor vehicle insurance yearly. The premiums are related to the amount of claims that insurance companies pay out each year.

Frank is a high school junior who recently got his license. At his part-time job, he earns minimum wage. Frank’s situation provides an example of what to consider to get the best insurance value—amount of coverage, insurance premium factors, and ways to reduce insurance premiums.
Amount of Coverage

The amount that Frank will pay for insurance depends on the amount of coverage he requires. He needs enough coverage to protect himself legally and financially.

Legal Concerns  As discussed earlier, most people who are involved in motor vehicle accidents cannot afford to pay an expensive court settlement with their own money. For this reason, most drivers buy liability insurance.

Many basic insurance policies provide 10/20 coverage for bodily injury liability. However, some accident victims have been awarded millions of dollars in bodily injury cases; therefore, coverage of 100/300 is usually recommended.

Property Values  Just as medical expenses amounts of and legal settlements have increased, so has the cost of vehicles. Therefore, Frank should consider a policy with a limit of $50,000 or even $100,000 for property damage liability.

Motor Vehicle Insurance Premium Factors

Vehicle type, rating territory, and driver classification are three other factors that influence insurance costs.

Vehicle Type  The year, make, and model of a vehicle affect insurance costs. High-priced vehicles and vehicles that have expensive replacement parts and complicated repairs cost more to insure. Also, premiums can be higher for those vehicle makes and models that are frequently stolen.

Rating Territory  In most states the rating territory, or owner’s place of residence, is used to determine the vehicle insurance premium. Different locations have different costs. For example, accidents and incidents of theft occur less frequently in rural areas. Your insurance would probably cost less than if you lived in a large city.

RATE QUOTES  Shopping around for the best auto insurance rate can save you money in the long run. What are some factors that may affect the rates offered by different companies?
Learn to identify and understand the standard financial documents you will use in the real world.

Investigate: An Auto Insurance Declaration
The declaration lists this information:
- Policy identification number
- Time period of insurance policy
- Amount of insurance coverage
- Premium amount

Your Motive: In most states the law requires that you insure your automobile. To protect yourself from financial loss, it is important to know exactly what your auto insurance covers and how much it will cost.

### The Premier Global Insurance Company Auto Declararions

<table>
<thead>
<tr>
<th>Policy Number</th>
<th>A02 0076215</th>
</tr>
</thead>
<tbody>
<tr>
<td>12:01 Standard Time at the Address of the Named Insured</td>
<td></td>
</tr>
</tbody>
</table>

#### Coverages and Limits of Liability

<table>
<thead>
<tr>
<th>Coverages</th>
<th>Vehicle 1</th>
<th>Vehicle 2</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Limit</td>
<td>Premium</td>
</tr>
<tr>
<td>A Bodily Injury and Property Damage</td>
<td>$1,000,000</td>
<td>$265.00</td>
</tr>
<tr>
<td>Each Accident</td>
<td>$5,000</td>
<td>$9.00</td>
</tr>
<tr>
<td>Bodily Injury</td>
<td>$76.00</td>
<td>$76.00</td>
</tr>
<tr>
<td>Each Accident</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>B Medical Payments</td>
<td>$5,000</td>
<td>$11.00</td>
</tr>
<tr>
<td>Other Than Collision</td>
<td>$63.00</td>
<td>$126.00</td>
</tr>
<tr>
<td>Actual Cash Value Less Deductible</td>
<td>$500.00</td>
<td>$500.00</td>
</tr>
<tr>
<td>Collision</td>
<td>$155.00</td>
<td>$271.00</td>
</tr>
<tr>
<td>Actual Cash Value Less Deductible</td>
<td>$500.00</td>
<td>$500.00</td>
</tr>
<tr>
<td>Additional Coverages</td>
<td>Included</td>
<td>Included</td>
</tr>
<tr>
<td>Transportation Expense</td>
<td>$20/$600</td>
<td>$20/$600</td>
</tr>
<tr>
<td>Towing and Labor Costs</td>
<td>$10.00</td>
<td>$10.00</td>
</tr>
<tr>
<td>Theft Coverage - Electronic</td>
<td>$50</td>
<td></td>
</tr>
<tr>
<td>GAP Coverage</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>$578.00</td>
<td>$833.00</td>
</tr>
</tbody>
</table>

#### Key Points: An auto insurance declaration details what is covered by the policy. It states what the policy will pay in the event of an accident. This includes damage to the car(s) and injury to people. The declaration also explains how the premium is determined.

#### Find the Solutions

1. What is the policy identification number?
2. What is the bodily injury payment limit?
3. How much will the policy pay for transportation expenses, such as renting a car?
4. How many vehicles are covered by this policy?
5. What is the cost of this policy?
**Driver Classification**  Driver classification is based on age, sex, marital status, driving record, and driving habits. In general, young drivers (under 25) and elderly drivers (over 70) have more frequent and more serious accidents. As a result, these groups pay higher premiums. Because Frank is under 25, he may have to pay a standard higher rate. Your driving record will also influence how much you pay for insurance premiums. If you have accidents or receive traffic tickets, your rates will increase.

The cost and number of claims that you file with your insurance company also affect your premium. If you file expensive claims, your rates will increase. If you have too many claims, your insurance company may cancel your policy, and it will be difficult to get coverage from another company. To deal with this problem, every state has an **assigned risk pool**, which is a group of people who cannot get motor vehicle insurance who are assigned to each insurance company operating in the state. These policyholders pay several times the normal rates. If they establish a good driving record, they can reapply for insurance at regular rates.

**Reducing Vehicle Insurance Premiums**

Two ways in which Frank can reduce his vehicle insurance costs are by comparing companies and by taking advantage of discounts.

**Comparing Companies** Rates and services vary among motor vehicle insurance companies. Even among companies in the same area, premiums can vary by as much as 100 percent. Frank should compare the services and rates of local insurance agents. Most states publish this type of information. Furthermore, Frank can check a company’s reputation with sources such as *Consumer Reports* or his state insurance department.

**DRIVER CLASSIFICATION**

A driver’s age affects the price of insurance premiums. Who is likely to pay more for insurance—teenagers or parents? Why?
Premium Discounts  The best way for Frank to keep his rates down is to maintain a good driving record by avoiding accidents and traffic tickets. In addition, most insurance companies offer various types of discounts.

Because Frank is under 25, he can qualify for reduced rates by taking a driver training program or maintaining good grades in school. In addition, installing security devices in his vehicle will decrease the chance of theft and lower Frank’s insurance costs. Being a nonsmoker can qualify him for lower motor vehicle insurance premiums as well. Discounts are also offered for insuring two or more vehicles with the same company. Increasing the amounts of deductibles will also lead to a lower premium. For example, an older car may not be worth the cost of carrying collision and comprehensive coverage.

No matter what coverage you choose, motor vehicle insurance is a valuable and mandatory protection to include in any personal finance plan.

Section 13.3 Assessment

QUICK CHECK
1. What are three main types of motor vehicle insurance that cover bodily injuries?
2. What is the difference between collision and comprehensive physical damage coverages?
3. Why do some insurance companies offer discounts to drivers who install security devices in their vehicles?

THINK CRITICALLY
4. Explain some ways you might reduce motor vehicle insurance premiums.

USE COMMUNICATION SKILLS
5. Drinking and Driving  Alcohol use is a factor in more than 60 percent of all traffic accidents. Interview classmates, parents, and others to get their views on what can be done to reduce alcohol-related traffic incidents. Consider contacting an organization such as MADD (Mothers Against Drunk Driving) for information.

Present  You have probably seen or heard public service announcements urging people not to drink and drive. Use what you have learned to create your own public service announcement. It may be in the form of a radio or television script. If possible, get some friends to help you produce your spot, using audio or video recording equipment.

SOLVE MONEY PROBLEMS
6. Cost of Motor Vehicle Insurance  Malcolm wants to buy an expensive sport-utility vehicle. However, his mechanic has warned him that the replacement parts for the vehicle that he wants are costly. His friend Ishiro is on a tight budget and does not have a car. He is considering buying a car that has low maintenance costs. Malcolm and Ishiro live in the same neighborhood. Malcolm has never had a traffic accident, but he received one traffic ticket last year. Ishiro’s driving record is perfect.

Analyze  Who will have a lower car insurance rate? Why?
• Risk is the probability of loss or injury; peril is something that may cause a loss; hazards increase the probability of loss; and negligence is failing to take reasonable care to prevent accidents. Risk avoidance, risk reduction, risk assumption, and risk shifting are ways of managing risk.
• Insurance involves the risk management method of shifting risk: In exchange for fees, the insurance pays for losses.
• Property insurance protects from losses resulting from natural causes, fire, and criminal activity. Liability insurance covers legal responsibility for the cost of losses to others.
• Homeowners insurance covers the building, living expenses, personal property, and personal liability.

Renters insurance covers personal possessions, living expenses, and personal liability.
• Factors affecting the cost of homeowners insurance are home location, structural type, coverage amount and policy type, discounts, and differences among insurance companies.
• The types of motor vehicle insurance include bodily injury liability, medical payments coverage, uninsured motorist’s protection, property damage liability, collision, and comprehensive physical damage coverage.
• Factors affecting the cost of motor vehicle insurance include the amount of coverage, type of vehicle, rating territory, and driver classification.

Communicating Key Terms
Your older brother is preparing to take the state test for an insurance license. Help him review the following terms by making up fill-in-the-blank sentences that define each term.

• insurance
• policy
• premium
• risk
• peril
• hazard
• negligence
• deductible
• liability
• homeowners insurance
• personal property floater
• medical payments coverage
• actual cash value
• replacement value
• bodily injury liability
• uninsured motorist’s protection
• property damage liability
• collision
• no-fault system
• assigned risk pool

Reviewing Key Concepts
1. Identify each type of risk and list the four methods of managing risk.
2. Describe how insurance uses different risk management methods to reduce risk.
3. Explain how property and liability insurance protect.
4. Identify reasons that home mortgage lenders require homeowners insurance.
5. Explain the difference between actual cash value and replacement value.
6. List advantages and disadvantages of the no-fault insurance system.
7. Discuss why lenders require drivers to carry bodily injury and property damage coverage.
**Geography** Prices for insurance vary in different areas of the United States. For example, auto insurance may be less expensive in rural areas.

**Research** Look at a map of the United States. Find your town or city, Los Angeles, Chicago, Dallas, and Orlando. Research the population and average cost of auto insurance in each of these cities. Compare the cost to the population of each city. Is there a connection? If so, explain.

**Insurance Deductibles** The annual premium for a 2,500 square foot home in a medium-sized Midwestern city was $628 in 2005—with discounts for a home security system, a good claims record, and the combination of home and auto insurance policies. Replacement cost for the dwelling is estimated at $237,000, and the current deductible is $1,000. The insurance company offered to reduce the premium by $73 if the policyholder agreed to increase the deductible to 1 percent of the replacement cost.

1. **Calculate** the new premium amount and new deductible amount.
2. **Compute** by using the Internet to locate and compare homeowners premium and coverage information from five insurance companies.

**Connect with Ethics and Social Studies** Laws and penalties for driving under the influence (DUI) are extremely strict in many states. Furthermore, the number of motor vehicle accidents involving young drivers has increased and become more serious, resulting in more deaths and injuries.

1. **Research** Access the Web site of your state’s department of motor vehicles for the laws and penalties for DUI. Also check in your local newspaper for recent accidents involving young drivers.
2. **Think Critically** Why are DUI penalties so stringent? Do you think the higher insurance premiums charged to younger drivers are “fair”? Why?

**Risk Assessment** Actuaries determine the costs and risks involved with insuring people’s property. Actuaries are experts in evaluating the likelihood of future events. They design creative ways to reduce the likelihood of undesirable events and decrease the impact of undesirable events that occur.

**Log On** Go to the Web sites of insurance companies and the Society of Actuaries to find out factors that affect the cost of homeowners insurance. Answer the following questions:

1. Should any of these factors influence decisions when buying a home?
2. How can homeowners premiums be reduced?

**Newsclip: Higher Rates** Car insurance companies charge higher rates for male teenagers than female teenagers.

**Log On** Go to finance07.glencoe.com and open Chapter 13. Learn about why insurance companies raise rates for males and not females. Write a list of reasons for this practice.
VEHICLE INSURANCE QUIZ

When you insure your vehicle, you will need to make decisions about the insurance you carry. Test your knowledge about motor vehicle insurance by answering questions on a separate sheet of paper.

1. Liability coverage pays for __________
   a. theft, fire, vandalism, or other damages not related to an accident
   b. the accident-related cost of repairing or replacing your vehicle
   c. damage or injury for which you are responsible

2. Collision coverage pays for __________
   a. theft, fire, vandalism, or other damages not related to an accident
   b. the accident-related cost of repairing or replacing your vehicle
   c. damage or injury for which you are responsible

3. Comprehensive coverage pays for __________
   a. theft, fire, vandalism, or other damages not related to an accident
   b. the accident-related cost of repairing or replacing your vehicle
   c. all the items that passengers lose in the backseat of your vehicle

4. If you are in an accident, your vehicle insurance medical coverage handles __________
   a. only people injured in your vehicle
   b. anyone injured
   c. only people injured who were not in your vehicle

5. A higher deductible results in __________
   a. a higher premium
   b. a lower premium
   c. tax savings

6. Speeding tickets or accidents may result in __________
   a. a higher premium
   b. a lower premium
   c. migraine headaches

7. Safety features such as antitheft devices and automatic seat belts may result in a __________.
   a. higher premium
   b. lower premium
   c. higher resale value

8. Taking driver education classes may result in a __________.
   a. higher premium
   b. lower premium
   c. later curfew
Your Financial Portfolio

The Price of Car Insurance

Before Mario bought the car he wanted, he needed to be sure he could afford the insurance for it. In this example he chose low liability, uninsured motorist coverage, and high deductibles to keep his insurance payments as low as possible. Clearly, Insurer B offered a lower price for the same coverage.

<table>
<thead>
<tr>
<th>Investigating Insurance Companies</th>
<th>Insurer A</th>
<th>Insurer B</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Bodily Injury Coverage:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bodily injury liability $50,000 each person; $100,000 each accident</td>
<td>$472</td>
<td>$358</td>
</tr>
<tr>
<td>Uninsured motorist’s protection</td>
<td>208</td>
<td>84</td>
</tr>
<tr>
<td>Medical payments coverage $2,000 each person</td>
<td>48</td>
<td>46</td>
</tr>
<tr>
<td><strong>Property Damage Coverage:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property damage liability $50,000 each accident</td>
<td>182</td>
<td>178</td>
</tr>
<tr>
<td>Collision with $500 deductible</td>
<td>562</td>
<td>372</td>
</tr>
<tr>
<td>Comprehensive physical damage with $500 deductible</td>
<td>263</td>
<td>202</td>
</tr>
<tr>
<td><strong>Car Rental:</strong></td>
<td>40</td>
<td>32</td>
</tr>
<tr>
<td><strong>Discounts:</strong> good driver, air bags, garage parking</td>
<td>(165)</td>
<td></td>
</tr>
<tr>
<td><strong>Annual Total</strong></td>
<td>$1,610</td>
<td>$1,272</td>
</tr>
</tbody>
</table>

Research

Identify a make, model, and year of a vehicle you might like to own. Research two insurance companies and get prices using this example. You can get their rates by telephone. Many companies also have Web sites. On a separate sheet of paper, record your findings. How do they compare? Which company would you choose and why?