Lesson 7.5: Everything You Ever Wanted to Know about Car Insurance

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*Lesson adapted from The National Council on Economic Education, "Everything You Ever Wanted to Know About Automobile Insurance"

Standards and Benchmarks

See pages 4

Lesson Description

In this lesson, students will learn basic information about automobile insurance in order to help them make better choices when they buy these policies. First, students will read about the different coverages offered in auto insurance policies and work to identify which type of coverage would be used in various scenarios. Next, students will brainstorm reasons as to why various lifestyle factors may cut the cost of auto insurance for individuals. Students will then analyze data to understand why car insurance rates differ for different age groups and genders. They will finish the lesson by calculating car insurance premiums for two different drivers. To obtain answer keys for the handouts and assessment in this lesson, create an account on FederalReserveEducation.org.

Concepts

Decision Making
Insurance
Liability
Risk
Types of automobile insurance

Objectives

Students will be able to:

- identify the automobile insurance coverage that would apply to various accident situations.
- identify common discounts insurance companies offer and explain why the companies offer these discounts.
- explain why automobile insurance rates vary for different age groups and different sexes.
- define the nature of financial responsibility laws and explain why many states have them.
- comparison shop for automobile insurance coverages.

Compelling Question

How does car insurance work?

Time Required

60 minutes

Materials

- Handout 7.5.1: What Are All Those Auto Insurance Coverages?, one copy for each student
- Handout 7.5.2: What's My Coverage?, one copy for each student
- Handout 7.5.3: How to Cut the Cost of Your Car Insurance, one copy for each student
- Handout 7.5.4: Why the High Cost of Car Insurance for Young People?, one copy for each student
- Handout 7.5.5: Car Insurance Comparison Assessment, one copy for each student
- Answer Key 7.5, one copy for teacher

Procedure

1. Begin the lesson by asking students the following questions:

    a. Approximately how much do you think the average monthly car insurance premium is for a 16 year old driver (*$457/month*)? What about a 50 year old driver (*$97/month*)?

    b. Why do you think that insurance companies charge teenage drivers so much more than adults? (*Answers will vary, but may include: Teenagers have less experience driving and therefore may get into more accidents*.)

2. Explain to students that they will be completing a variety of activities in this lesson that will give them insight into the types of coverages that make up an auto insurance policy, as well as different factors that go into the cost of car insurance.

3. Provide each student with a copy of Handout 7.5.1: What Are All Those Auto Insurance Coverages?, and have students read the information regarding the different types of coverage associated with car insurance policies.

    NOTE: Because states require different coverages and have different mixes of fault and no-fault insurance, you should be knowledgeable about coverages unique to your state.

4. Give each student a copy of Handout 7.5.2: What's My Coverage?. Have students work in partners to complete the activity. In Part I, they will read each scenario and determine which type of coverage applies. In Part II, they will try to determine the dollar amount that insurance will cover.

5. Upon students finish, review the correct answers. After reviewing the answers, ask students, "What are some general principles you should follow in getting car insurance?" (*Answers will vary but can include "Buy the coverages required by your state, but consider buying more than the minimum coverages if you can afford the higher premium. Make sure that you at least have bodily-injury and property-damage liability since the risk of large losses occurs when you damage something or hurt someone else in an accident."*)

6. Distribute Handout 7.5.3: How to Cut the Cost of Your Car Insurance to each student. Explain to students that insurance companies often give discounts on car insurance. In this activity students will brainstorm reasons as to why these factors would provide a discount.

Students will work in pairs, or in small groups of 3-4 students. Upon completion, review the answers with the class.

7. Distribute Handout 7.5.4: Why the High Cost of Car Insurance for Young People? to each student. In this activity, students will review data that shows fatalities from car accidents by drivers' and passengers' age groups. Have students work independently to complete the handout. Upon completion, review the answers with students.

Closure

8. Review important points of the lesson by asking students the following questions:
   a. Why do many states have financial responsibility laws that require auto insurance? (*Drivers can damage other people and property through their use of their vehicles. Individual drivers should be responsible for their actions, which means that they should pay for the damages they cause.*)
   b. What two coverages should everyone have, regardless of state requirements? Why are these coverages so important? (*Bodily-injury liability and property-damage liability. Injuring people or damaging property can involve major losses that most people cannot afford to pay without insurance.*)
   c. Why should a consumer comparison shop for automobile insurance? (*Prices and coverages vary among insurance companies. To get the best insurance for your money, it is a good idea to comparison shop.*)

Assessment

9. Distribute Handout 7.5.5: Car Insurance Comparison Assessment to each student. Students will use the information from the table in Part I to calculate quotes for two different drivers and complete the Check for Understanding questions to assess their knowledge.

Standards and Benchmarks

National Standards for Personal Financial Education

Standard 6: Managing Risk

People are exposed to personal risks that can result in lost income, assets, health, life, or identity. They can choose to manage those risks by accepting, reducing, or transferring them to others. When people transfer risk by buying insurance, they pay money now in return for the insurer covering some or all financial losses that may occur in the future. Common types of insurance include health insurance, life insurance, and homeowner's or renter's insurance. The cost of insurance is related to the size of the potential loss, the likelihood that the loss event will happen, and the risk characteristics of the asset or person being insured. Identity theft is a growing concern for consumers and businesses. Stolen personal information can result in financial losses and fraudulent credit charges. The risk of identity theft can be minimized by carefully guarding personal financial information.

Benchmarks: Grade 12

1. People vary with respect to their willingness to accept risk and in how much they are willing to pay for insurance that will allow them to minimize future financial loss.

4. Insurance premiums are lower for people who take actions to reduce the likelihood and/or financial cost of losses and for those who buy policies with larger deductibles or copayments.

Handout 7.5.1: What Are All Those Insurance Coverages? (Page 1 of 3)

Directions: The typical automobile-insurance policy includes a considerable number of coverages that pay others for damages the insured person causes and pay the insured for damages he or she suffers in an accident. Let's take a look at some of the common coverages and when they apply.

1. Bodily-Injury Liability: The name given to this coverage explains what it is all about. Liability means legal responsibility. Put this together with bodily injury, and it means that **this coverage pays off when the insured has caused an accident and people require care, such as hospitalization, as a result**. This coverage applies to people in other cars and in the insured's car, unless they are members of the insured's immediate family (spouse, children and siblings). The coverage is stated in terms of maximum payouts per person and accident: $50,000/$100,000 means a maximum of $50,000 for each injured person and $100,000 for each accident. Many states require a minimum for this coverage — such as 20/40 ($20,000 per injured person, $40,000 for each accident) — that each driver must have to register a car or obtain license plates. If this minimum does not cover all of the costs from the accident, the additional amount must come out of the pocket of the insured. That's why some people carry much more than the required minimum coverage, especially since the additional coverage is not that expensive. Some people base their coverage on the amounts that defendants are awarded in local bodily-injury liability lawsuits. Other people rely on their insurance agents to give them guidance about the level of coverage they should purchase.

2. Property-Damage Liability: This coverage kicks in when the insured causes an accident that damages another person's property such as a car or a fence. Many states require a minimum amount of property-damage liability coverage, and many experts suggest a minimum of $25,000 because of the current value of vehicles. Since property-damage liability coverage is relatively inexpensive, it is a good idea to have $50,000 worth.

Insurance companies have a special way of expressing liability coverages: 100/300/25 means that the policy provides a maximum of $100,000 for each injured person, $300,000 for each accident and $25,000 for property damage.

Regardless of whether a state requires automobile insurance, it is important for every driver to have at least the bodily-injury liability and property-damage liability coverages. Why? Because the driver can suffer the highest losses if he or she causes an accident in which someone else is injured or something other than the driver's property is damaged.

3. Collision: This coverage pays for damages to the insured's car when he or she causes an accident. Many people buy this coverage with a deductible, which is the amount of loss the insured will assume when the vehicle is damaged. For example, suppose the cost of repairing a vehicle is $3,000 and the insured has collision coverage with a $500 deductible. In this case, the insured would pay the first $500 in damages, and the insurance company would pay the remaining $2,500. One way to cut your premium cost is to get a higher deductible, because the higher the deductible, the lower the premiums for this coverage.

Insurance companies will not pay more than book value to fix a vehicle, or what the vehicle was worth before an accident. Assume that you have insurance with a $500 deductible. You are in an accident, the cost of fixing your car is $4,000, and the vehicle is worth only $3,000. Most insurance companies will consider your car "totaled," or damaged beyond repair, and will give you a cash settlement equal to the value of your car less the deductible — in this case, $2,500: $3,000 minus $500. A few insurance companies will write collision coverage with the provision that they will replace a car with a new car if the vehicle has been totaled. Keep in mind, though, that the premiums for this type of coverage are higher than if the insurance company based its coverage on the book value of the car.

You should drop collision coverage if your vehicle becomes so old that it has little book value. For example, if you have a car worth $1,000 and collision coverage with a $1,000 deductible, the insurance company won't pay you anything if your car is damaged in an accident.

4. Comprehensive: This coverage pays for damages to the insured's car caused by situations other than collision such as theft, fire, earthquake, weather, explosions, riots, and collisions with birds or animals. Suppose that a hailstorm damages the paint on your vehicle. Comprehensive coverage would provide money for a new paint job. Comprehensive, like collision, coverage has a deductible. If a new paint job costs $2,000 and the deductible is $500, the insurance company will pay $1,500.

In some instances, comprehensive coverage includes a provision that provides a certain amount per day, such as $20, to pay for another means of transportation. This applies when the policyholder cannot use his or her vehicle for a period of time because the car is damaged. There is a maximum amount, such as $600 and 30 days, for each accident. Most people use this money to rent a car. Insurance companies are increasingly offering this coverage separately, however.

Handout 7.5.1: What Are All Those Insurance Coverages? (Page 3 of 3)

5. Medical Payments: This covers medical and death benefits for you, your family members and others riding in your car who are injured or who die because of an accident, no matter who is at fault. This is stated as a maximum amount, such as $5,000, for each individual. For example, if you have an accident and three of your sisters and brothers are injured, the insurance company will pay up to $5,000 for each person for medical expenses. Medical payments coverage also covers you and your family if you and/or they are injured or die in an accident while riding in another person's car. If you cause an accident and you have health insurance, your health insurance should cover the injuries to you and your family. But health insurance does not provide a death benefit. This is one reason why people carry medical-payments coverage. Another reason is because their state requires it. A third reason is that it supplements bodily-injury liability coverage for nonfamily members who are riding in your automobile. Medical payments coverage generally supplements other types of coverage.

6. Personal Injury: Some states, particularly those with no-fault laws, require this coverage. Even if it is not required, you should purchase it because **it covers not only doctor bills but also wages lost because of an accident. It also covers the cost if the insured person is injured and must hire someone to assume responsibilities, such as household chores, that he or she cannot do because of the accident.** Suppose you are a young parent with small children. If you are unable to care for them after an accident, this coverage will provide money to pay someone to come into your home and take care of them. This coverage is generally inexpensive.

7. Uninsured and Underinsured Motorist: Many states require this coverage; but even if it is not required, it is important to have and is relatively inexpensive. **This coverage kicks in when the other driver is at fault and does not have any insurance or enough insurance to pay for the damages you suffer — not only the medical bills but also lost wages and pain and suffering.** This coverage also applies if you or a member of your family is injured by a hit-and-run driver who is never identified. This coverage is stated, like bodily-injury liability, as two numbers: One is the maximum amount of coverage for one person, and the other is the maximum coverage for the entire accident.

Automobile insurance is based on the principle of fault. The person who is at fault in an accident must pay for the damages that result. While this may sound like a very easy process to implement, insurance companies often use lengthy court cases to prove who was at fault. Injured people often must wait a long time before they get a settlement. Several states have implemented no-fault laws, which vary from state to state. These laws don't eliminate the principle of fault but require insurance companies to pay their own policyholders the damages sustained in accidents. Insurance companies are not allowed to sue each other if the damages are below a minimum amount, but they can sue if the damages are above the minimum. In either case, policyholders do not have to wait to get settlements.

Handout 7.5.2: What's My Coverage? (Page 1 of 3)

Part I

Directions: Imagine that you are a licensed driver. Listed below are various situations that could occur to you or your automobile. If you are in an accident, suppose that you and the other driver have insurance with all the following types of coverages. Which coverage would pick up the costs associated with each situation?

Types of Coverages

Bodily-Injury Liability
Property-Damage Liability
Collision
Comprehensive
Medical Payments
Personal Injury
Uninsured and Underinsured Motorist

A. Someone vandalizes your car with spray paint.

B. You are injured by a hit-and-run driver as you are walking along the road.

C. Your car is in the shop because of an accident you caused. You need money to rent a car while your vehicle is being fixed.

D. You have medical costs from an accident another driver caused.

E. You destroy a fence in an accident that is your fault.

F. Your car is completely destroyed by a fire in your garage.

G. Your car is damaged as a result of an accident that you caused.

H. You injure two people in another car. You caused the accident.

Handout 7.5.2: What's My Coverage? (Page 2 of 3)

I. You hit a deer, which mangles the front end of your car.

J. Someone rams into your home with his car.

K. Your car is damaged because of an accident that the other driver causes.

L. You are in a serious accident that the other driver causes. You suffer $80,000 in medical bills, but the other driver has only $40,000 maximum coverage for bodily-injury liability. Which coverage picks up the remaining $40,000?

M. You live with an elderly parent. You get into an accident and cannot care for your parent anymore. You must hire someone else. In a no-fault state, which coverage will provide money for hiring this person?

Part II

Directions: In Part II, your job is to figure out the dollar amount that insurance will cover.

N. You cause an accident that injures three people seriously. Their costs from the accident are $400,000. You have a maximum of $300,000 coverage under bodily-injury liability. How much are you responsible for from your own pocket?

O. You cause an accident; the body shop says that it will cost $5,000 to fix your car. The car was worth $4,500 before the accident. How much will you receive from the insurance company if you have collision coverage with a $500 deductible?

Handout 7.5.2: What's My Coverage? (Page 3 of 3)

P. You are seriously injured in an accident caused by another driver. She has $25,000 bodily-injury liability insurance, and your insurance company has found that she cannot afford to give you any more than this $25,000. You have $25,000 uninsured/underinsured motorist coverage. Your costs from the accident total $55,000. How much out-of-pocket cost will you have for this accident?

Q. You are in an accident that is the other driver's fault. You suffer $10,000 in medical costs as a result. How much will your bodily-injury liability coverage give you toward the $10,000 damages?

R. You rent a car because your car is in the shop getting fixed after an accident. Your comprehensive insurance provides $30 a day for other transportation up to a maximum of $900. You have the rental car for 20 days, and it costs you $25 a day. How much out-of-pocket cost will you pay?

Handout 7.5.3: How to Cut the Cost of Your Automobile Insurance

Directions: Insurance companies often offer discounts on automobile insurance, though not all companies offer the same discounts. Why might insurance companies offer each of the following discounts?

A. The insured has a good driving record.

B. The insured is over 50 years of age.

C. The insured's car has antilock brakes.

D. The insured drives fewer than 5,000 miles per year.

E. The insured has taken a defensive driving course.

F. The insured is a high school student with a B or higher average in school.

G. The insured's vehicle has antitheft devices.

H. The insured's family has a number of insurance policies with the same company.

I. The insured's vehicle is a lower-priced, instead of a higher-priced, model.

J. The insured lives in an area with few people, not in an area with a lot of people.

Handout 7.5.4: Why the High Cost of Auto Insurance for Young People? (Page 1 of 2)

Directions: Study the data below and answer the questions that follow. As you answer the questions, keep in mind that insurance companies use this data to help determine the probability of accidents for each age group.

Fatal Crash Involvements per 100,000 Licensed Drivers, 2023

Age Group	Male Rate	Female Rate	Gap
15-20	60.94	22.47	2.7x
21-24	51.79	17.83	2.9x
25-34	42.93	14.71	2.9x
35-44	36.45	11.94	3.1x
45-54	33.19	10.38	3.2x
55-64	30.50	8.75	3.5x
65+	23.70	8.81	2.7x

Source: National Highway Traffic Safety Administration, 2023

A. Are female or male drivers generally involved in more fatal crashes? Does this vary by age group? If so, how?

B. Which three driver age groups have the highest rate of fatal crashes for males and females? Why do you think that may be the case?

Handout 7.5.4: Why the High Cost of Auto Insurance for Young People? (Page 2 of 2)

C. Erica and Juan, both 17 years old, find it difficult to get car insurance in their own names. Many companies will not accept them as risks. Their insurance has to be a part of their parents' policies. Both sets of parents have the same insurance company and similar makes and models of cars. They also have the same insurance coverages, and each pays an annual premium of about $1,200 a year. When the parents ask about adding their children to the policies, they learn that the annual cost for Erica will be $2,100, and the cost for Juan will be $3,200. Why do you think there is such a big difference between the premiums for Erica and Juan, and why are their premiums so much higher than their parents'?

D. Insurance representatives will tell you that insurance premiums decline considerably at age 25 for both males and females. Looking at the data, why do you think this is true?

E. Do you think it is fair that younger people pay higher premiums than people in the 25-74 age range? Do you think it is fair that men pay more than women for car insurance? Why or why not?

Handout 7.5.5: Car Insurance Comparison Assessment (Page 1 of 2)

Part I: The Market Data (2026 Estimates)

Insurance companies use different formulas to determine your premium. Use this rate sheet to calculate quotes for the drivers below.

Insurance Company	Base Monthly Rate (18 yr. old)	Accident Surcharge	Good Student Discount (GPA= 3.0+)	Annual Mileage Surcharge (over 10k miles/yr)	Safety/Tech Discount (car is less than 3 yrs. old)
Summit Auto Insurance	$480	+$140	10% off Base Rate	+$50	-$40
Shield Guard Mutual	$540	+$70	20% off Base Rate	+$20	-$70
Velocity Coverage	$510	+$110	15% off Base Rate	+40	-$25

Part II: The Drivers

Driver: Leo; age 18
Record: Clean; no accidents
GPA: 3.9 (Qualifies for Good Student Discount)
Mileage: 12k per year
Vehicle: 2018 sedan

Monthly Quotes
Summit Auto Insurance:

Shield Guard Mutual:

Velocity Coverage:

Handout 7.5.5: Car Insurance Comparison Assessment (Page 2 of 2)

Driver: Sarah, age 18
Record: 1 at-fault accident
GPA: 2.5 (No Good Student Discount)
Mileage: 8k per year
Vehicle: 2026 pickup truck

Monthly Quotes
Summit Auto Insurance:

Shield Guard Mutual:

Velocity Coverage:

Part III: Check For Understanding

1) Which company offered the best overall value for Leo? What about Sarah?

2) Why would a company like *Shield Guard* have a higher base rate but a lower accident surcharge?

3) If you and your friend both drive the exact same car model, list and explain three reasons why your monthly premium could still be completely different.