

OVERVIEW OF INSURANCE (30-1)

EO 1. **INSURANCE** is one way to treat **loss exposures** (conditions that create the possibility of financial loss). Insurance transfers **risk** (the chance of financial loss) from the **insured** (the entity covered by the insurance policy) to the **insurance company (aka insurer)**.

The insured pays an **insurance premium** (a periodic fee) in exchange for the insurer's promise to reimburse the insured for any covered losses.

In effect, **insureds share the risks** when they buy insurance because **the insurer pools premiums** and uses them to **pay for losses**.

The claimant presents a demand for payment of a loss (**claim**).

A **claim representative (CR) aka a claim rep** is the insurer's representative responsible for settling claims.

THREE UNDERLYING PRINCIPLES OF INSURANCE:

1. **The principle of indemnity**--states that no insured should profit from a covered loss. The insured is compensated **only** for the amount of financial loss.
2. **The law of large numbers**--lets insurers predict the group's losses and charge adequate premiums to cover those losses. **The law of large numbers states** that as the number of similar, independent, exposure units (cars, homes, lives) increases, the relative or percentage accuracy of loss predictions increases.
3. **Insurable interest**--exists in property if a person would suffer a financial loss from damage to the property. An applicant **may** buy insurance **only** if he has an insurable interest in the insured property, but he still must meet the insurer's guidelines before he **can** buy insurance.

THE EIGHT BENEFITS OF INSURANCE:

1. **Indemnification for loss**--Insurance restores people to their pre-loss conditions, thereby stabilizing society.
2. **Peace of mind**--Insurance reduces uncertainty and anxiety as we can all better predict our financial losses and therefore worry a lot less.
3. **Loss control**--Insurers, to control claims expenses and lower premiums, recommend **loss controls** (measures to reduce the frequency and/or severity of loss).
4. **Efficient use of resources**--We need to set aside less 'for a rainy day' because insurance makes our futures more secure. **That extra money, not held in savings accounts,**
 - a. improves our current quality of life (buying new cars, homes, and dinners at restaurants),
 - b. lets us invest more in our businesses, **and**
 - c. lets us save more for our retirements.
5. **Support for credit--Lenders take**
 - a. **liens** on personal property **and**
 - b. **mortgages** on real property**to secure (guarantee repayment of) loans.**

But, if that property were destroyed, they could not **repossess** personal property or **foreclose** on real property. So, lenders require that their collateral be insured.
6. **Satisfaction of legal and business requirements--Insurance allows**
 1. automobile owners to meet auto financial responsibility laws,
 2. employers to satisfy workers' compensation laws,
 3. building contractors to meet surety requirements, **and**
 4. other service professionals to meet liability insurance requirements.
7. **A source of investment funds**--Insurers use premiums to invest in businesses and social projects.
8. **Reduction of social burdens**--People who suffer losses often become burdens to society if they don't have enough life, medical expense, disability income, workers' compensation, auto liability, or unemployment insurance.

THE FIVE COSTS OF INSURANCE:

1. **Premiums**--Insurers collect premiums to pay losses and cover business costs.
2. **Insurers' operating costs**--**Insurers pay** salaries, commissions, advertising, *and* overhead expenses.
The cost of insurance also includes a reasonable profit for the insurers.
3. **Opportunity costs**--Money and labor used in the insurance industry are not available to be productive elsewhere.
4. **Increased losses**--**Insurance can result in**
 - a. **moral hazards**--**involve active inducement of loss** (as when an insured wants the insurance money more than his car or building or when he knowingly claims more than he is justly entitled to under his policy) *and*
 - b. **morale (attitudinal) hazards**--**involve passive indifference to loss** (which results when people are less worried about whether they will suffer a loss because they're insured).
5. **Increased litigation**--Many people view insurance as a pool of 'free money'.
That attitude might encourage people to sue and juries to award larger verdicts.

EO 2. THE TWO PARTIES TO AN INSURANCE POLICY:

1. **Insureds**--**include**
 - a. individuals and families who buy **personal insurance** *and*
 - b. for-profit businesses and nonprofit organizations that buy **commercial insurance**.An insured who suffers a covered loss files a **first-party claim** against its insurer.
2. **Insurers**--accept insureds' exposures, collect premiums, and pay covered losses.
 - a. **Private insurers**--are owned by individuals or non-governmental organizations. They are formed to meet the needs of insureds *and* to make a profit or to share the costs of insurance. Private insurers include property-casualty insurers and life and health insurers.
 - b. **Government insurance programs**--**include** flood insurance, Social Security (retirement benefits and Medicare), Medicaid, crop insurance, *and* state unemployment and workers' compensation insurance.
Government insurance programs address the problem of **adverse selection** (Entities with a higher-than-average chance of loss are the entities most likely to buy insurance.).
Example: Flood insurance is not readily available in the private market because only people who live in areas prone to floods want to buy flood insurance.

OTHER BENEFICIARIES OF INSURANCE--An individual who suffers bodily injury or property damage due to the insured's actions can file a **third-party claim** against the insured and its liability insurer.

EO 3. PARTIES THAT PROVIDE INSURANCE PRODUCTS AND SERVICES:

1. **Producers**--sell insurance products. **Agents** represent insurers. **Brokers** represent insureds.
2. **Underwriters**--decide which applicants to accept at what price under what terms and conditions in order to earn a profit.
Underwriters monitor the exposures and loss experience on the policies written.
3. **Loss control specialists**--prevent and minimize losses to hold down premium costs.
Loss control specialists perform loss control surveys, analyze the results, make loss control recommendations, *and* summarize their findings in loss control reports for underwriters.
4. **Actuaries**--calculate rates, develop rating plans, and set loss reserves.
Actuaries strive to develop rates that are both competitive and equitable.
5. **Claim representatives**--investigate, evaluate, and settle claims.
They perform the insurer's duties to first-party insureds and third-party claimants after losses.
6. **Special investigation unit (SIU) personnel**--investigate suspicious claims and possible fraud.
7. **In-house counsel**--represent the insurer and insured in court proceedings.

INSURANCE DISTRIBUTION AND MARKETING SYSTEMS:

1. **The independent agency system--uses independent agents who**
 - a. are independent contractors,
 - b. represent several insurers,
 - c. are paid by commission, *and*
 - d. own their expirations (ie, have the exclusive right to solicit policy renewals).
2. **The exclusive agency system--uses exclusive agents who**
 - a. are independent contractors,
 - b. represent only one insurer, *and*
 - c. are paid by commission.The *insurer* owns the expirations.
3. **The direct writing system--uses agents who** are employed by insurers.
The *insurer* owns the expirations.

EO 4. **INSURERS' TWO SOURCES OF INCOME:**

1. **Underwriting income**--from the sale of insurance.
2. **Investment income**--from the investment of funds.

THE FIVE WAYS INSURERS USE PREMIUM DOLLARS: To pay

1. claims and claim expenses,
2. sales and administration costs,
3. taxes and license fees,
4. dividends to policyholders or stockholders, *and*
5. for investments.

EO 5. **THE COMBINED RATIO** measures an insurer's overall results from insurance operations. The combined ratio compares losses and expenses incurred against premiums earned during a fiscal year. **A combined ratio greater than 1.00 indicates** that the insurer's operations were *not* profitable. **A combined ratio less than 1.00 indicates** that the insurer's operations were profitable.

EO 6. **PARTIES THAT INTERACT WITH THE CLAIM REPRESENTATIVE:**

1. **The insured/claimant**-- Claim reps provide guidance with the claims process, promptly pay amounts due, *and* honestly negotiate disputed amounts.
The claim rep must be able to explain the policy's claim provisions.
If coverage is questionable, the claim rep must
 - a. explain his concerns to the claimant *and*
 - b. take steps to preserve the insurer's right to deny a claim that is not covered.
2. **Producers**--The producer can be a good source of information about the claim.
3. **Underwriting department**--The claims department provides loss information (and other information about the insured and his loss exposures) to the underwriters.
Underwriters help the claims department with coverage interpretation.
4. **Loss control**--Loss control specialists provide the claims department with information about the pre-loss condition of property.
Loss information from the claims department supplements loss control reports and triggers loss control inspections.
5. **Actuarial department**--The claims department provides the actuaries with loss data.
6. **Special investigation unit (SIU) personnel**--Claim reps should refer suspicious claims to SIU personnel as soon as fraud is suspected.
SIU personnel educate claims personnel about fraud indicators and fraud schemes.
7. **Attorneys**--The legal department provides advice on specific losses and on other legal issues.

EO 7. **SIX TYPES OF INSURANCE POLICY PROVISIONS:** *[For memory: DICED]*

DECLARATIONS--customize the insurance policy to the insured.

The declarations page contains the insured's name and address, a description of the covered property or activity, any information from the application used to underwrite and rate the policy, the policy **inception** (beginning) and **expiration** (ending) dates, the policy limits, the deductible, the premium, *and* the forms and endorsements made part of the policy.

INSURING AGREEMENT--is any policy statement granting coverage.

The insuring agreement describes covered perils or activities in broad terms. Exclusions then limit coverage.

CONDITIONS--state the insurer's and insured's rights, duties, and options.

The insured *must* comply with the conditions for coverage to apply to losses.

EXCLUSIONS--clarify the coverage granted by the insurer by eliminating or restricting the perils or activities that would have been covered under the insuring agreement.

Six reasons insurance policies contain exclusions: *[Expect a question or two related to this list.]*

1. **eliminate uninsurable losses**--such as intentional harm, nuclear radiation, earthquake, and flood.
2. **reduce moral/morale hazards**--as for arson and theft of cars left with the engine idling.
3. **eliminate coverage duplications**--so only the proper policy provides coverage.
4. **limit unnecessary coverage**--to reduce premiums.
Personal auto policies don't cover livery exposures because most people don't use their personal cars to provide taxi services.
5. **eliminate coverage requiring special treatment**--where special rating, underwriting, or reinsurance treatment is needed.
Valuable property policies exclude coverage while the property is on exhibit at trade fairs.
6. **keep premiums reasonable (and give insureds and underwriters a choice)**--eliminating otherwise acceptable losses to keep premiums low.

DEFINITIONS give the precise meanings of words as used in the policy.

Some policies print defined policy terms in **boldface** or "quotation marks" to indicate that the term has a special meaning and is defined in the definitions.

If a policy does not define a word or phrase, these rules apply:

1. Everyday language is given its ordinary meaning.
2. Technical words are given their technical meanings.
3. Legal terms are given their legal meanings.
4. Consideration is given to local, cultural, and trade usage meanings.

MISCELLANEOUS PROVISIONS do *not* fit into any of the other five categories.

[Always figure there might be a final category, usually labeled 'miscellaneous'.]

Miscellaneous provisions clarify the insurer-insured relationship or establish procedures.

Obj 8. **ENDORSEMENTS** modify the terms of the original contract.

An endorsement can add to, delete, replace, or otherwise modify another provision in the contract.

Two rules of interpretation when an insurance policy has an endorsement:

1. The endorsement takes precedent over any conflicting terms in the contract *unless* the endorsement violates a law or regulation.
2. A handwritten endorsement supersedes a computer-printed or typed endorsement.