

OVERVIEW OF PERSONAL INSURANCE (22-1)

*[Personal insurance transfers the financial consequences of losses from individuals and families to insurers. A **loss exposure** is any condition that creates the possibility of financial loss.]*

[The three major types of loss exposures faced by individuals and families:

1. *property loss exposures--EO 2,*
2. *liability loss exposures--EO 3, and*
3. *financial planning loss exposures--EO 4.]*

EO 1. **THE THREE ELEMENTS OF A LOSS EXPOSURE:**

1. **asset (aka item subject)**--is the subject or item exposed to loss, such as a home, money, personal property, a worker's income, an investment portfolio, or a worker's good health;
2. **peril or cause of loss**--is the agent that causes reduction in the asset's value; *and*
3. **financial consequence of loss**--is the reduction the asset's value, which varies depending on the type of asset exposed to loss, the cause of loss, and the severity of loss.

EO 2. **A PROPERTY LOSS EXPOSURE** is a condition or set of circumstances that presents the possibility of property damage, destruction, or disappearance as a result of a **peril** (cause of loss).

ASSETS EXPOSED TO PROPERTY LOSS:

1. **Real property**--is what you'd leave behind if you sold your home--the land and all its attached structures, whether built on or built into the land, and all those structures' attached fixtures.
Kinds of real property that might be exposed to loss include the individual's or family's home, vacation home, detached garage, built-in swimming pool, gazebo, satellite dish, tool shed, dog house, condominium private and common areas, and rental property.
2. **Personal property**--is what you'd take with you if you sold your home.
Kinds of personal property that might be exposed to loss: personal
 - a. **dwelling contents**--normally located at home, so exposed to the same types of losses as the house; but also movable, so also subject to theft.
Contents losses are generally easy to value.
 - b. **high-valued property**--small and light, but expensive, so highly subject to theft; includes money, securities, coins, silverware, precious metals, jewelry, gems, watches, furs, and guns.
 - c. **property with intrinsic value**--intrinsic value based on rarity, artistic merit, historic value, or other scarce characteristics; includes art, stamp collections, antiques, photographs, computer software, and valuable papers.
Values of property with intrinsic value should be agreed to when insurance is purchased; *not* at time of loss.
 - d. **business personal property**--such property should be insured by the business even when it's at someone's home.
 - e. **motor vehicles, watercraft, aircraft, and recreational vehicles**--if self-powered, such vehicles are either completely excluded under homeowners coverage and need separate insurance *or* the coverage is *extremely* limited. **Exception:** Self-propelled equipment for maintaining premises (such as riding lawnmowers) and self-propelled wheelchairs *are* adequately covered by homeowners insurance.

CAUSES OF PROPERTY LOSS include fire, lightning, windstorm, hail, aircraft, riot, vehicles, explosion, smoke, vandalism, theft, falling objects, weight of ice and snow, volcanic eruption, flood, damage caused by building mechanical systems, auto collision, earthquake, *and* other means.

FINANCIAL CONSEQUENCES THAT MIGHT RESULT FROM A PROPERTY LOSS:

1. **reduction in the property's value**--from its pre-loss to its post-loss value,
2. **increased expenses**--for additional living expenses or car rental, *and*
3. **lost income**--if owned property was rented to others.

EO 3. A **LIABILITY LOSS EXPOSURE** is a condition that creates the possibility that an individual's financial resources may be diminished as a result of a **liability loss** (claim for money damages due to injury to another or damage to another's property).

ASSETS EXPOSED TO LIABILITY LOSS include all currently owned financial assets and, possibly, some future income.

Damages refers to the monetary award one party is required to pay to another for

1. bodily injury *or*
2. property damage

for which the first party is legally liable.

Compensatory damages compensate a person for his bodily injury or property damage.

Compensatory damages include

1. **special damages** (compensation for out-of-pocket losses) *and*
2. **general damages** (compensation for noneconomic losses, such as pain and suffering).

Punitive (aka exemplary) damages punish wrongdoers and set an example to others to deter similar future misconduct.

THE CAUSE OF LIABILITY LOSS is the chance of a **claim for money damages** (since financial loss starts with investigation), including defense, and maybe culminating with a judgment for money damages.

BASES ON WHICH LIABILITY CLAIMS FOR DAMAGES MIGHT BE SOUGHT:

1. **Tort liability**--arises from a **tort (non-contractual civil wrong against another)**.
 - a. **Intentional torts: Defamation** damages another's reputation with an untruth. It's **libel** if it's written; **slander** if it's spoken.
Assault threatens another with unprivileged touching.
Battery is the actual touching.
Trespass is unauthorized use of another's land.
Nuisance interferes with another's quiet enjoyment of his property.
 - b. **Negligence torts--require the four elements of negligence:**
 - 1) a legal duty to another,
 - 2) a breach of that duty,
 - 3) injury or harm to another,
 - 4) as a direct result of the breach.*[Simply, breached duty caused damage.]*
Negligence is the failure to use reasonable care to prevent injury to another or damage to another's property.
You might serve a friend tainted food or shoot someone's horse while deer hunting.
 - c. **Absolute liability torts**--involve inherently dangerous, but legal, activities such as owning a wild pet, a vicious dog, or a gun; blasting; and using explosives.
The injured party *only* needs to prove injury as a result of the defendant's activity.
2. **Contractual liability**--arises when one person agrees to accept the financial responsibility for another's liability.
Leases and rental agreements often shift the owner's liability to the user.
3. **Statutory liability**--is liability imposed by a specific law.
Most commonly, statutory liability relates to auto liability and workers' compensation.

FINANCIAL CONSEQUENCES THAT MIGHT RESULT FROM A LIABILITY LOSS:

1. **investigation costs,**
2. **defense costs, and**
3. **damages**--if the defense is not successful or the claim settles out of court.

EO 3. A **PERSONAL FINANCIAL PLANNING LOSS EXPOSURE** is a situation that might cause financial loss to an individual or his family and/or that is related to retirement, premature death, poor health, disability, *or* unemployment.

FOUR TYPES OF PERSONAL FINANCIAL PLANNING LOSS EXPOSURES:

1. **Retirement**--The assets exposed to loss include the worker's regular income and benefits, such as health insurance.
Upon retirement, a worker must replace most of his regular income with Social Security, private retirement plans, and personal savings.
The primary risk associated with retirement is that the retired worker will not have enough assets and retirement income to compensate for the loss of income and benefits.
2. **Premature death**--A death is premature if it occurs before a person reaches his life expectancy.
The assets exposed to loss include the decedent's future income.
The causes of loss include accident, illness, and intentional death.
3. **Poor health and disability--An individual faces**
 - a. **increased expenses**--for medical care due to illness or injury *and*
 - b. **decreased revenues**--lost income and reduced employee benefits due to illness or injury.
The causes of loss associated with health and disability loss exposures are chronic illness and/or physical or mental disability.

The four types of disability classifications:

- a. **Temporary partial disability**--means the worker can perform some job duties for a period of time and will eventually resume full job duties.
 - b. **Temporary total disability**--means the worker can perform no job duties for a period of time, but will eventually resume full job duties.
 - c. **Permanent partial disability**--means the worker will not recover, but can work at a lower capacity.
 - d. **Permanent total disability**--means the worker can *not* work and will *not* recover.
4. **Unemployment**--The assets exposed to loss include income and employer-provided benefits.
The causes of loss may be voluntary or involuntary.
Earnings stop, *but* costs of job searching, retraining, and counseling increase.

EO 5. **PERSONAL RISK MANAGEMENT** is the 1) identification, 2) analysis, *and* 3) treatment of the pure loss exposures of an individual or family.

THE SIX STEPS IN THE RISK MANAGEMENT PROCESS:

1. **Identify loss exposures**--Individuals and families usually rely on themselves, friends, family, and their insurance agents to help identify loss exposures.
The most common personal loss exposures arise from home and auto ownership.
2. **Analyze loss exposures**--Estimate the likelihood and significance of the losses identified.
The four dimensions used in loss exposure analysis:
 - a. **Loss frequency**--is the number of losses within a specified period.
 - b. **Loss severity**--is the amount of a loss, measured in dollars.
 - c. **Total dollar losses**--is the total dollar amount of all losses within a specified period.
 - d. **Timing**--has two dimensions: when losses occur *and* when payments are made.
3. **Examine alternative risk management treatment techniques**--See EO 6.

4. **Select the best technique**--Choose the technique(s) that best prevent or reduce losses and/or finance those losses that do occur.
5. **Implement the selected technique(s)**--Take the necessary steps to make the techniques happen.
Examples: Make a list of assets at risk. Buy loss reduction devices. Hire loss prevention services. Begin loss control programs. Get expert help for complicated exposures. Buy insurance.
6. **Review and revise the plan as needed**--Periodically review the risk management program and make adjustments as needed to address changes in loss exposures.

EO 6. **TWO TYPES OF RISK MANAGEMENT TECHNIQUES:**

1. **Risk control techniques**--prevent and/or reduce loss exposures.
2. **Risk financing techniques**--generate funds to pay for losses that do occur.

FIVE CATEGORIES OF RISK CONTROL TECHNIQUES:

1. **Avoidance**--shuns exposures that don't have to be assumed and/or eliminates exposures that already exist.
2. **Loss control**--changes the loss exposure through
 - a. **loss prevention measures**--reduce **loss frequency** (how often losses occur--measures the *number* of losses) and
 - b. **loss reduction measures**--reduce **loss severity** (the amount of damage caused by losses which do occur--measures the *size* of losses).
3. **Separation**--disperses resources over two or more locations.
Example: Keep some jewelry at home and some in a bank's safety deposit box.
4. **Duplication**--creates copies or spares of important items and stores them at separate locations.
Example: Save important files on both the computer's hard drive and on a removable flash drive.
5. **Diversification**--spreads loss exposures over several projects, products, markets, and/or regions.
Example: Allocate investments among a mix of stocks and bonds from companies in different industries.

THREE CATEGORIES OF RISK FINANCING TECHNIQUES:

1. **Noninsurance transfer**--transfers the loss exposure to another party that is *not* an insurance company.
Examples: A **hold harmless agreement** is a contract in which one party assumes another's legal liability, such as in an apartment lease.
Hedging is a financial transaction in which one asset is held to offset the risks associated with another asset.
2. **Insurance transfer**--transfers the loss exposure to an insurer.
3. **Retention**--has the individual or family bear the loss exposure and fund the consequences of any losses directly.
Example: a **deductible** (part of an insured loss that is *not* paid by the insurer).
Planned retention retains identified loss exposures.
Unplanned retention retains unidentified loss exposures.

EO 7. **PERSONAL INSURANCE** consists of three layers:

1. **Individual insurance**--such as homeowners and personal auto insurance.
2. **Group insurance**--such as group health and life insurance sold to a firm's employees.
3. **Social insurance**--that provide a base layer of protection for losses caused by injury, death, retirement, and unemployment.
Social insurance programs include Social Security, unemployment insurance, railroad worker programs, *and* state temporary disability insurance.

HOW INSURANCE ADDRESSES PERSONAL LOSS EXPOSURES:

1. **Property and liability loss exposures**--The personal auto policy (**PAP**) covers auto-related property and liability loss exposures.
The homeowners policy covers homes and their contents, and also personal liability.
The personal umbrella policy covers large awards for personal liability.
2. **Retirement loss exposures**--Individuals use savings plans, pension plans, and individual retirement accounts to mitigate the financial consequences of retirement loss.
Social Security is available for workers who are at least 62 years old.
Some retirees convert their savings into annuities to guarantee monthly incomes for life.
3. **Premature death loss exposures**--Life insurance is the most common way to manage the premature death exposure.

Two methods for determining how much life insurance to buy:

- a. **Needs-based approach**--determines the appropriate amount of life insurance by analyzing the family's cash requirements to meet debts and to meet obligations to dependents (based on their number and ages) and the surviving spouse and to pay for educational expenses, mortgage and rent requirements, and other needs.
 - b. **Human life value approach**--determines life insurance needs by calculating the economic value of a person's life based on that person's earning capacity and others' financial dependence on that earning capacity.
4. **Health and disability loss exposures**--Health and disability insurance reduces the financial burden of illness and disability.
Social insurance programs include Medicare, Medicaid, and workers' compensation insurance.
Workers' compensation refers to those state statutes that provide for fixed awards and medical reimbursement to employees and their dependents for employment-related injury and illness.
 5. **Unemployment loss exposures**--State unemployment compensation programs provide weekly cash benefits to eligible workers who are involuntarily unemployed.
Unemployment benefits are typically paid up to a set maximum number of weeks, but a state may increase the number of weeks depending on economic conditions, especially high state unemployment rates.
Federally-subsidized benefits may be available in states with especially depressed economies.

EO 8. **THE SIX PARTS OF A PROPERTY-CASUALTY POLICY:**

1. **Declarations**--provide specific details about the insured and the subject of the insurance.
The declarations page identifies the policy number, the coverage period, the insurer and agent, the insured, the other entities with covered interests, the insured's mailing address, the physical address, the description of covered property or operations, the policy limits, the deductible, the premium, and any applicable forms and **endorsements** (documents that amend the policy).
2. **Definitions**--assign meanings to policy terms.
Policies often indicate defined terms with boldface type, quotation marks, capital letters, *or* italics.
Undefined words and phrases follow these general rules of contract interpretation:
 - a. Everyday words are given their ordinary meanings.
 - b. Technical words are given their technical meanings.
 - c. Words with established legal meanings are given those legal meanings.
 - d. Consideration is given to local, cultural, and trade meanings.
3. **Insuring agreements**--state that under some circumstances the insurer will make a payment *or* will provide a service.
A policy may have more than one insuring agreement.
Example: The personal auto policy (PAP) provides coverage (and has insuring agreements) for liability, medical payments, uninsured motorists, and damage to your auto.

4. **Conditions**--qualify an otherwise enforceable promise of the insurer.
Examples: The insured's duties to pay premiums, report losses promptly, document losses, and cooperate with the insurer.
5. **Exclusions**--include any policy provision that eliminates coverage for a specified loss exposure.
Exclusions clarify coverage by indicating what is *not* covered.
Examples: Most property insurance policies exclude war and nuclear contamination. Most liability policies exclude loss that the insured expected or intended.
6. **Miscellaneous provisions**--do *not* qualify as declarations, definitions, insuring agreements, conditions, *or* exclusions.
Miscellaneous provisions may discuss the insurer/insured relationship or establish policy procedures, *without* carrying the force of conditions.
Example: a valuation provision that states the method of measuring covered losses.

SEVEN REASONS FOR POLICY EXCLUSIONS: to

1. **eliminate uninsurable loss exposures**--such as war, earthquake, flood, normal wear and tear, inherent vice, *and* the insured's intentional acts.
2. **help control moral hazards.**
Moral hazards arise from
 - a. active inducement of loss *and/or*
 - b. the temptation to exaggerate loss.
3. **help control attitudinal hazards.**
Attitudinal hazards aka morale hazards arise from
 - a. passive indifference to loss *and/or*
 - b. carelessness in controlling loss.
4. **eliminate coverage duplications between standard policies**--such as the exclusion of business losses from personal liability policies.
5. **eliminate unneeded coverage for typical purchasers**--such as the HO's limits on boats, money, and business property.
6. **eliminate coverage that requires special rating or underwriting treatment**--such as the exclusion of steam boiler explosions from commercial property policies.
7. **keep premiums more affordable**--such as by eliminating coverage for road damage to tires from personal auto policies.

EO 9. **POLICY ANALYSIS:**

1. **Pre-loss policy analysis**--determines what losses would be covered.
Three skills required for before-loss policy analysis: the abilities to
 - a. understand the different ways policies describe coverage,
 - b. identify and evaluate unusual policy provisions, *and*
 - c. understand the risk's exposures.

Pre-loss policy analysis relies on **scenario analysis**, which involves determining what losses might occur and then comparing the provisions of the policy against those possible losses.
Sources of information for an insured's scenario analysis include the insured's past loss experience, the experiences of friends and relatives, *and* insurance producers.
2. **Post-loss policy analysis**--determines if that particular loss is covered.
Two steps in post-loss policy analysis:
 - a. Determine if the claim is covered by the policy.
 - b. Then, *if* the claim is covered, find the dollar amount to be paid.

The primary method of post-loss policy analysis is the **DICE method** (acronym for declarations, insuring agreements, conditions, and exclusions), which involves a four-step systematic review of the policy provisions to see if any of the provisions precluded coverage.

THE DICE METHOD OF POST-LOSS POLICY ANALYSIS:

1. **Declarations page**--Did the loss occur during the policy period?
Did the policy cover the person or property at the time of the loss?
2. **Insuring agreement**--Did the loss occur to covered property or due to a covered event?
Was the loss caused by a covered cause of loss?
Did the loss occur in the coverage territory?
3. **Conditions**--Did the insured meet his duties?
4. **Exclusions**--Does the policy eliminate coverage for the loss?

DETERMINING THE AMOUNT PAYABLE--Property insurance policies include valuation provisions that indicate how values are determined.

Liability insurance policies contain promises to provide the defense *and* to pay the amount of legal liability. Policies may include other expenses, such as expenses to protect property against further loss.

Settlement calculations should consider the valuation basis, the deductible, any coinsurance, the policy limit, *and* any other loss-sharing provisions.