Segment C:

Insurance Contracts, Loss Exposures, and Risk Management

This final segment begins by discussing common characteristics of insurance contracts. It continues by presenting both property and liability loss exposures and policy provisions that cover those exposures. Finally, risk management is introduced as a means of managing loss exposures.

Chapter 7

Insurance Contracts

Educational Objectives

After studying this chapter, you should be able to:

1. Identify and explain the four essential elements of any valid contract. (pp. 7-4 to 7-6)
2. Identify and describe the special characteristics of insurance contracts. (pp. 7-6 to 7-12)
3. Explain and illustrate the principle of indemnity. (pp. 7-10 to 7-12)
4. Identify and describe the items usually found on the declarations page of an insurance policy. (pp. 7-12 to 7-14)
5. Explain the purpose in an insurance policy of each of the following: (pp. 7-13 to 7-18)
   a. Definitions
   b. Insuring agreements
   c. Exclusions
   d. Conditions
   e. Miscellaneous provisions
6. a. Describe and distinguish between manuscript policies and standard forms. (pp. 7-18 to 7-19)
   b. Describe the advantages of standard forms to (1) insurers and (2) insureds. (pp. 7-19 to 7-20)
7. Describe and distinguish between a self-contained and a modular policy. (pp. 7-20 to 7-23)

8. Describe the conditions commonly found in property and liability insurance policies. (pp. 7-23 to 7-28)
9. Explain how subrogation works. (pp. 7-27 to 7-28)
10. Define or describe each of the Key Words and Phrases for this assignment. (All Key Words and Phrases appear in bold print in the text and in boxes in the margins throughout this chapter.)

Chapter 7

Insurance Contracts

Purchasing an insurance policy differs from purchasing tangible goods. A car buyer, for example, can examine and even test drive a car before buying it. Although warranties and promises of reliable service might influence the decision to buy, the primary consideration is the car itself. The car's physical characteristics are readily apparent at the time of the sale. The buyer cannot blame the dealer if the car is too small or the wrong color. Insurance, on the other hand, is not something a person can test before buying. The essence of insurance is the insurance company's promise that it will pay claims in the future for losses that are covered under the policy.

The evidence of this promise is the insurance contract, or policy. The policy defines in detail the rights and duties of both parties to the contract: the insured and the insurer. A particular insurance policy meets a buyer's needs only if the terms of the policy obligate the insurer to provide the protection desired. Although it is possible to evaluate a car with a test drive, evaluating an insurance policy requires an analysis of its terms.

This chapter provides a foundation for such an analysis. The chapter first discusses contracts in general and then describes the special characteristics of insurance contracts, their content, and their structure; it concludes with a description of several conditions that are common to most property and liability insurance policies. The material in this chapter provides a basis for studying Chapters 8 and 9, which deal with property and liability loss exposures and specific provisions in policies that cover those exposures.

Educational Objective 1

Identify and explain the four essential elements of any valid contract.

Elements of a Contract

A **policy** is a complete written *contract* of insurance. (As stated in Chapter 4, a *binder* is a temporary contract of insurance and can be either oral or written; a binder is usually replaced within a short period by a policy.)

A **contract** is a legally enforceable agreement between two or more parties.

An insurance contract, called a **policy**, is an agreement between the insurer and the insured. An insurance policy must meet the same requirements as any other valid **contract**, which is a legally enforceable agreement between two or more parties.

If a dispute arises between the parties to a contract, a court will enforce only those agreements that are valid contracts. The validity of a contract depends on four essential elements:

- Agreement (offer and acceptance)
- Competent parties
- Legal purpose
- Consideration

If a court cannot confirm the presence of all of these elements, it will not enforce the contract.

Agreement (Offer and Acceptance)

One essential element of a contract is that agreement must exist between the parties to the contract. One party must make a legitimate *offer* and another party must *accept* the offer. In other words, there must be mutual assent.

In the case of insurance, the process of achieving mutual assent generally begins when someone who wants to purchase insurance completes an insurance application—an offer to buy insurance. The details on the application describe the exposures to be insured and indicate the coverage the applicant requests.

In an uncomplicated case, an insurance company underwriter (or an agent, acting on behalf of an insurer) accepts the application and agrees to provide the coverage requested at a price acceptable to both the insurer and the applicant. At this point, agreement exists; the insurer has accepted the applicant's offer to buy insurance.

In a more complicated case, the underwriter might not be willing to meet all the requests of the applicant. As explained in Chapter 5, one of the underwriter's options is to accept the application with modification. In other words, the underwriter might be willing to provide coverage, but only on somewhat different terms. For example, the underwriter might insist on a

higher deductible than the applicant had requested. When the underwriter communicates the proposed modifications to the applicant, these modifications constitute a *counteroffer*. Several offers and counteroffers might be made before both parties agree to an exact set of terms. If the other essential elements of a contract exist, the mutual assent of the insurer and the applicant forms a contract.

To be enforceable, the agreement cannot be the result of duress, coercion, fraud, or a mistake. If either party to the contract can prove any of these circumstances, a court could declare the contract to be void.

Competent Parties

For the contract to be enforceable, all parties must be legally competent. In other words, each party must have the legal capacity to make the agreement binding. Individuals are generally considered to be competent and able to enter into legally enforceable contracts, *unless* they are one or more of the following:

- Insane or otherwise mentally incompetent
- Under the influence of drugs or alcohol
- Minors (persons not yet of legal age)

However, minors are sometimes considered competent to purchase auto insurance, especially when auto insurance qualifies as a necessity. State laws vary in regard to issues involving minors.

Another aspect of legal capacity involves the fact that, in most states, an insurer must be licensed to do business in the state. If an insurer mistakenly writes a policy in a state where that insurer is not licensed, the insured might later argue that the contract is not valid and demand the return of the premium. This demand would be based on the fact that the insurer did not have the legal capacity to make the agreement.

Legal Purpose

An enforceable contract must also have a legal purpose. The courts might consider a contract to be illegal if its purpose is against the law or against public policy (as defined by the courts). For example, an agreement to pay a bribe to a government official in exchange for receiving a government job would not be enforced by the courts because such activities are against public policy.

Although most insurance policies do not involve a question of legality, certain situations do exist that might invalidate an insurance policy. Courts will refuse to enforce any insurance policy that is illegal or that tends to injure the public welfare.

Insurance contracts must involve a legal subject matter. Property insurance on illegally owned or possessed goods is invalid. For example, property insurance covering illegal drugs would be illegal and therefore unenforceable. If fireworks are illegal in a particular state, then an insurance policy covering fireworks would be illegal in that state. In addition, no insurance contract will remain valid if the wrongful conduct of the insured causes the operation of the contract to violate public policy. Thus, arson by an insured would render a property insurance policy unenforceable and would preclude recovery by the insured under the policy for a building the insured intentionally burned.

Consideration

Consideration is an exchange of something of value that is required in any valid contract. In insurance, consideration given by the insured is the payment of (or the agreement to pay) the premium. Consideration on the part of the insurer is the promise to pay covered losses. Even though someone purchasing insurance receives only a document containing a promise, that promise has value because it is a legal obligation.

Consideration is something of value given by each party to a contract. For example, when an auto is purchased, the buyer gives money (consideration) to the seller who, in turn, provides the car (which is also consideration).

Some contracts do not involve the exchange of one tangible item for another, but instead involve *performance*. For example, an author might sign a contract agreeing to write a book in exchange for payment by the publisher.

Performance can also involve a promise to perform some act in the future that is dependent on a certain event occurring. In the case of an insurance contract, the insurer's consideration is its promise to pay a claim in the future *if* a covered loss occurs. If no loss occurs, the insurer is still fulfilling its promise to provide financial protection even though it does not pay a claim. In insurance contracts, two types of consideration are involved:

- The *insured's* consideration is the payment of (or the promise to pay) the premium.
- The *insurer's* consideration is its promise to pay claims as specified in the contract, conditioned on the occurrence of covered losses.

Insurance Contracts

In addition to having the four essential elements of all contracts, insurance contracts have certain special characteristics.

Educational Objective 2

Identify and describe the special characteristics of insurance contracts.

Special Characteristics of Insurance Contracts

The wording of an insurance policy reflects certain fundamental principles of insurance. An insurance policy is a contract that generally has certain distinct characteristics:

- A personal contract
- A conditional contract
- A contract involving the exchange of unequal amounts
- A contract of the utmost good faith
- A contract of adhesion
- A contract of indemnity

Personal Contract

The identities of the people insured are extremely relevant to the insurance company, which has the right to select the insureds with whom it is willing to enter into contractual agreements. Once an insurance policy is in effect, an insured may not freely transfer the policy to some other party. If such a transfer were allowed to take place, the insurance company would be legally bound to a contract with a party it might not wish to insure. Most insurance policies contain a provision (called *assignment*) that states that the insurer's written permission is required before an insured can transfer a policy to another party.

Conditional Contract

An insurance policy is a **conditional contract** because the parties have to perform only under certain *conditions*. Whether the insurer pays a claim depends on whether an insured loss occurs. In addition, the insured must fulfill certain duties before a claim is paid, such as giving prompt notice to the insurance company when a loss occurs.

A **conditional contract** is a contract in which one or more parties must perform only under certain conditions.

An insured loss might not occur during a particular policy period, but that fact does not mean the insurance contract has been worthless. In buying an insurance policy, the insured acquires a valuable promise—the promise of the insurer to make payments if a covered loss occurs. The promise exists, even if the insurer's performance is not required during the policy period.

Contract Involving the Exchange of Unequal Amounts

In addition to being conditional, insurance contracts involve an exchange of unequal amounts. Sometimes, the premium paid by the insured for a particular policy is more than the amount paid by the insurer to, or on behalf of, the insured because no losses occur. If a large loss occurs, on the other hand, the insurer's claim payment might be much more than the premium paid by

the insured. It is the additional factor that the insurer's obligation *might* be much greater than the insured's (if covered losses occur) that makes the insurance transaction a fair trade.

For example, suppose an insurance company charges a $1,000 annual premium to provide property coverage (known as auto "physical damage" coverage) on a car with an actual cash value of $20,000.

- If the car is not damaged while the policy is in force, the insurance company pays nothing.
- If the car is partially damaged, the insurance company pays the cost of repairs, after subtracting a deductible.
- If the car is a total loss, the insurance company pays $20,000 (minus any deductible) to the insured.

Unless by chance the insurer's obligations in a minor accident come to exactly $1,000, unequal amounts are involved in all three cases. However, it does not follow that insureds who have no losses—or only very minor losses—do not get their money's worth or that insureds involved in major accidents profit from the insurance.

As stated in Chapter 2, the premium for a particular policy should reflect the insured's share of estimated losses that the insurer must pay. Many insureds have no losses, but some have very large losses. The policy premium reflects the insured's proportionate share of the total amount the insurer expects to pay to honor its agreements with *all insureds* with similar policies.

Contract of Utmost Good Faith

Utmost good faith is an obligation to act in complete honesty.

Because insurance involves an intangible promise, it requires complete honesty and disclosure of all relevant facts from both parties. For this reason, insurance contracts are considered contracts of **utmost good faith.** Both parties to an insurance contract—the insurer and the insured—are expected to be ethical in their dealings with each other.

The insured has a right to rely on the insurance company to fulfill its promises. Therefore, the insurance company is expected to treat the insured with utmost good faith. An insurance company that acts in bad faith, such as denying coverage for a claim that is clearly covered, could face serious penalties under the law.

The insurer also has a right to expect that the insured will act in good faith. An insurance buyer who intentionally conceals certain information or misrepresents certain facts does not act in good faith. Because an insurance contract requires utmost good faith from both parties, an insurance company could be released from a contract because of *concealment* or *misrepresentation* by the insured.

Concealment

Courts have held that the insurer must prove two things in order to establish that **concealment** has occurred. First, it must establish that the failure to disclose information was *intentional*, which is often difficult. The insurer must usually show that the insured knew that the information should have been given and then intentionally withheld it.

Second, the insurer must establish that the information withheld was a **material fact**—information that would affect an insurer's underwriting or claim settlement decision. For an auto insurance applicant, for example, material facts include how the autos are used, who drives the autos, and the ages and driving records of the drivers. If an insured intentionally conceals the material fact that her 16-year-old son lives in the household and is the principal driver of one of her cars, that concealment of a material fact could *void* the policy.

Insurance companies carefully design applications for insurance to include questions regarding facts material to the underwriting process. The application includes questions on specific subjects to which the applicant must respond. These questions are designed to encourage the applicant to reveal any pertinent information.

Concealment is an intentional failure to disclose a *material fact.*

For insurance purposes, a **material fact** is any information that would affect the insurer's underwriting decision to provide or maintain insurance or that would affect a claim settlement.

Jargon Alert!

There is a difference among the terms used in regard to the termination of an insurance policy: void, canceled, and nonrenewed.

When a policy is *void*, it never had any legal existence.

When a policy is *canceled*, it is terminated (by either the insurer or the insured) during the policy period.

When a policy is *nonrenewed*, it is terminated (by either the insurer or the insured) at the end of the policy period.

Misrepresentation

In normal usage, a misrepresentation is a false statement. As used in insurance, a **misrepresentation** is a false statement of a material fact on which the insurer relies. Unlike a concealment, the insurer does not have to prove that the misrepresentation is intentional.

For example, assume an applicant for auto insurance has had two speeding tickets during the eighteen months immediately before he submitted his application for insurance. When asked if any driving violations have occurred within the past three years (a question found on most auto application forms), an applicant giving either of the following answers would be making a misrepresentation:

- "I remember having one speeding ticket about two years ago."
- "I've never been cited for a moving violation—only a few parking tickets."

The first response provides incorrect information, and this false statement might or might not be intentional. The false statement made in the second response is probably intentional. The direct question posed in the application requires a full and honest response from the applicant because the insurer relies on the information. Anything less is a misrepresentation, whether intentional or not.

In insurance, a **misrepresentation** is a false statement of a material fact.

As with a concealment, if a material fact is misrepresented, the insurer could choose to void the policy because of the violation of utmost good faith.

Contract of Adhesion

A **contract of adhesion** is a contract in which one party (the insured, in insurance) must adhere to the agreement as written by the other party (the insurer).

The wording in insurance contracts is usually drafted by the insurance company (or an insurance advisory organization), enabling the insurer to use preprinted forms for many different insureds. Since the insurance company determines the exact wording of the policy, the insured has little choice but to "take it or leave it." That is, the insured must adhere to the contract drafted by the insurer. Therefore, insurance policies are considered to be **contracts of adhesion**, and that characteristic significantly influences their enforcement.

If a dispute arises between the insurance company and the insured about the meaning of certain words or phrases in the policy, the insured and the insurer are *not* on an equal basis. The insurer designed the policy wording, and the insured did not have a chance to select the wording. For that reason, if the policy wording is ambiguous, a court will generally apply the interpretation that favors the insured.

Educational Objective 3

Explain and illustrate the principle of indemnity.

Contract of Indemnity

In a **contract of indemnity**, the insurer agrees, in the event of a covered loss, to pay an amount directly related to the amount of the loss. Property insurance policies contain a valuation provision that explains how the value of the insured property is to be established at the time of the loss. Liability insurance policies agree to pay, on behalf of the insured, amounts that the insured becomes legally obligated to pay to others.

The purpose of insurance is to provide indemnification—that is, to *indemnify* an insured who suffers a loss. As stated in Chapter 1, to indemnify is to restore a party who has had a loss to the same financial position that party held before the loss occurred. Most property and liability insurance policies are contracts of indemnity. With a **contract of indemnity**, the amount paid by the insurer depends on the amount of loss the insured has suffered, as follows:

- Property insurance generally pays the amount of money necessary to repair covered property that has been damaged or to replace it with similar property. The policy specifies the method for computing the amount of the loss. For example, most auto policies, both personal and commercial, specify that vehicles are to be valued at their actual cash value (ACV) at the time of a loss. If a covered accident occurs that causes a covered vehicle to be a total loss, the insurer will normally pay the ACV of the vehicle less any applicable deductible.
- Liability insurance generally pays to a third-party claimant, on behalf of the insured, any amounts (up to the policy limit) that the insured becomes legally obligated to pay as damages due to

a covered liability claim, as well as the legal costs associated with that claim. For example, if an insured with a liability limit of $300,000 is ordered by the court to pay $100,000 for bodily injury incurred by the claimant in a covered accident, the insurer will pay $100,000 to the claimant and will also pay the cost to defend the insured in court.

A contract of indemnity does not necessarily pay the *full* amount necessary to restore an insured who has suffered a covered loss. However, the amount the insurer pays is directly related to the amount of the insured's loss. Most policies contain a policy limit that specifies the maximum amount the insurer will pay for a single claim. Many policies also contain limitations and other provisions that could reduce the amount of recovery. For example, a homeowners policy is not designed to cover large amounts of cash. Therefore, most homeowners policies contain a special limit, such as $200, for all covered losses to money owned by the insured. If a covered fire destroys $1,000 in cash belonging to the insured, the homeowners insurer will pay only $200 for the money that was destroyed.

According to the **principle of indemnity**, the insured is not supposed to profit from the insured loss. That is, the insured should not be better off financially after the loss than before. Insurance policies usually include certain provisions that reinforce the principle of indemnity. For example, policies generally contain an "other insurance" provision to prevent an insured from receiving full payment from two different insurance policies for the same claim. Insurance contracts usually protect the insurer's subrogation rights, as discussed in Chapter 6. "Other insurance" provisions and subrogation provisions clarify that the insured cannot collect more than the amount of the loss.

The **principle of indemnity** states that the insured should not be better off financially after a loss than before. In other words, the insured should not profit from an insured loss.

Another factor enforcing the principle of indemnity is that a person usually cannot buy insurance unless that person is in a position to suffer a financial loss. In other words, as discussed in Chapter 6, the insured must have an insurable interest in the subject of the insurance. For example, property insurance contracts cover losses only to the extent of the insured's insurable interest in the property. This restriction prevents an insured from collecting more from the insurance than the amount of the loss he or she suffered. A person cannot buy life insurance on the life of a stranger, hoping to gain if the stranger dies. Insurance companies normally sell life insurance when there is a reasonable expectation of a financial loss from the death of the insured person, such as dependents of the insured person losing that person's future income. Insurable interest is not a problem in liability insurance because a liability claim against an insured causes that insured to suffer a financial loss if the insured is legally responsible; even if the insured is not responsible, the insured could incur defense costs.

A **valued policy** is one in which the insurer pays a stated amount in the event of a specified loss (usually a total loss), regardless of the actual value of the loss.

Some insurance contracts are not contracts of indemnity but **valued policies**. When a loss occurs, a valued policy pays a specified sum that might bear no direct relationship to the amount that is actually lost. For example, an accident insurance policy might specify that it will pay "$10,000 for loss of one arm." The amputee might have medical bills much smaller or much greater than $10,000, but the policy will pay $10,000 in either case. Life insurance policies are also valued policies because they state that the insurer will pay a fixed sum when the insured person dies rather than attempting to measure the financial consequences of the death.

Content of Insurance Policies

Because they must provide for contingencies, insurance policies must be drafted carefully. The parties must agree on how to handle many situations that could arise even if these situations are not likely to occur. The resulting documents are far from simple. Although insurance contracts can be complex, a framework of knowledge helps enormously in understanding them. Some familiarity with both the content and the structure of insurance policies in general helps in analyzing the terms of a particular policy.

An insurance policy specifically describes the coverage it provides. Since no insurance policy can cover every contingency, the policy must describe its limitations, restrictions, and exclusions as clearly as possible. For example, most insurance policies do not cover losses caused by acts of war or nuclear contamination. If the insurer does not intend to cover such losses, the policy must clearly state that fact. The best way to determine the coverage provided by a particular policy is to examine its provisions, which are generally included in the following sections of the policy:

- Declarations
- Definitions
- Insuring agreements
- Exclusions
- Conditions
- Miscellaneous provisions

Educational Objective 4

Identify and describe the items usually found on the declarations page of an insurance policy.

Declarations

An insurance policy must first identify the parties to the contract. Information such as the name and location of the insurer and the name and address of the insured is usually shown on the first page of the policy. This information page is called the **declarations page**, or simply the **declarations** or **dec**. As its name implies, a declarations page declares important information about the specific policy of which it is a part. The name of the insurance company is almost always preprinted on the declarations page; the name and address of the insured are entered when the policy is issued. Exhibit 7-1 shows the declarations page of a personal auto policy.

Insurance policies usually provide coverage for a specified period. The inception date of the policy is stated in the declarations. The expiration date might also appear in the declarations, or the policy period might be clarified elsewhere in the policy, usually as part of the conditions.

The insurance policy must describe the consideration involved. As stated previously, the insured's consideration is the premium, and the insurer's consideration is its promise to pay if an insured loss occurs. The premium amount is normally shown in the policy declarations. Other statements regarding when the premium should be paid, to whom it should be paid, and the consequences if it is not paid might appear elsewhere in the policy.

The policy limits are also shown in the declarations. A *limit* is the maximum amount of coverage the insurer will pay for a given type of loss. In some situations, however, the insurer might ultimately pay an amount greater than a policy limit. For example, under some liability policies, defense costs might be paid in addition to the amount of damages. Some property policies include additional coverages, such as debris removal, which might be paid in addition to a policy limit.

In addition, a declarations page usually includes any information that specifically describes the covered property or locations, specific coverages, deductibles, policy forms, endorsements, and other important details about the insured, the subject of the insurance, and the coverages provided by the policy.

The **declarations page** (also simply called the **declarations** or **dec**) of an insurance policy is an information page that provides specific details about the insured and the subject of the insurance, such as:

- Name and location of the insurer
- Name and address of the insured
- Policy number
- Policy period (inception and expiration dates)
- Description of covered property or locations
- Schedule of coverages and limits
- Deductibles
- Premium(s)
- Policy forms
- List of endorsements, if any
- Agent's name
- Other important details

Educational Objective 5

Explain the purpose in an insurance policy of each of the following:
a. Definitions
b. Insuring agreements
c. Exclusions
d. Conditions
e. Miscellaneous provisions

Exhibit 7-1
Declarations Page of a Personal Auto Policy

INS Insurance Company, Malvern, PA

Personal Auto Policy Declarations

POLICYHOLDER: (Named Insured) David M. and Joan G. Smith
216 Brookside Drive
Anytown, USA 40000

POLICY NUMBER: 296 S 468211

POLICY PERIOD: FROM: December 25, 1999
TO: June 25, 2000

But only if the required premium for this period has been paid, and for six-month renewal periods if renewal premiums are paid as required. Each period begins and ends after 12:01 A.M. standard time at the address of the policyholder.

INSURED VEHICLES AND
SCHEDULE OF COVERAGES

VEHICLE	COVERAGES	LIMITS OF INSURANCE		PREMIUM
1. 1990 Toyota Tercel		ID #JT2AL21E0B3306553		
	Coverage A—Liability	$300,000	Each Occurrence	$102.00
	Coverage B—Medical Payments	$ 5,000	Each Person	$ 18.00
	Coverage C—Uninsured Motorists	$300,000	Each Occurrence	$ 31.00
			TOTAL	$151.00
2. 1998 Ford Taurus		ID #1FABP3OU8GG212619		
	Coverage A—Liability	$300,000	Each Occurrence	$102.00
	Coverage B—Medical Payments	$ 5,000	Each Person	$ 18.00
	Coverage C—Uninsured Motorists	$300,000	Each Occurrence	$ 31.00
	Coverage D—Other Than Collision	Actual Cash Value Less $100		$ 51.00
	—Collision	Actual Cash Value Less $250		$136.00
			TOTAL	$338.00
			TOTAL PREMIUM	$489.00

POLICY FORM AND ENDORSEMENTS: PP 00 01 PP 03 06

COUNTERSIGNATURE DATE: December 1, 1999

AGENT: A. M. Abel

Definitions

Since insurance policies often contain technical terms or words that are used in a very specific way, most policies define terms that have a specific meaning with regard to the coverage provided. These definitions might be in a separate section of the policy, or the terms might be defined where they first appear in the policy. If a policy definition differs from normal usage for a term, the definition in the policy prevails. Unless the contract provides specific definitions, the words in insurance policies and other contracts are generally interpreted according to their ordinary meanings or dictionary definitions. If ambiguity exists, the words could be interpreted by the courts.

Insurance policies sometimes distinguish defined terms by placing quotation marks around the terms or by printing them in boldface type each time they appear in the policy. Exhibit 7-2 shows the definitions section of a typical homeowners policy.

Insuring Agreements

An insurance policy contains at least one **insuring agreement**, which is a specific statement regarding the nature of the insurer's promises. For example, the personal auto policy developed by Insurance Services Office (ISO) has one broad insuring agreement, which simply states that "In return for payment of the premium and subject to all the terms of this policy, . . .", the insurer agrees with the insured to the policy provisions. The policy then provides a separate insuring agreement for each of the four coverages provided by the policy: liability, medical payments, uninsured motorists, and coverage for damage to the insured's auto.

An **insuring agreement** in an insurance policy is a statement that the insurer will, under certain circumstances, make a payment or provide a service.

For example, the insuring agreement in the ISO personal auto policy for Part D—Coverage for Damage to Your Auto reads, in part, as follows:

> We will pay for direct and accidental loss to "your covered auto" or any "non-owned auto," including their equipment, minus any applicable deductible shown in the Declarations.

The words in quotation marks in the above insuring agreement are defined in the definitions section of the policy.

Exclusions

The **exclusions** in an insurance policy indicate the exposures the insurer does not cover. While the insuring agreement makes a broad promise to provide coverage, the exclusions eliminate some of the coverage that would otherwise be provided. No insurance policy can reasonably cover *all* possible losses. Insurance policies contain exclusions for several reasons:

Exclusions are policy provisions that eliminate coverage for specified exposures.

Exhibit 7-2
Definitions Section of a Homeowners Policy

DEFINITIONS

In this policy, "you" and "your" refer to the "named insured" shown in the Declarations and the spouse if a resident of the same household. "We," "us" and "our" refer to the Company providing this insurance. In addition, certain words and phrases are defined as follows:

1. "Bodily injury" means bodily harm, sickness or disease, including required care, loss of services and death that results.
2. "Business" includes trade, profession or occupation.
3. "Insured" means you and residents of your household who are:
   a. Your relatives; or
   b. Other persons under the age of 21 and in the care of any person named above.

   Under Section II, "insured" also means:
   c. With respect to animals or watercraft to which this policy applies, any person or organization legally responsible for these animals or watercraft which are owned by you or any person included in **3.a.** or **3.b.** above. A person or organization using or having custody of these animals or watercraft in the course of any "business" or without consent of the owner is not an "insured";
   d. With respect to any vehicle to which this policy applies:
      (1) Persons while engaged in your employ or that of any person included in **3.a.** or **3.b.** above; or
      (2) Other persons using the vehicle on an "insured location" with your consent.
4. "Insured location" means:
   a. The "residence premises";
   b. The part of other premises, other structures and grounds used by you as a residence and:
      (1) Which is shown in the Declarations; or
      (2) Which is acquired by you during the policy period for your use as a residence;
   c. Any premises used by you in connection with a premises in **4.a.** and **4.b.** above;
   d. Any part of a premises:
      (1) Not owned by an "insured"; and
      (2) Where an "insured" is temporarily residing;
   e. Vacant land, other than farm land, owned by or rented to an "insured";
   f. Land owned by or rented to an "insured" on which a one or two family dwelling is being built as a residence for an "insured";
   g. Individual or family cemetery plots or burial vaults of an "insured"; or
   h. Any part of a premises occasionally rented to an "insured" for other than "business" use.
5. "Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions, which results, during the policy period, in:
   a. "Bodily injury"; or
   b. "Property damage."
6. "Property damage" means physical injury to, destruction of, or loss of use of tangible property.
7. "Residence employee" means:
   a. An employee of an "insured" whose duties are related to the maintenance or use of the "residence premises," including household or domestic services; or
   b. One who performs similar duties elsewhere not related to the "business" of an "insured."
8. "Residence premises" means:
   a. The one family dwelling, other structures, and grounds; or
   b. That part of any other building;

   where you reside and which is shown as the "residence premises" in the Declarations.

   "Residence premises" also means a two family dwelling where you reside in at least one of the family units and which is shown as the "residence premises" in the Declarations.

- *To avoid covering "uninsurable" losses.* Some losses cannot reasonably be insured by private insurers. For example, war and nuclear losses involve a potential for catastrophic losses that are not economically feasible to insure.
- *To avoid insuring losses that could be prevented.* Some losses are within the control of the insured. For example, many policies exclude coverage for damage intentionally caused by the insured.
- *To eliminate duplicate coverage.* Some losses are best covered by one type of insurance and are thus excluded by other types of policies. For example, most motor vehicle exposures are excluded from homeowners policies because they should be covered under automobile insurance policies.
- *To eliminate coverage that most insureds do not need.* For example, since the average homeowner does not own a private airplane, coverage for destruction of aircraft is not needed by most homeowners and is not provided under the homeowners policy.
- *To eliminate coverage for exposures that require special handling by the insurer.* For example, most commercial property policies exclude coverage for steam boiler explosions because boilers require special inspections and coverage that many insurance companies do not have the expertise to handle.
- *To keep premiums reasonable.* For example, auto insurance policies exclude coverage for mechanical breakdown of the auto. If auto insurers were to provide coverage for all regular maintenance of insured autos, premiums would probably become unreasonable because of the large number of expected losses.

Many exclusions, including those given as examples above, fit into more than one of the above reasons. Any exclusion can serve more than one purpose. To a certain extent, all exclusions fit the last purpose of keeping premiums reasonable. Logically, it would require a higher premium to pay for the additional losses that might be covered whenever a policy is broadened by eliminating an exclusion.

Although exclusions often appear in a separate section or sections labeled "Exclusions," they can also appear in various places throughout the policy. The term "exclusion" can accurately apply to any policy provision whose function is to eliminate coverage for specified loss exposures—whether or not the provision is labeled as an exclusion. For example, in the ISO homeowners policies, exclusions appear in various parts of the policy, labeled in different ways, including:

- "Property Not Covered," which lists specific types of uninsured property

- "Section I—Perils Insured Against," which lists both covered causes of loss and specific causes of loss that are not covered
- "Section I—Exclusions," which specially lists exclusions that apply to covered property

Conditions

Insurance policies contain several conditions relating to the coverage provided. The insured must generally comply with these conditions if coverage is to apply to a loss. Some of the more common conditions included in insurance policies are discussed later in this chapter.

Miscellaneous Provisions

Insurance policies often contain provisions that do not qualify as one of the policy components described above. These miscellaneous provisions sometimes deal with the relationship between the insured and the insurer, or they might help to establish procedures for carrying out the terms of the contract. However, actions by the insured that depart from the procedures in the miscellaneous provisions normally do not affect the insurer's duty to provide coverage.

Some miscellaneous provisions are unique to particular types of insurers. For example, a policy issued by a mutual insurance company is likely to describe the right of each insured to vote in the election of the board of directors.

Educational Objective 6

a. Describe and distinguish between manuscript policies and standard forms.
b. Describe the advantages of standard forms to (1) insurers and (2) insureds.

Manuscript Policies and Standard Forms

A **manuscript policy** is an insurance policy that is specifically drafted according to terms negotiated between a specific insured (or group of insureds) and an insurer.

Although insurance contracts, like all other contracts, represent freely negotiated agreements between the parties, most insurance policies use standard, preprinted forms. The parties do not normally negotiate all the terms of the contract each time someone purchases an insurance policy. Only in a special situation, usually involving a large amount of insurance, might such negotiation happen. When it does, the result is a **manuscript policy**, specifically drafted for the purpose.

As mentioned in Chapter 5, insurance advisory organizations such as Insurance Services Office (ISO) and the American Association of Insurance Services (AAIS) develop industrywide standardized forms for different types of insurance, and many

insurers use these *standard forms* for any insured accepted for a particular coverage. Similarly, an insurer might develop its own standard forms that meet the coverage needs of most insureds. A standard policy form has no specific reference to the insured's name, address, policy limits, premiums, and so forth. Instead, the standard form is attached to a declarations page that contains all of the specific information relating to the insured.

The use of standard forms has many advantages for insurers and is an efficient way to provide contracts to thousands of insureds. Not only do standard forms save considerable time and expense in issuing the policy, but they also promote consistency in the insurance company's operations. When a prospective insured applies for a specific insurance policy, the underwriter knows the scope of the coverage provided by that policy, including the applicable restrictions and exclusions. If the underwriter had to develop a manuscript policy for each individual case, underwriting efficiency and consistency would be seriously hampered. With standardized forms, the underwriter can choose from among applicants for the same coverage and can determine appropriate premiums on a consistent basis. Similarly, claim representatives know the extent of coverage provided by standardized forms and can more quickly and easily decide whether the policy covers a particular loss.

Standard policies benefit insureds as well as the insurance companies that use these policies. For example, a person in the process of selecting an insurer does not need to compare differences in policy provisions and language if the various insurers use the same standard form. In addition, if a loss is covered by two or more insurers, the likelihood of claim disputes is reduced if all insurers involved have provided coverage under the same standardized form.

Standardized wording also leads to a more consistent interpretation of insurance policies. When disagreements arise between the insured and the insurer concerning the interpretation of a particular insurance contract, a court ruling might be necessary to determine the appropriate legal interpretation of the contested policy language. If the identical language appears in many other policies of the same type, the insurer knows how the court is likely to interpret this language in the future and can properly underwrite and price the policy based on that interpretation. If the language were constantly changing or were different for each insured, more disputes would occur, and there would be no standard legal interpretation on which the insurer and the insured could rely. Therefore, insurance policies often repeat terms and clauses used elsewhere in the same policy or in different policies to diminish the possibility of a disputed interpretation.

After the policy wording has been drafted by the insurer or advisory organization and approved by state regulators, the

Reminder

Standard forms are insurance forms that contain standardized policy wording. Insurance advisory organizations develop standard forms that many insurers use in their insurance policies. Some insurers develop their own standard forms that they use in policies for their insureds.

insurance company prints thousands of copies of each standardized form. When insurance is purchased, the appropriate preprinted documents are combined with a declarations page to create the policy for that particular insured. The documents can be combined in many different ways to create policies that meet the needs of many different insureds.

Educational Objective 7

Describe and distinguish between a self-contained and a modular policy.

Structure of Insurance Policies

Insurance companies use two approaches to structuring an insurance policy, whether manuscript or standardized. A policy can be either *self-contained* or *modular*.

Self-Contained Policies

A **self-contained policy** is a single document that contains all the agreements between the insurer and the insured and that forms a complete policy by itself.

One example of a **self-contained policy** is the personal auto policy. Probably the most widely used auto insurance policy, this policy includes both property and liability insurance coverage in a single document.

The cover of a personal auto policy might be a multicolor wrapper or "jacket" containing the name and logo of the insurance company. Like the wrappers on most products, the purpose of the cover is to enhance the appearance of the product, to highlight the provider's name, and to protect the contents.

Inside the cover of a personal auto policy is the declarations page. Although the preprinted personal auto policy form is the same for all insureds, the declarations page and any attached endorsements personalize it for a particular insured. As described earlier, the policy contains a broad insuring agreement and separate insuring agreements that relate specifically to the four coverages provided. Exclusions and conditions that relate to each coverage are presented as well. The personal auto policy contains a definitions section that defines certain terms as they are used in the policy. The policy also includes a section that states the duties of the insured after a loss occurs. A separate section called "General Provisions" provides conditions that apply to the policy as a whole.

An **endorsement** is a document that amends an insurance policy in some way. Endorsements might add or delete coverage, include state-specific changes, show a change in the insured's exposures, or otherwise modify the policy.

The personal auto policy, with the declarations page added to the standard form, is a complete contract of insurance. However, it is often modified by the addition of one or more endorsements. An **endorsement** might add coverage—such as coverage for towing and labor on a car that breaks down. An endorsement might modify the policy in some way to conform to the requirements of the state where the insured lives. For

example, an endorsement might change the termination provision in the policy by placing some state-specific restrictions on cancellation of the policy by the insurer. An endorsement might also deal with a change in the insured's exposures, such as the purchase of an additional car or the addition of a new driver in the insured's household.

Modular Policies

Modular policies combine coverage forms and other documents to tailor a policy to the insured's needs. Commercial package policies (CPPs), for example, are modular policies.

A **modular policy** consists of several different documents, none of which by itself forms a complete contract.

CPPs can provide many different coverages to businesses and other organizations. Unlike the personal auto policy, which contains four coverages in one form, a CPP combines different forms, depending on the coverages a particular insured purchases. Modular policies contain a combination of coverages, some of which might not be purchased by a given insured. An insured elects coverages by having a limit and premium shown in the declarations and declines other coverages by leaving the limit and premium blank.

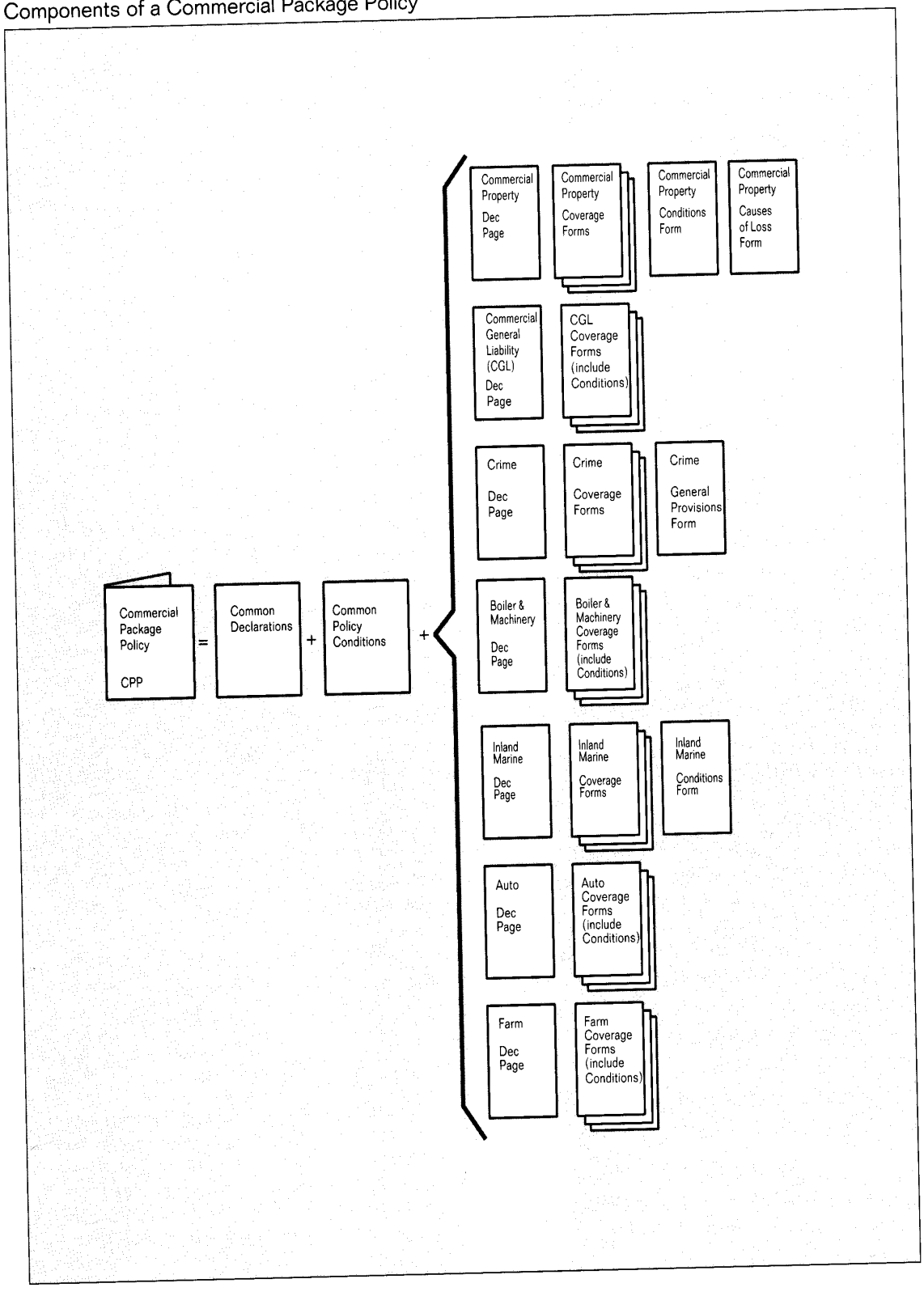
The components that can be used to compile a CPP are illustrated in Exhibit 7-3.

All CPPs must contain common policy declarations and common policy conditions. The *common policy declarations* contain information that applies to the entire policy, such as the name and address of the insured, the policy period, and the coverage(s) for which a premium has been or will be paid. The *common policy conditions* are standard provisions that apply to all CPPs, regardless of the coverages included.

The remaining components of a CPP vary, depending on the coverage needed by the insured. In most cases, a separate declarations page is included for each coverage provided in the CPP. As illustrated in Exhibit 7-3, a CPP can be used to provide many types of coverage that a commercial enterprise might need. Unlike a self-contained policy such as the personal auto policy, however, a CPP includes several different documents. For example, if a business owner wanted to purchase property and liability insurance, the CPP would include the following documents:

- Common policy declarations
- Common policy conditions
- Commercial property declarations
- One or more commercial property coverage forms
- Commercial property conditions
- One or more causes of loss forms
- Commercial general liability declarations
- Commercial general liability coverage form

Exhibit 7-3
Components of a Commercial Package Policy



If the business owner wanted other coverages, such as coverage for autos used in the business, additional documents would be added to the CPP. Detailed information about the various CPP documents is provided in INS 23—*Commercial Insurance*.

Educational Objective 8

Describe the conditions commonly found in property and liability insurance policies.

Conditions Commonly Found in Property and Liability Insurance Policies

An insurance policy describes the coverage the insurance company provides and also stipulates the conditions under which the coverage is provided. These conditions provide the rules for the relationship between the insurance company and the insured. Without such rules, insurers would find it difficult to operate efficiently. Some conditions relate to a specific coverage and appear only in policies providing that coverage. Other conditions typically appear in most property and liability insurance policies. Similarly, some conditions appear in both personal and commercial insurance policies, while others are in only one or the other type of policy. Conditions common to most property and liability insurance policies, both personal and commercial, include:

- Cancellation
- Changes
- Duties of the insured after a loss
- Assignment
- Subrogation

The descriptions of policy conditions in this section are based on policies developed by ISO. Policies developed by other advisory organizations, such as AAIS, and by individual insurance companies might have different names for these conditions, or the provisions themselves might differ from those presented here.

Cancellation

Cancellation occurs when either the insurer or the insured terminates a policy during the policy term. The cancellation provision states the procedures that must be followed when cancellation is initiated by the insured or by the insurer. This

Cancellation refers to the termination of a policy, by either the insurer or the insured, during the policy period.

provision also states any limitations on the rights of either party to cancel the policy midterm and explains how any premium refunds will be computed.

Cancellation by the Insured

The insured may usually cancel the policy at any time. To do this, the insured may either:

- Return the policy to the insurer
- Provide the insurer with advance written notice of the date the policy is to be canceled

Written notice obviously eliminates the possibility of a dispute over an oral cancellation request. The reason for requiring advance notice is also fairly obvious. Suppose an insured were permitted to request that an insurance company cancel insurance on a given building as of six months earlier and return the premium for those six months. The insurer would have been obligated to pay a claim if the building had been damaged during that six-month period because there was a policy in force. Now that the time has passed and no loss has occurred, the insurer has a right to keep the premium for that period during which claims would have been paid if they had occurred.

Cancellation by the Insurance Company

The insurance company may also cancel most insurance policies. However, the procedures described in the policy provide the insured with some safeguards, such as a given number of days' written notice before the cancellation takes effect. Many policies also prohibit the insurer from canceling, except for certain stated reasons. State law might require a longer notification period or limit the reasons for which an insurer may cancel. If the law is more favorable to the insured than are the policy provisions, the law prevails.

When a policy is canceled, the insured might be entitled to a refund. If the insurance company cancels the policy, the return premium is calculated on a pro rata basis. Therefore, if the insurer cancels a one-year policy and the cancellation is effective exactly six months after the policy's inception date, the insurer will return to the insured a **pro rata refund** of exactly half the premium.

Some policies state that if the insured requests the cancellation, the premium refund will be less than pro rata. For example, the insurance company might return only 45 percent of the premium on a policy that is canceled at exactly the halfway point of the policy term. This cancellation penalty (also known as a short-rate charge) reflects the fact that the insurer incurred some expense in issuing the policy and will not be able to keep the full premium. The **short-rate refund** also serves to discourage insurance buyers from canceling their insurance before the end of the policy period.

A **pro rata refund** is the unused premium (based on the pro rata portion of the premium for the number of days remaining in the policy) returned to the insured when a policy is canceled.

A pro rata refund of a one-year policy is calculated by dividing the premium by 365 days of the year and multiplying the resulting number by the number of days that would have remained in the policy period. For example, if the one-year policy premium is $365, and the policy is canceled after 200 days, the pro rata refund to the insured would be $165:

($365/365 = $1; $1 x 165 days remaining = $165).

A **short rate refund**, which is sometimes used when the insured cancels a policy midterm, is a refund of premium that is less than the pro rata refund would be. A short rate refund includes a penalty for the insured's cancellation of the policy before the end of the policy period.

Changes

Many policies contain a policy changes provision stating that the written insurance policy contains all the agreements between the insurer and the insured and that the terms of the policy can be changed only by a written endorsement issued by the insurer. Other policies state that changes to the policy are valid if the insurer agrees to the change in writing.

A **liberalization clause** in most policies addresses a different situation. Some insurers revise their policies fairly frequently, perhaps to clarify policy language or to broaden or restrict coverage. If a revision broadens coverage with no additional premium charge to insureds, the liberalization clause makes it clear that the revision automatically applies to all similar policies in force at the time of the revision. The liberalization clause is a benefit to insurers as well as insureds because it precludes the need for such a change to be endorsed on every similar policy already in force.

A **liberalization clause** is a policy condition that provides that if a policy form is broadened at no additional premium, the broadened coverage automatically applies to all existing policies of the same type.

Duties of the Insured After a Loss

If a covered loss is to be paid, the insurer must be informed that the loss occurred. Therefore, under property and liability insurance policies, the insured must immediately notify the insurer of the loss; most policies state that notice be given "promptly" or "as soon as is practical." Insureds are also required to cooperate with the insurer and to perform certain other duties in settling a loss. The type of cooperation and the duties required depend on the type of coverage. For example, property insurance policies generally require that the insured prepare an inventory of damaged and undamaged property and protect the property from further damage. Liability insurance policies usually require that the insured promptly forward all papers regarding a claim or suit to the insurer. Other specific duties of the insured are determined by the type of coverage provided and by the wording of the policy.

Exhibit 7-4 shows the section of the ISO personal auto policy that lists the duties of the insured after an accident or loss.

Assignment

As previously stated, an insurance policy is a personal contract between the insurance company and the insured. Insurance companies select their insureds carefully. The selection process would be bypassed if an insured were permitted to transfer the insurance coverage to some other person. The other person might be someone with whom the insurer would prefer not to do business.

The assignment provision, which is sometimes labeled "Transfer of Your Rights and Duties Under This Policy," makes it clear

Exhibit 7-4
Part E of the ISO Personal Auto Policy: Duties of the Insured After an Accident or Loss

PART E—DUTIES AFTER AN ACCIDENT OR LOSS

We have no duty to provide coverage under this policy unless there has been full compliance with the following duties:

A. We must be notified promptly of how, when and where the accident or loss happened. Notice should also include the names and addresses of any injured persons and of any witnesses.

B. A person seeking any coverage must:

1. Cooperate with us in the investigation, settlement or defense of any claim or suit.
2. Promptly send us copies of any notices or legal papers received in connection with the accident or loss.
3. Submit, as often as we reasonably require:
   a. To physical exams by physicians we select. We will pay for these exams.
   b. To examination under oath and subscribe the same.
4. Authorize us to obtain:
   a. Medical reports; and
   b. Other pertinent records.
5. Submit a proof of loss when required by us.

C. A person seeking Uninsured Motorists Coverage must also:

1. Promptly notify the police if a hit-and-run driver is involved.
2. Promptly send us copies of the legal papers if a suit is brought.

D. A person seeking Coverage For Damage to Your Auto must also:

1. Take reasonable steps after loss to protect "your covered auto" or any "non-owned auto" and their equipment from further loss. We will pay reasonable expenses incurred to do this.
2. Promptly notify the policy if "your covered auto" or any "non-owned auto" is stolen.
3. Permit us to inspect and appraise the damaged property before its repair or disposal.

Assignment is the transfer of rights or interest in a policy to another party by the insured. Most policies cannot be assigned without written permission of the insurer.

that **assignment** is not permitted without the written consent of the insurer. For example, a homeowner cannot transfer his or her homeowners policy to a new owner when the house is sold unless the insurer agrees in writing to the transfer, which is seldom the case. Insurers rarely agree to such policy transfers because they want the right to reunderwrite the policy based on the exposures presented by the new owner.

The assignment provision could present a problem when an insured dies, because coverage would cease at the time of death. Property that is now part of the insured's estate could be damaged or destroyed, and liability claims could be brought against the estate. Because of this problem, insurance policies usually state that the rights and responsibilities of an insured who has died pass to the insured's legal representative (such as the executor of an insured's estate).

Educational Objective 9

Explain how subrogation works.

Subrogation

Most property and liability insurance policies contain a *subrogation* provision. This provision is sometimes labeled "Our Right to Recover Payment" or "Transfer of Rights of Recovery Against Others to Us." Insurance practitioners, however, often use the term subrogation even when that word is not used in the policy.

When the insurer pays an insured for a loss, the insurer takes over the insured's right to collect damages from any other person responsible for the loss. The insurer is subrogated to the insured's rights of recovery, and the insurer's process of recovering is called subrogation. In short, subrogation shifts the ultimate cost of a loss to the party responsible for causing the loss.

For example, suppose Michael drives his car too fast for the existing road conditions and slides off the road into Joanne's building. Joanne would have a right to recover damages from Michael. However, Joanne might also file a claim with the insurer providing her property coverage, and her insurer would pay for the damage to her building. After paying the property insurance claim, Joanne's insurer has the right of subrogation against Michael.

In the above example, Joanne has no further rights of recovery if she has been fully indemnified for her loss. If she could *also* recover from Michael, the principle of indemnity would be violated. Joanne's insurer now has any rights of recovery Joanne had before the insurer paid for the loss, including the right to file a claim against Michael. If Michael has liability insurance, his insurance company is obligated to defend him and to pay damages on his behalf.

However, if Joanne has not been fully indemnified, she could recover the portion of her loss that her insurer did not cover. For example, if Joanne had a deductible of $1,000 on her property insurance policy, she could recover the $1,000 from Michael that her insurer deducted from its payment to her. Usually, insurers will help insureds recover deductibles as part of the subrogation process.

Most subrogation provisions require that the insured do nothing *after* a loss to impair the insurer's subrogation rights. Therefore, in the above example, Joanne may not tell Michael, "Don't worry about the damage—you won't have to pay anything because my property insurance will cover it." If Joanne were to

Reminder

As discussed in Chapter 6, *subrogation* is the insurer's right to recover payment from a negligent third party for losses the insurer has paid to an insured. When an insurer pays an insured for a loss, the insurer takes over the insured's right to collect damages from a third party responsible for the loss.

make such a statement, her property insurer could refuse to pay for the loss because Joanne has no authority to waive the insurer's rights.

Some insurance policies, however, permit an insured to waive rights of recovery *before* a loss. For example, in a property lease that states the tenant will not be held responsible for accidental damage to property owned by the insured, the insurer will have no right to recover from the tenant if the tenant accidentally causes a fire that damages the insured's property.

Educational Objective 10

Define or describe each of the Key Words and Phrases for this assignment. (All Key Words and Phrases appear in bold print in the text and in boxes in the margins throughout this chapter.)

Summary

When someone buys an insurance policy, the value he or she receives is the insurance company's binding promise to pay for specified kinds of losses. The promise is binding because the policy is a contract that can be enforced in a court of law. To be legally valid, any contract must have certain essential elements:

- It must represent an *agreement* between the parties.
- Each party must be legally *competent* to make the agreement.
- The purpose of the agreement must be *legal.*
- Each party must give some form of *consideration* to the other party.

Although all of the rules of contract law apply to insurance policies, certain special characteristics distinguish insurance policies from other contracts:

- An insurance policy is a *personal contract.*
- An insurance contract is a *conditional contract.*
- The insurance contract involves an *exchange of unequal amounts.*
- The policy is a *contract of utmost good faith.*
- The policy is a *contract of adhesion.*
- Most insurance policies are *contracts of indemnity.*

All insurance policies contain certain components, and the insured should review the provisions in each of these components in order to determine the coverage provided. Most policies include the following:

- The declarations page
- Definitions

- One or more insuring agreements
- Exclusions
- Conditions
- Miscellaneous provisions

In general, insurance policies consist of standard forms to which only the specific details regarding a particular insured must be added. Occasionally, a manuscript policy is drafted according to terms specially negotiated between the insured and the insurer. An insurance policy can be either self-contained or modular. A self-contained policy (such as a personal auto policy) is a single document that, when combined with a declarations page, forms a complete policy. A modular policy (such as a commercial package policy) comprises several different documents, none of which forms a complete contract by itself.

Insurance policies stipulate certain conditions under which the policy is issued. The insured accepts those conditions as part of the transaction. Typical conditions found in most property and liability insurance policies include:

- A cancellation provision
- A policy changes provision
- Duties of the insured after a loss
- A assignment provision
- A subrogation provision

This chapter provides a basis for studying the material in the next two chapters. Those chapters deal with property and liability loss exposures and specific provisions in policies that insure many of those exposures.