

# Understanding the Insurance Product

LEARNING OBJECTIVES	KNOWLEDGE STATEMENTS
<b>A.4. Describe, analyze, or design the information requirements for ratemaking related to loss and loss adjustment expense and demonstrate the use of loss and loss adjustment expenses in ratemaking.</b> <i>Range of weight: 8-12 percent</i>	<b>b. Policy provisions</b>

Before learning about how to price or set reserves for insurance products, it is helpful to understand more about the policies themselves. While these items will likely not be tested directly on the exam, they will be referred to often throughout the syllabus. As such, this is meant as a brief review.

## Policy Types, Coverages, and Customers

There are generally 2 types of customers for insurance products: individuals/families and businesses/business professionals. Insurance for individuals is known as personal insurance, and insurance for companies is known as commercial or business insurance.

Common Property/Casualty Personal Insurance Lines of Business:

- Personal Automobile
- Homeowners
- Personal Articles Floater
- Personal Umbrella

Common Property/Casualty Commercial Insurance Lines of Business:

- Commercial Automobile
- Commercial Property
- Commercial General Liability (sometimes just called General Liability)
- Professional Liability (including Medical Malpractice)
- Workers' Compensation

Commercial policies can have several of the above lines combined into single package policies.

Let's go through each of the above lines of business and talk briefly about the coverages.

## Personal Automobile

Personal Automobile Insurance (sometimes just called Personal Auto or Auto for short) is mandatory in all states for anyone who drives a motor vehicle, and it includes the following primary coverages (varying by state):

- **Bodily Injury Liability:** Known as BI for short. Covers damage to other persons for which the insured is liable as a result of a car accident. Damages could include medical expenses, lost wages, and pain and suffering. Policies usually have limits on what they will pay in damages per person and total per accident. Also provides legal defense costs for the insured if the insured is sued for these damages.
- **Property Damage Liability:** Known as PD for short. Covers damage to the property of others for which the insured is liable as a result of a car accident. Generally the damage is to another vehicle, but it could be other property as well (e.g., buildings). Policies have limits on what they will pay in damages per accident. Also provides legal defense costs for the insured if the insured is sued for these damages.
- **Personal Injury Protection:** Known as PIP for short, and also called No-Fault. This covers the bodily injury to the insured and the insured's passengers as a result of an accident. States will usually have either PIP or BI/PD required.
- **Medical Payments:** Similar to PIP, this covers the bodily injury to the insured and the insured's passengers as a result of an accident. Generally, this is offered in states without PIP.
- **Collision:** Covers damage to the insured's vehicle as a result of an auto accident. The insured will generally have a deductible for this coverage.
- **Comprehensive:** Known as Comp for short. Covers theft of or damage to the insured's vehicle due to reasons other than Collision. The insured will generally have a deductible for this coverage.
- **Uninsured Motorist:** Covers damages to the insured and the insured's passengers as a result of an accident caused by an uninsured or unknown motorist. This sometimes also covers damage to property in addition to damage to the persons.
- **Underinsured Motorist:** Covers damages to the insured and the insured's passengers as a result of an accident caused by a motorist with insufficient liability coverage to pay for the damages. This sometimes also covers damage to property in addition to damage to the persons.

## Homeowners

Homeowners insurance is insurance that protects a homeowner or renter from damage to their property as a result of various types of perils. The policy also provides some liability coverage. Coverages can be provided on a named peril or open peril basis. Some commonly covered perils are fire, wind (including tornado and hurricane), hail, theft, water damage, vandalism, and lightning. Perils such as flood and earthquake are generally excluded and must be purchased by a separate policy. Property can be insured either to replacement cost, actual cash value, or sometimes other values such as market value. Policies will carry a deductible, and may have different deductibles for different coverages or perils.

The main coverages are:

- **Dwelling:** This covers damage to the house itself. For homeowners policies, the coverage amount for the other property coverages are generally set as a percentage of the dwelling coverage. Renters policies generally would not have this coverage, since renters do not own the building.
- **Other Structures:** This covers damage to structures that are separate from the house, such as a detached garage or a tool shed.
- **Personal Property:** This covers damage to the contents inside the home. This is the primary coverage for renters policies. Some contents are not covered or have sublimits.
- **Additional Living Expense:** This covers costs of the insured to continue their standard of living while the home becomes uninhabitable due to a covered loss. For example, this might mean hotel expenses.
- **Comprehensive Personal Liability:** This covers the insured from claims coming from injury to others or their property for which the insured is liable. This includes things such as slip and falls on the insured's property, and dog bites from the insured's dog. The policy generally has a per occurrence limit, but not a per person limit (unlike auto insurance).
- **Medical Expense:** This covers the medical expenses of others for injuries caused by the insured or occurring on the insured's property. The insured does not have to be liable for the damages for this coverage to apply. The limits for this coverage are per person and sometimes per accident, and are often very small (e.g., \$500 per person).

## Personal Articles Floater

A Personal Articles Floater policy can be added as part of a Homeowners policy or it can be a stand-alone policy. It provides coverage for individually listed valuable items such as jewelry, furs, silverware, cameras, stamp or coin collections, guns, musical instruments, or fine arts. The floater policy will also cover more perils than a standard Homeowners policy. This line of insurance is also known as Inland Marine.

## Personal Umbrella

Personal Umbrella insurance is used to purchase additional liability coverage for higher limits than what is provided in a standard Auto or Homeowners policy. In addition to extending the limits of coverage from underlying policies, Umbrella policies can also include "drop-down" coverage, which provides first-dollar coverage for some damages for which the insured is liable but are not covered by the underlying policies.

## Commercial Automobile

Commercial Auto insurance generally provides the same coverages as a Personal Auto policy for vehicles used for business purposes. Delivery vehicles and long-haul trucks are examples of commercial auto vehicles. Commercial Auto insurance has additional complications for insurers not found in Personal Auto such as higher coverage limits and unlisted drivers or vehicles.

## Commercial Property

Commercial Property insurance has some similarities to the property coverages and perils found in Homeowners insurance, though the risks and covered items can vary significantly by business type. The main coverages are:

- **Building:** This covers damage to the building owned by the business. Note that some businesses act as renters in the buildings in which they operate, so they wouldn't need this coverage. On the other extreme, this coverage can be very high (e.g., the World Trade Center).
- **Business Personal Property:** This covers damage to the property owned by the business, such as furniture, equipment, merchandise, and materials.
- **Business Interruption:** This covers the loss of income resulting from the business being unable to operate at full capacity due to a covered loss.

## Commercial General Liability

Commercial General Liability insurance covers damage to persons or property for which the business is liable. There are 2 primary coverages:

- **Premises/Operations:** This covers damage to persons or property that occurs on the business premises or as a result of business operations.
- **Products/Completed Operations:** This covers damage to persons or property that occurs away from the business premises caused as a result of business products or completed work.

## Professional Liability

Professional Liability insurance covers damages for which a person acting in a professional capacity is liable. In medical professions, it is called Medical Malpractice insurance, while for many other professions it is called Errors & Omissions (E&O) insurance. The types of damages covered are not limited to direct bodily injury and property damage. For example, actuaries could be professionally liable for the financial consequences of not following actuarial standards of practice and providing improper estimates in ratemaking or reserving.

## Workers' Compensation

Workers' Compensation is a type of insurance that covers income replacement and medical expenses of employees suffering bodily harm, illnesses, or death as a result of workplace-related accidents or conditions. The coverages are provided without having to prove the liability of the employer for the accident. In exchange for the coverages being provided without fault, injured employees lose the right to sue the employer for the damages related to workplace accidents (except in a few special cases). In most states, Workers' Compensation is required by law for businesses that have employees. There are 2 sections in Workers' Compensation policies that provide coverages:

- **Section I:** This section provides the coverages required by Workers' Compensation laws, which includes the medical expenses and lost wages of employees as a result of workplace-related injuries, illnesses, or death. The lost wages component is also known as indemnity or income replacement. State laws may put caps on the amount of income that can be replaced per week that the employee is out of work due to a workplace injury. However, there is no policy limit on section I claims, so they can be very large.
- **Section II:** This section provides coverage for Employer's Liability, which covers the employer for any remaining liability they may incur for employee workplace accident scenarios not covered by Workers' Compensation laws. Common examples include Third Party Over, Loss of Consortium, Dual Capacity, and Consequential Bodily Injury. These claims are extremely rare compared to the medical and lost wage claims, and are often ignored when discussing Workers' Compensation claims. There are coverage limits in the policy for Employers' Liability that are generally per employee, per accident, and per policy for disease losses.