1 – Personal Insurance Overview

**Elements of Loss Exposures**

Individuals and families incur losses when assets they own, such as a home or an auto, or assets they generate, such as earning power, experience and reduction in value. Additionally, they could expose their assets to loss through their activities if they cause another person to suffer injury or loss. The chance that a tree will fall on a home and damage the roof is an example of a loss exposure. An actual loss need not occur for a loss exposure to be present; rather, simply the possibility of loss must exist. **Every loss exposure has three elements:**

* **Asset exposed to loss**
* **Cause of loss**
* **Financial consequence of loss**

The loss exposure equation: The “product” of the elements “equals” a loss exposure. Remove any one of the three elements and a loss exposure is no longer present.

Loss exposure = Asset exposed to loss x Cause of Loss x Financial consequence of loss

**Asset Exposed to Loss**

**An asset exposed to loss can be any item with value that is exposed to a possible reduction in that value due to loss.**

**Cause of Loss**

**A cause of loss (or peril) is the means by which an asset can be reduced in value.**

Cause of Loss and Multiplier Effect

Sometimes on cause of loss can have a multiplier effect, demonstrating the unpredictable nature of causes of losses. For example, a fire burns down a three unit rental dwelling owned by a retired couple. The couple suffers not only the loss of the dwelling but also the loss of rental income they rely on as their primary source of monthly income. Additionally, consider a homeowner whose vacation property is vandalized. Because a broken rear window in the house goes unnoticed for several days, a subsequent rainstorm causes extensive water damage to the owner’s hardwood floors.

**Fire, wind, hail, lightning, theft, vandalism, auto collision, loss of employment, and long-term illness are all examples of causes of loss that can occur to assets**.

**Financial Consequence of Loss**

**The financial consequences of a loss depend on the type of asset exposed to loss, the cause of loss and the severity of the loss**.

**Property Loss Exposures**

Property loss exposure is a condition that presents the possibility that a person or an organization will sustain a loss resulting from damage (including destruction, taking, or loss of use) to property in which that person or organization has a financial interest.

All property is subject to property loss exposures. Property may be destroyed, damaged, stolen, or lost, or may otherwise suffer a decrease in values because of a particular cause of loss (or peril).

Property loss exposures can be examined in terms of three loss exposure elements.

* **Asset exposed to loss**
* **Cause of loss**
* **Financial consequence of loss**

**Assets Exposed to Loss**

Assets exposed to loss are any items of property that have value. **Two types of property that individuals and families own that may be exposed to loss are (1) real property and (2) personal property.**

**Examples of real property that may be exposed to loss can include a home, foundations, underground pipes, sheds attached to the land, or anything growing on the land, including trees.**

**Examples of personal property that may be exposed to loss can include furniture; televisions, electronic equipment, including computers; and additional household personal property, such as appliances, dishes, carpets, sports equipment, clothing, tools, books, jewelry, cameras, and digital recording devices. Other personal property examples can include autos, boats, aircraft and intangible property**.

**Real Property**

All real property is tangible property having a physical form that can be seen or touched.

**Personal Property**

For the purpose of identifying, insuring, and pricing personal property loss exposures, personal property can be divided into these categories.

* Dwelling contents – the broadest category of personal property
* High-value personal property – property worth considerable sums of money (jewelry, silverware, furs, and firearms).
* Rare or unusual property – items with unique characteristics (one of a kind, rare, not easily replaced).
* Business personal property – office furniture, computer
* Motor vehicles, trailers, watercraft and aircraft – mobile property – covered under other policies.

**Causes of Loss**

**Causes of loss (or perils) that can damage or destroy real property, such as a dwelling, include fire, lightning, earthquake, or wind. (Other real property/dwelling cause of loss of loss examples are acceptable.**

**Financial Consequences of los**

**Financial consequences of loss can include one or more of these outcomes:**

* **Reduction in value of property – the difference between the value of the property before the loss (pre-loss value) and after the loss (post-loss value).**
* **Increased expenses – Expenses in addition to normal living expenses that are necessary because of the loss.**
* **Lost income – loss of income that results if property is damaged.**

**3 -Liability Loss Exposures**

Liability loss exposure is any condition or situation that presents the possibility of a claim alleging legal responsibility of a person or business for injury or damage suffered by another party.

Damages – money claimed by, or a monetary award to, a party who has suffered bodily injury or property damage for which another party is legally responsible.

**Whether through owning property, driving a car, or entering into contracts with others, all individuals and families face personal liability loss exposures. Even if a liability claim is successfully defended, and therefore does not result in payment of damages, the party against whom the claim was made nonetheless incurs defense costs, other claim related, expenses, and potentially adverse publicity, al of which may produce a financial loss**.

**Assets Exposed to Loss**

**The assets exposed to loss in a liability loss exposure are money or other financial assets.**

Damages awarded in a liability judgment can take the form of general special and punitive damages.

**General damages** are monetary awards to compensate victims for losses, **such as pain and suffering**

**Special damages** are a form of compensatory damages that compensate for specific, identifiable expenses associated with the injured person’s loss, such as **medical expenses and lost wages**

Punitive, or exemplary damages are awarded by a court to punish the defendant for reckless, malicious, or deceitful act, or to deter similar conduct.

**Causes of Loss**

**The cause of loss associated with liability loss exposure Is the claim of liability or the filing of a lawsuit.** The settlement of disputes between individuals and the indemnification for wrongs committed are handled by through civil law. Several types of claims fall under civil law, but the most common personal liability claims involve tort liability, contractual liability and statutory liability.

Tort a wrongful act or an omission, other than a crime or a breach of contract that invades a legally protected right.

**Tort Liability**

An individual may face a claim for tort damages on the basis of any act of negligence, intentional torts, or absolute liability.

Negligence is the most common cause of liability losses. To prove negligence has occurred, an injured party must prove that all **four legal elements of negligence** has occurred:

* **A duty to act**
* **A breach of that duty**
* **An injury or damage occurs**
* **The breach of duty is the direct cause of the injury or damage in an unbroken chain of events**

Regardless of whether the harm that results in intended an intentional act can create liability. These are **examples of intentional torts**

* **Libel – written or printed untrue statement**
* **Slander – oral untrue statement**
* **Assault – unlawful threat of bodily harm**
* **Battery – unlawful physical contact**
* **Trespass – unauthorized possession or use of land**
* **Nuisance – violation of a persons right to enjoy the use of property without disruption**

Absolute liability does not involve proving negligence. If a person keeps a pet alligator in a cage in his back yard and the alligator bites a neighbor, the owner of the alligator could be held liable.

**Contractual liability**

When an individual enters into a contract or an agreement. Leases for homes and apartments, as well as rental agreements typically contain provisions that transfer the financial consequences of liability losses from the owner of the property to the renter.

**Statutory Liability**

Statutory liability exists because of the passes of a statute or law. Most important to individuals and families are the laws dealing with liability arising out of automobile accidents.

**Financial Consequences of Loss**

Because the assets exposed to loss in a liability loss exposure is money or other financial assets, the financial consequences of a liability loss can be serious.

When a liability claim occurs an individual or a family can suffer two major financial consequences:

* Cost of investigation and defense
* Money damages awarded if the defense is not successful or if the claim is settled out of court

**4 – Personal Financial Planning Loss Exposures**

One component of personal financial plan entails accounting for circumstances that may unexpectedly affect spending or income.

Certain personal financial planning loss exposures can cause significant financial difficulty for individuals and families. Three elements of personal financial planning loss exposures are the assets exposed to loss, causes of loss and financial consequences of loss. Primary examples of personal financial planning loss exposures include retirement loss exposures, premature death exposures, poor health and disability exposures and unemployment exposures.

**Retirement Loss Exposures**

**The assets exposed to loss when an individual retires are regular employment income ant the related benefits, such as health insurance.**

The actual retirement related loss stems from failure to maintain resources sufficient to sustain a desired lifestyle for from an underestimation of the length of the retirement period.

**Premature Death Loss Exposures**

**A death is considered premature if it occurs before an individual reaches his or her life expectancy. The assets exposed to loss as the result of an individual’s premature death include the expected income on which his or her family or heirs rely**. The causes of loss associated with premature death include accident, illness, or the intentional taking of life.

**Health and Disability Loss Exposures**

**The causes of loss associated with health and disability loss exposures are chronic illness and/or physical or mental disabilities.**

**There are four types of disability**

* **Temporary partial**
* **Temporary total**
* **Permanent partial**
* **Permanent total**

**Unemployment**

The assets exposed to los by unemployment include income and employer provided benefits. The causes of loss of unemployment may be voluntary or involuntary.

**5 – Risk Management Process**

Individuals and families should use the risk management process to determine the best techniques for managing their loss exposures.

Risk management process is the method of making, implementing, and monitoring decisions that minimize the adverse effects of risk on an organization. **These are the six (6) steps of the risk management process:**

* **Identify loss exposures**
* **Analyze loss exposures**
* **Examine the feasibility of risk management techniques**
* **Select the appropriate risk management techniques**
* **Implement the selected risk management techniques**
* **Monitor results and revise the risk management program**

**Identifying Loss Exposures**

Step 1 is identifying the loss exposures. Individuals and families usually rely on friends, family members, and their insurance agent to help them identify their loss exposures

**Analyzing Loss Exposures**

Analyzing loss exposures entails estimating the likely significance of possible losses identified in step one. Together, these two steps constitute the process of assessing loss exposures and they are therefore often consider the most important components of the risk management process.

**The loss characteristics that individuals and families may use to analyze their loss exposures are:**

* **Loss frequency – during the previous year**
* **Loss severity – amount of auto claims**
* **Total dollar losses**
* **Timing – usually settled in a matter of days or weeks, however auto claim may require years**

**Examining the Feasibility of Risk Management Techniques**

Loss exposures can be addressed through risk control techniques and risk financing techniques. Risk control techniques minimize the frequency or severity of losses, Risk Financing, such as insurance generate funds to finance losses that risk control techniques cannot reduce or prevent.

Unlike organizations, most individuals and families have access to limited number of feasible risk control and risk financing techniques, the most prevalent of which is the purchase of insurance.

**Selecting the Appropriate Risk Management Techniques**

Once loss exposures have been identified and analyzed and possible risk management techniques considered, individuals and families can select the techniques that best prevent or reduce losses and that will adequately finance losses that occur. Selecting the most appropriate combination of risk management techniques is usually based on quantitative financial considerations as well as qualitative, nonfinancial considerations.

Most households choose risk management techniques by using financial criteria. That is, they choose the most effective techniques that will have the greatest positive (or least negative) effect on their assets.

**Implementing the Selected Risk Management techniques**

**Implementing risk management techniques may involve any of these measures**

* **Purchasing loss reduction devices (smoke alarms, flame retardant roofing)**
* **Contracting for loss prevention services (burglar alarm)**
* **Funding retention programs (savings account)**
* **Implementing and continually reinforcing loss control programs (keeping flammable material away from heat sources)**
* **Selecting agents or brokers, insurers, and other insurance providers who can suggest ways to deal with specific loss exposures (such as rare items or expensive collections)**
* **Requesting insurance policies and paying premiums for loss exposures that they are not willing to retain (such as purchasing homeowners, auto)**
* **Creating and updating a list of possessions that may be subject to loss**

**Monitoring Results and Revising the Risk Management Program**

Individuals and families must monitor and periodically review their risk management program to ensure that it is achieving expected results. They also should adjust it to accommodate changes in loss exposures and in the availability or cost-effectiveness of alternative risk management techniques.

A risk management program should be adjusted as life-changing events occur.

**6 – Risk Management Techniques**

All risk management techniques fall into one of two categories: risk control or risk financing.

**Risk Control Techniques**

**Risk Control techniques fall into one of six (6) broad categories:**

* **Avoidance**
* **Loss Prevention – break the sequence of events that leads to the loss, reducing frequency**
* **Loss reduction – reduces severity**
* **Separation**
* **Duplication**
* **Diversification**

**Risk Financing Techniques**

**The risk financing techniques individuals and families use include these:**

* **Retention**
* **Transfer**

**Retention**

Usually, a family deliberately uses retention only to treat loss exposures that are within its financial means, such as when it selects a $1,00 deductible on collision insurance.

Most families and individuals do not retain losses on a pre-planned, structured basis. They generally pay for retained losses with reserve savings or may change budgeting priorities to pay for them. Retention can be planned or unplanned; complete or partial; or funded or unfunded.

**Planned retention is a deliberate assumption of loss that has been identified and analyzed** and may be chosen because it is the most cost effective or convenient technique, or because no other alternatives are available.

**Unplanned retention is the inadvertent, unplanned assumption of a loss exposure that has not been identified or accurately analyzed**. (flood losses)

**Transfer**

Insurance is the most prevalent form of risk transfer.

**Some risk transfer techniques, however do not involve insurance. A hold-harmless agreement, is a non-insurance risk transfer in which one party assumes the legal liability of another party to the contract, such as in an apartment lease.**

**Hedging is another noninsurance risk transfer technique whereby one asset (money) is paid to offset the risk associated with another asset**.

**7 – Insurance as a Risk Financing Technique**

Personal insurance is a risk transfer technique individuals and families use to finance their personal loss exposures. All individuals and families have personal loss exposures. **Although some of these loss exposures may be managed through noninsurance transfers and retention, the most prevalent risk management technique is the purchase of personal insurance.**

**Personal insurance consists of 3 layers:**

* **Social Insurance (social security benefits)**
* **Group insurance (health care)**
* **Individual insurance (home and auto)**

**Property and Liability Loss Exposures**

Property loss exposures stem from a legal interest n both real property and personal property. Liability loss exposures originate from the possibility of being sued or being held responsible for someone else’s injury.

**Retirement Loss Exposures**

**The assets exposed to loss when an individual retires are regular employment income and the related benefits of employment, such as health insurance**.

**Methods individuals and families use to mitigate the financial consequences of retirement loss exposures include maintaining savings plans and pension plans to help them prepare for retirement. Social Security, and example of social insurance, is available for covered workers who are at lease sixty-two (62) years old. Other methods include maintaining individual retirement accounts, employer-sponsored group pension plans, 401(k) savings plans, and defined benefit plans**.

**Premature Death Loss Exposures**

A death is considered premature if it occurs before an individual reaches his or her life expectancy**. The assets exposed to loss as the result of an individual’s premature death include the expected income on which his or her family or heirs rely**.

Individuals and families use life insurance as a risk management technique for many of the same reasons that they use property-casualty insurance. The basic principle of insurance is that the financial losses of the few are drawn from the paid premiums of many.

**The amount of life insurance that an individual or family should purchase can be determined by the needs-based approach or the human life value approach. The needs-based approach attempts to estimate a family’s future financial needs to determine the life insurance compensation they will require. This value is calculated after also accounting for any Social Security or other applicable benefits the family will received**.

The human life value approach does not attempt to estimate a family’s future financial needs. Instead, it uses the estimated present value of the insured’s financial contribution to the family to determine the income that the family could lose in the event of premature death. Courts often use the human life value approach to determine appropriate compensation for a wage earner’s family for its loss.

**Health and Disability Loss Exposures**

**Health and disability insurance may be more important to an individual or family than life insurance because if a person becomes critically ill or disabled, the cost of hospital care, medication, and care giving could become a seve financial burden. The illness or disability may also prevent a spouse from obtaining employment that would help replace the income generated by the ill or disabled spouse**.

Three prominent government programs (social insurance programs) that provide health and disability benefits are Medicare, Medicaid and workers compensation.

**Unemployment Loss Exposures**

The assets exposed to loss by unemployment include income and employer provided benefits. All state governments sponsor unemployment compensation programs that pay benefits to covered individuals who are involuntarily unemployed.

**States derive unemployment benefits from the taxes or premiums they assess employers. Generally, unemployed workers receive unemployment benefits for a particular number of weeks or until they secure employment. The state may legislate an increase in the number of week over which the unemployed can collect benefits, depending on economic conditions or state unemployment rates**.

Chapter overview:

**A family might consider selecting from among social insurance, group insurance and private insurance.**

**Social insurance provides a basic foundation of coverage. If the only monetary provider for the family, were to die or become disabled, social insurance in the form of Social Security or workers compensation would likely be available to the family.**

**Group insurance (life and health insurance) is provided by many employers. The family may augment its group coverage with individual insurance.**

**Individual insurance is insurance available for families for their homes and automobiles and other property and liability coverages. A liability umbrella can be purchased relatively inexpensively to cover extensive liability exposures, known as well as unknown**.

**8 – Common Policy Provisions**

Every insurance policy is composed of numerous policy provisions.

Some policy provisions are common to most insurance policies, whereas others are unique to specific policies. Despite the wide variation in property-casualty insurance provisions, they typically fall into one of six categories, depending on the purpose the serve.

**The policy declarations typically contain this information:**

* **Policy or policy number**
* **Policy inception and expiration dates (policy period)**
* **Name of the insurer**
* **Name of the insurance agent**
* **Name of the insured(s)**
* **Name of additional interests that are covered**
* **Mailing address of the insured**
* **Physical address and description of the covered property**
* **Numbers and edition dates of attached forms and endorsements**
* **Dollar amounts of applicable policy limits**
* **Dollar amounts of applicable deductibles**
* **Premium**

**Definitions**

Words and phrases defined within an insurance policy have special, defined meanings when they are used within that particular policy. The definitions section defines the terms used throughout the entire policy or form. Boldface type or quotation marks typically are used to distinguish words and phrases defined elsewhere in the policy**. Undefined words and phrases are interpreted according to these rules of policy interpretation:**

* **Everyday words are given in their ordinary meanings**
* **Technical words are given in their technical meanings**
* **Words with an established legal meaning are given their legal meanings**
* **Consideration is also given to the local, cultural, and trade-usage meanings of words, if** applicable.

**Insuring Agreements**

Following the declarations, and possible preceded by a section containing definitions, the body of most insurance policies begins with an insuring agreement. **The insurance agreement is the promise of coverage the insurer makes to the insured and is essentially what the insured is buying**.

**Conditions**

The insurer’s promise in the insuring agreement are enforceable only if an insured event occurs and only if the insured has fulfilled its contractual duties as specified in the policy conditions. Such as pay premiums, report losses promptly, provide documentation, cooperate with the insured.

**Exclusions**

The primary function of exclusions is not only to limit coverage but also to clarify the coverages granted by the insured. Specifying what the insured does not intend to cover is a way of clarifying what the insurer does intend to cover. Exclusions have six (6) purposes:

* Eliminate coverage for uninsurable loss exposures
* Assist in managing moral and morale hazards
* Reduce likelihood of coverage duplications
* Eliminate coverages not need by the typical insured
* Eliminate coverages requiring special treatment
* Assist in keeping premiums reasonable

**Miscellaneous Provisions**

Miscellaneous provisions that specify the relationship between the insured and the insurer or help establish working procedures for implement the policy.

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| --- | --- |
| **Policy Provision Category** | **Effect on Coverage** |
| **Declarations** | **Outline who or what is covered and where and when coverage applies** |
| **Definitions** | **May limit or expand coverage based on definitions of terms** |
| **Insuring agreements** | **Outline circumstances under which the insurer agrees to pay** |
| **Conditions** | **Outline steps insured needs to take to enforce policy** |
| **Exclusions** | **Limit insurers payments based on excluded persons, places, things, or actions** |
| **Miscellaneous** | **Deal with the relationship between the insured and the insurer or establish procedures for implementing the policy** |

**9 – Policy Analysis**

Each pre-loss question posed or post-loss claim filed by an insured is a unique situation that may require a review of policy provisions

Insurance professional should conduct a pre-loss analysis to prepare themselves to answer an insured’s coverage questions and to ensure that the policy being sold is appropriate for the insured’s loss exposures. Insureds should conduct pre-loss policy analysis to verify that the policy they’re purchasing adequately addresses their loss exposures.

**Pre-loss Policy Analysis**

**Pre-loss policy analysis almost exclusively relies on scenario analysis to determine the extent of coverage (if any) the policy provides for the losses generated by a given scenario. For insureds, the primary source of information for generating scenarios for analysis is their past loss experience. Particularly, if the insured has never suffered a loss that triggered insurance coverage, friends, neighbors, co-workers, and family member can also provide information about their experiences with losses and the claim process. The insurance producer and customer service representatives are also good sources of information.**

**One of the limitations of scenario analysis is that, because of the number of possible loss scenarios is theoretically infinite, it is impossible to account for every possibility**. Such as terrorist attacks of 9/11/01, or Andrew in 1992.

**Post-Loss Policy Analysis**

**The primary post-loss policy analysis is the DICE (an acronym representing the policy provision categories; declarations, insuring agreements, conditions, and exclusions) method, which is a systematic review of all the categories of property-casualty policy provisions**

**Dice decision tree will be followed to determine whether the family’s policy covered the loss**.

**First sept is an examination of the declarations page**

**Second Reviewing the insuring agreement**

**Third check the policy conditions to determine if anything precluded coverage**

**Fourth check the exclusions and all other policy provisions not already analyzed, including the endorsements and miscellaneous provisions to make sure that nothing would preclude coverage. If not, he or she will determine the amount payable under the policy**.