

Class 4 Outline
Business Finance 640 - Insurance and Risk
Autumn Quarter, 2007

This class provides an introduction to the insurance contract. We will discuss the basic parts of the insurance contract: declaration page, definitions, insuring agreement, exclusions, conditions and miscellaneous provisions. In our discussion of the insuring agreement, we will review the important difference between a named-perils policy and an “all risks” policy in property insurance.

We will also discuss the definition of an insured, endorsements and riders to policies, different types of deductibles, coinsurance and other insurance provisions. In examining coinsurance, we will see how coinsurance differs in property insurance from coinsurance in health insurance. Our discussion of other insurance provisions will include a look at pro-rata liability, contribution by equal shares, and primary and excess insurance.

We will start the class by reviewing several topics from the Class 3 outline, that were not discussed during the previous class. These include the general rules of agency, the agent’s authority to bind the insurer and the doctrines of waiver and estoppel.

I. Law and the Insurance Agent

A. General Rules of Agency

1. There is no presumption of an agency relationship.
2. Agents may bind principal by express authority, implied authority, or apparent authority
3. Principal responsible for agent’s torts and charged with agent’s knowledge of notice

B. Agent’s Authority To Bind Insurer – Varies by type of insurance

1. Property and liability insurance
 - a. P & L agents typically have the power to bind the company through the use of a binder
 - b. A binder is a temporary contract for insurance and can be either written or oral
2. Life insurance
 - a. Life insurance agents do not have the power to bind the insurer.
 - b. After the applicant completes the application and pays the first premium, the agent can issue a conditional premium receipt.
 - c. If the applicant is found insurable according to the company’s normal underwriting standards, the insurance becomes effective as of the date of the application.

C. Doctrines of Waiver and Estoppel

1. Waiver—voluntary relinquishment of a known legal right
2. Estoppel—representation of fact made by one person to another person that is reasonably relied on by that person to such an extent that it would be inequitable to allow the first person to deny the truth of the representation
3. Practical significance of these legal doctrines—insurer legally may be required to pay a claim that it ordinarily would not have to pay.

II. Basic Parts of an Insurance Contract

A. Declarations Page

1. Nature—statements made by the applicant for insurance

Class 4 Outline
Business Finance 640 - Insurance and Risk
Autumn Quarter, 2007

2. Purpose – to provide information for underwriting, rating and identifying who and what is insured and for how much.

B. Definitions

C. Insuring Agreement

1. Named perils coverage
2. “All risks” coverage

D. Exclusions

1. Excluded perils
2. Excluded losses
3. Excluded property

E. Reasons for exclusions

1. Some perils are considered uninsurable.
2. Extraordinary hazards are present.
3. Coverage is provided by other contracts.
4. Moral hazard is present to a high degree.
5. Coverage is not needed by the typical insured.

F. Conditions

1. Give notice of loss
2. Preserve and protect property from further loss or damage
3. Submit proof of loss

G. Miscellaneous Provisions

1. Cancellation clause
2. Appraisal
3. Assignment
4. Other insurance

III. Definition of the Insured

- A. One person
- B. Definition of named insured
- C. Additional insureds

IV. Endorsements and Riders

- A. Purpose—to add, delete, or modify provisions in the original contract
- B. Riders may increase or decrease benefits or amounts of insurance.
- C. Riders may add coverage for new perils or losses.

Class 4 Outline
Business Finance 640 - Insurance and Risk
Autumn Quarter, 2007

V. Deductibles

- A. Purposes of Deductibles
 - 1. Eliminate small claims
 - 2. Reduce premiums
 - 3. Reduce moral and morale hazard

- B. Types of Deductibles
 - 1. Property insurance
 - a. Straight deductible
 - b. Aggregate deductible

 - 2. Health insurance
 - a. Calendar-year deductible
 - b. Corridor deductible
 - c. Elimination period

VI. Coinsurance

- A. Nature of Coinsurance - Property
 - 1. Requires the insured to carry insurance equal to a specified percentage of the actual cash value of the property of the insured.

 - 2. If the amount of insurance carried is equal to or greater than the required percentage, the insurer will pay covered losses in full (subject to any deductible) up to the limit of insurance.

 - 3. If the amount of insurance carried is less than the required percentage, loss payments will be reduced proportionately.

 - 4. If the amount of insurance does not meet the coinsurance requirement, the insurer will pay according to the following formula:

$$\text{Loss payment} = \frac{(\text{Amount of Insurance Carried}) \times \text{Loss}}{(\text{Amount of Insurance Required})} - \text{Deductible}$$

- 5. The amount of insurance required is the ACV just prior to the loss multiplied by the coinsurance percentage.

- B. Purpose of Coinsurance—to achieve equity in rating

- C. Coinsurance in Health Insurance (Percentage Participation Clause)

Class 4 Outline
Business Finance 640 - Insurance and Risk
Autumn Quarter, 2007

VII. Other Insurance Provisions

A. Types

1. Pro rata liability clause
2. Contribution by equal shares
3. Primary and excess coverage
4. Coordination-of-benefits provision

B. Purpose is to prevent profiting from insurance and to support the principle of indemnity.