Property Section 1
Insurance Terms and Related Concepts

A. Insurance: Transferring pure risk (no gain) from individuals to a group. Pools large numbers of individual risks. Charges a small premium to each in the pool in exchange for protection.

1. *Law of Large Numbers*: The basic principle of this law is that the larger the number of separate risks of a like nature combined into one group, the more predictable the number of future losses of that group within a given time period. For the law of large numbers to operate, it is essential that a large number of exposure units be combined. The exposure unit in life and health insurance is the economic value of the individual person's life. In property and casualty insurance, it is the car, home, or other item to be insured. Insurance companies can only predict the number of losses expected for a group, not for each individual.

B. Insurable Interest: Based upon economics or an equity position. Insurable interest is required at the time of loss in order to recover on a policy.

C. Risk: The uncertainty of loss. For example, when you drive your car, the risk is that you may become involved in an accident.

1. *Pure Risk*: No chance of gain, only chance of loss. You can only insure pure risk.

2. *Speculative Risk*: You may gain, you may lose; investing in the stock market is speculative risk. You cannot insure speculative risk.

D. Hazard: Something that increases the risk. Drinking while driving is a hazard since it greatly increases the chance of an accident.

1. *Physical*: There are physical hazards that result from material or structural features of a risk, as opposed to human or management factors, such as an oily rag left by the furnace.

2. *Moral*: There are moral hazards, which are circumstances of morals or habits that increase the probability of a loss from an insured peril, such as an insured previously convicted of arson. A dishonest person is a moral hazard. A person who is not paying their credit card bills timely is a moral hazard.

3. *Morale*: Lastly there are morale hazards, which are an increase in the hazards presented by a risk arising from the insured's indifference to loss because of the existence of insurance. For example, an insured fails to repair faulty wiring, believing it is less expensive to pay insurance premiums than to pay an electrician. A careless person is a morale hazard.

E. Peril: The cause of loss. Wind is a peril. It may damage your roof. Some policies, such as the standard fire policy are named or specified perils, meaning that if whatever happens to the structure is not named as a peril in the policy, there is no coverage. Other policies, such as the HO-3 are all-risk on the building structures, meaning that whatever may happen is covered unless that peril is excluded. All-risk policies are sometimes called open peril policies.

F. Loss: Damage resulting to the structure caused by a peril, such as fire or lightning, which are examples of:

1. *Direct Loss*: For example: A fire burns the house down. The burnt down house is a direct loss.

2. *Indirect Loss*: Sometimes called a consequential loss. Loss of rental value (loss of use) is an indirect loss that is covered on some policy forms. Losses of this nature are also called time-element losses since they occur over a period of time.

G. Loss Valuation:

1. *Actual Cash Value*: Replacement cost (at the time of loss, also known as current value) minus depreciation (based on the age of the structure), if any equals actual cash value.

2. *Replacement Cost*: Starting with the DP-02 broad form fire insurance policy, the contract promises to pay all covered property insurance losses to the building structure in full (without deduction for depreciation), *if the insured carries 80% of the full replacement cost* of the structure as a policy limit at the time of the loss. Remember, you can never recover more than the policy limit.

3. *Market Value*: Market value is the amount of money you could get for property in the market. The market value of a property may be higher or lower than the replacement cost of the property, depending upon the location of the property and the current market conditions.

4. *Stated Value*: A policy insured at a stated value means that the insured chooses a limit of coverage for the property. In the event of a loss, the insurer will pay the claim in one of three ways, choosing whichever is least: the stated value; the cost to repair the property not to exceed the stated value; or actual cash value. A stated value policy does not guarantee that the stated value will be paid in the event of a total loss. When insuring property such as a classic car, agreed value is a better type of coverage. A policy with an agreed value (amount) means that in the event of a loss the insurer must pay either: the agreed value, or the cost to repair the covered property not to exceed the agreed value.

5. *Salvage Value*: The right to salvage belongs to both the insurer and the insured. If the insured requests to keep the salvage, the insurer will lower the claim amount paid. If the claim is paid in full, then the insurer owns the salvage and may sell it to offset their loss. If a claim is paid in full and the stolen item is found, it should be returned to the insurer, who may then offer to sell it back to the insured. The salvage value is the amount that the insurer can get for the salvage left after a total loss.

H. Proximate Cause: This is a negligence term, meaning that a party's negligence must be the proximate cause or reason for the resulting injury to others. Generally, there must be a direct chain of events leading from the negligent act up to the resulting injury or property damage in order for the negligent act to be considered the proximate cause.

I. Deductible: The amount the insured must pay on every claim. The purpose of the deductible is to discourage the insured from turning in small claims to the insurance company, since they are very costly to process. The higher the deductible, the lower the premium. Hence, by having a deductible the insurance company will end up paying less of every claim.

J. **Indemnity**: The word indemnify means to pay. Property insurance policies are contracts of indemnity, meaning that the insured may not recover more than he or she actually lost. For example, if you had two policies covering the same property, and you were hoping to be able to collect from each policy in the event of a loss, you would be in violation of this principle. This, of course, would be prevented from happening by the pro-rata liability clause in a property insurance contract.

K. **Limits of Liability**: The policy limits. However, on HO policies, the cost of defense (hiring a lawyer to defend you) is in addition to limits. On property insurance, such as the standard fire policy, the policy will pay the ACV, or the policy limits, whichever is less. The policy limits are shown in the policy's declarations (on the first page of the contract).

L. **Coinsurance/Insurance to Value**: In property insurance, a clause under which the insured shares in losses to the extent that he or she is underinsured at the time of the loss. On a DP-02, in order to get replacement cost coverage, the insured must insure his building structure *for at least 80% of the current replacement cost*. This is the coinsurance requirement, sometimes called *the 80% clause*. This clause is designed to ensure that the insured carries adequate policy limits.

M. **Occurrence**: Something occurring over a period of time, but still covered by the policy.

N. **Cancellation**: Cancellation may be done by either the insured or insurer. Cancellation is done mid-term. If the insurer is canceling the policy mid-term they must have a specific reason and give written advance notice of the cancellation. In a cancellation situation, a refund is due to the insured, either short-rate if the insured canceled the policy, or pro-rata if the insurer cancels the policy.

O. **Non-Renewal**: Occurs at the policy anniversary date. The insurer must give the insured advance written notice that their policy will not be renewed. No premium refund is due.

P. **Vacancy and Unoccupancy**: Vacancy occurs when the insured has moved out and taken his or her belongings. Unoccupancy is defined as when the insured is on a vacation or trip, his contents are still on the premises and he will be returning. On the standard fire policy, vacancy or unoccupancy, after *60 consecutive days*, suspends all coverages. However, when the dwelling property form is added to the standard fire policy, this condition is eliminated entirely, except for the limitation that says there is no coverage for vandalism if the property has been vacant beyond *60 days*.

Q. **Liability**: Liability covers bodily injury (BI) and property damage (PD) to others caused by the negligent acts of the insured. Although fire policies do not contain any coverage for liability, all homeowners policies do. The liability portion of coverage has no deductible.

1. *Absolute Liability*: Strict or absolute liability is liability without negligence (keeping a pet tiger). Under absolute liability, the claimant does not have to prove anything. You are absolutely liable for keeping a pet tiger. Another area of strict liability is the responsibility for handling explosives.

2. *Strict (generally the same as Absolute Liability)*: Liability without fault. For example, in products liability, manufacturers and retailers have been held strictly liable for products that have caused

injuries and have been shown to be defective, even though the manufacturer or retailer was not proven to be at-fault or negligent. In many states the owner of an animal is held strictly liable for injuries it may cause, even though it does not have a past history of violence.

3. *Vicarious Liability*: Some state statutes spell out situations where one party may be responsible for the negligent activities of another party. For example, if you ask your secretary to drive her own car on your company's business, you can be sued if she negligently injures someone. Also, owners of taverns and night clubs are often found to be vicariously negligent for the actions of customers to whom they may have served too many drinks. Further, under the Doctrine of Agency, insurers are vicariously liable for the acts of their agents.

R. Negligence: Failure to act as a reasonable person would in the same set of circumstances. Negligence is a tort, it is a civil wrong, it is grounds for a lawsuit.

S. Binder: A temporary insurance contract that may be verbal or written. A binder is deemed to include all usual terms of the policy for which it was given, plus endorsements.

T. Endorsements: An endorsement is something added to a policy to modify its terms.

U. Medical Payments: Medical payments coverage is basically a no-fault type coverage, designed to prevent lawsuits. The insurer will pay medical payments to others up to the policy limit regardless of fault, as a goodwill gesture. The only time that medical payment is not paid to others is the medical payments coverage on a personal auto policy (PAP). Medical payments on a PAP is a coverage for reasonable expenses incurred, *within three years from the date of the accident*, for necessary medical and funeral services because of bodily injury caused by an accident and sustained by an insured. An insured under medical payment of a PAP includes the named insured, spouse, or any family member while occupying, or as a pedestrian when struck by, a motor vehicle designed for use mainly on public roads (not necessarily one insured by the policy) or by a trailer and any other person who is occupying a covered auto.

V. Blanket vs. Specific: Specific property insurance insures a specific property at a specific location for a specific amount. In contrast, blanket insurance provides a single amount of insurance that blankets all properties at a specific or at multiple locations.

W. Burglary: The taking of property from inside the premises by a person unlawfully entering or leaving the premises, as evidenced by marks of forcible entry or exit. Visible marks or damage at the point of entry or exit are needed to confirm the burglary.

Robbery: Taking property from the care and custody of a person by someone who has caused or threatened to cause bodily harm.

Theft (larceny): Any act of stealing. Theft is a broad category. It includes all of the more narrowly defined acts of stealing, such as burglary and robbery.

Mysterious disappearance: Property that is gone without any apparent reason, an unspecified loss. Mysterious disappearance is the probability of theft.