

Risk Management MGM510

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**Lec .10 : Analysis of Insurance
Contracts
The Liability Risk**

Part 1 : Analysis of Insurance Contracts

“I was never ruined but twice, once when I lost
a lawsuit and once when I won one.”

Voltaire



Lecture objectives

After studying this chapter, you should be able to:

- ❖ Identify the basic parts of any insurance contract.
- ❖ Explain the meaning of “insured” in an insurance contract.
- ❖ Describe the common types of deductibles that appear in insurance contracts.
- ❖ Explain how coinsurance works in insurance contracts.
- ❖ Explain how losses are paid when more than one insurance contract covers the same loss.

Basic Parts of an Insurance Contract

Despite their complexities, insurance contracts generally can be divided into six parts:

1. Declarations
2. Definitions
3. Insuring agreement
4. Exclusions
5. Conditions
6. Miscellaneous provisions

Basic Parts of an Insurance Contract

6- Miscellaneous provisions

Although all insurance contracts do not necessarily contain all six parts in the order given here, such a classification provides a simple and convenient framework for analyzing most insurance contracts.

Declarations

The declarations section is the first part of an insurance contract.

Declarations are statements that provide information about the particular property or activity to be insured.

Definitions

Insurance contracts typically contain a page or section of definitions. Key words or phrases have quotation marks (“ . . .”) around them. For example, the insurer is frequently referred to as “we,” “our,” or “us.” The named insured is referred to as “you” and “your.” The purpose of the various definitions is to define clearly the meaning of key words or phrases so that coverage under the policy can be determined more easily..

Exclusions

Exclusions are another basic part of any insurance contract. There are three major types of exclusions

(1) excluded perils, (2) excluded losses, and (3) excluded property.

- ❖ Excluded Perils The contract may exclude certain perils, or causes of loss.
- ❖ Excluded Losses Certain types of losses may be excluded.
- ❖ Excluded Property The contract may exclude or place limitations on the coverage of certain property.

Conditions

- ❖ Conditions are another important part of an insurance contract.
- ❖ Conditions are provisions in the policy that qualify or place limitations on the insurer's promise to perform. In effect, the conditions section imposes certain duties on the insured. If the policy conditions are not met, the insurer can refuse to pay the claim.
- ❖ Common policy conditions include notifying the insurer if a loss occurs, protecting the property after a loss, preparing an inventory of damaged personal property, and cooperating with the insurer in the event of a liability suit.

Miscellaneous Provisions

Insurance contracts also contain a number of miscellaneous provisions. In property and casualty insurance, miscellaneous provisions include cancellation, subrogation, requirements if a loss occurs, assignment of the policy, and other-insurance provisions. In life and health insurance, typical miscellaneous provisions include the grace period, reinstatement of a lapsed policy, and misstatement of age. Details of these provisions are discussed later in the text when specific insurance contracts are analyzed.

Definition of “insured”

An insurance contract must identify the person or parties who are insured under the policy. For ease in understanding, the meaning of “insured” can be grouped into the following categories:

- ❖ **Named insured** : The named insured is the person or party named on the declarations page of the policy.
- ❖ **First named insured**: is the first name that appears on the declarations page of the policy as an insured
- ❖ **Other insureds** : are persons or parties who are insured under the named insured’s policy even though they are not specifically named in the policy.
- ❖ **Additional insureds**: is a person or party who is added to the named insured’s policy by an endorsement.

Deductibles

- ❖ A deductible is a common policy provision that requires the insured to pay part of the loss.
- ❖ A deductible is a provision by which a specified amount is subtracted from the total loss payment that otherwise would be payable. Deductibles typically are found in property, health, and auto insurance contracts.
- ❖ A deductible is not used in life insurance because the insured's death is always a total loss, and a deductible would simply reduce the face amount of insurance. Also, a deductible generally is not used in personal liability insurance because the insurer must provide a legal defense, even for a small claim.

Purposes of Deductibles

Deductibles have several important purposes. They include the following:

- ❖ **To eliminate small claims** : deductible eliminates small claims that are expensive to handle and process
- ❖ **To reduce premiums**: Deductibles are also used to reduce premiums paid by the insured.
- ❖ **To reduce moral hazard and attitudinal hazard**: deductibles are used by insurers to reduce both moral hazard and attitudinal (morale) hazard.

Coinsurance

- ❖ Coinsurance is a contractual provision that often appears in property insurance contracts. This is especially true of commercial property insurance contracts.
- ❖ **A coinsurance clause in a property insurance** contract encourages the insured to insure the property to a stated percentage of its insurable value. If the coinsurance requirement is not met at the time of loss, the insured must share in the loss as a coinsurer.
- ❖ **Purpose of Coinsurance** : The fundamental purpose of coinsurance is to achieve equity in rating (premiums).
- ❖ **Health insurance contracts** typically contain a coinsurance percentage clause, which is a provision that requires the insured to pay a specified percentage of covered medical expenses in excess of the deductible.
- ❖ **The purposes of coinsurance** in health insurance are (1) to reduce premiums and (2) to prevent overutilization of policy benefits.

coinsurance percentage

- ❖ A coinsurance percentage clause is typically found in individual and group medical expense policies. A typical provision requires the insured to pay 20, 25, 30 percent, or some higher percentage of covered expenses in excess of the deductible up to some specified annual limit.
- ❖ Other-insurance provisions are present in many insurance contracts. These provisions apply to payment of a loss when more than one policy covers the same loss. The purpose of these provisions is to prevent profiting from insurance and violation of the principle of indemnity.
- ❖ Some important other-insurance provisions include the pro rata liability clause, contribution by equal shares, and primary and excess insurance.

Part two: The Liability Risk



Lecture objectives

After studying this chapter, you should be able to:

- ❖ Define negligence and explain the elements of negligence.
- ❖ Explain the following legal defenses that can be used in a lawsuit:
 - ❖ Contributory negligence
 - ❖ Assumption of risk
 - ❖ Comparative negligence
 - ❖ Last clear chance rule
- ❖ Apply the law of negligence to specific liability situations.
- ❖ Explain the defects in the current tort liability system and the proposals for tort reform.

Basis of Legal Liability

Each person has certain legal rights. A legal wrong is a violation of a person's legal rights, or a failure to perform a legal duty owed to a certain person, to a business organization, or to society as a whole.

There are three broad classes of legal wrongs. A crime is a legal wrong against society that is punishable by fines, imprisonment, or death. A breach of contract is another class of legal wrongs.

Finally, a tort is a legal wrong for which the law allows a remedy in the form of money damages. The person who is injured or harmed (called the plaintiff or claimant in a legal action) by the actions of another party (the tortfeasor [alleged wrongdoer] or defendant in a legal action) can sue for damages.

Insurance companies often find themselves in court as a plaintiff or a defendant.

Law of Negligence

Negligence is defined as the failure to exercise the standard of care required by law to protect others from an unreasonable risk of harm. The meaning of the term standard of care is based on the care required of a reasonably prudent person. In other words, your actions are compared with the actions of a reasonably prudent person under the same circumstances. If your conduct and behavior are below the standard of care required of a reasonably prudent person, you may be found negligent.

Elements of negligence.

There are **four essential elements of negligence**.

- ❖ Existence of a legal duty
- ❖ Failure to perform that duty
- ❖ Damage or injury to the claimant
- ❖ Proximate cause relationship between the negligent act and the infliction of damage

Existence of a legal duty

- ❖ The first requirement is the existence of a legal duty to protect others from harm. For example, a motorist has a legal duty to stop at a red light and to drive a car safely within the speed limits. A manufacturer has a legal duty to produce a safe product. A physician has a legal duty to inquire about allergies before prescribing a drug.

Failure to perform that duty

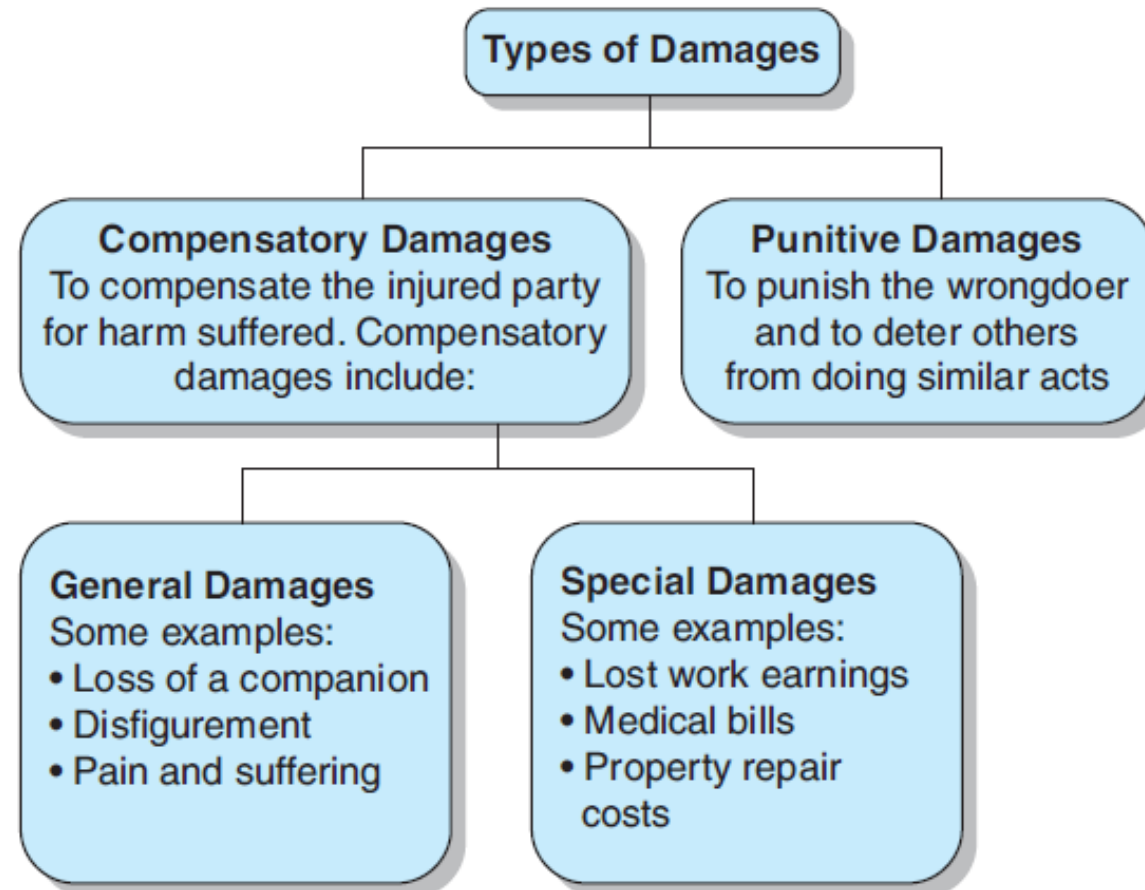
- ❖ The second requirement is the failure to perform the legal duty required by law; that is, you fail to comply with the standard of care to protect others from harm. Your actions would be compared with the actions of a reasonably prudent person under similar circumstances. If your conduct falls short of this standard, the second requirement would be satisfied.

damage to the claimant

- ❖ The third requirement is damage or injury to the claimant. The injured person must show damage or injury as a result of the action or inaction of the alleged tortfeasor
- ❖ **Compensatory damages** are awards that compensate injured victims for the losses they have actually incurred. These damages include: **Special damages**: Awards for losses that can be determined and documented, such as medical expenses, lost earnings, or property damage. **General damages**: Awards for losses that cannot be specifically measured or itemized, such as compensation for pain and suffering, disfigurement, or loss of companionship of a spouse.
- ❖ **Punitive damages** are awards designed to punish individuals and organizations for egregious acts, with the aim of deterring similar behavior in the future. others are deterred from committing the same wrongful act.

injury to the claimant

Types of Damages



Proximate Cause Relationship

- ❖ The final requirement is that a proximate cause relationship must exist. A proximate cause is a cause unbroken by any new and independent cause, which produces an event that otherwise would not have occurred.

Defenses Against Negligence

Certain legal defenses can defeat a claim of negligence. Some important legal defenses include the following:

- ❖ Contributory negligence
- ❖ Comparative negligence
- ❖ Last clear chance rule
- ❖ Assumption of risk

Contributory negligence

- ❖ **Contributory negligence** refers to the principle that if the injured person's conduct falls below the standard of care required for their protection and this conduct contributes to the injury, the injured person cannot collect damages. Therefore, under a strict application of common law, if you contributed in any way to your own damage or injury, you cannot recover damages.

Comparative Negligence

- ❖ Comparative negligence laws are not uniform among the states. They can be classified into major types as follows:
- ❖ Pure Rule
- ❖ 50 Percent Rule
- ❖ 51 Percent Rule.

Last clear chance rule

- ❖ Another statutory modification of the contributory negligence doctrine is known as the last clear chance rule. This rule states that a plaintiff who is endangered by his or her own negligence can still recover damages from the defendant if the defendant had a last clear chance to avoid the accident but failed to do so.

Assumption of risk

- ❖ The assumption of risk doctrine is a defense that can be used to defeat a claim for damages.

Under this doctrine, a person who understands and recognizes the danger inherent in a particular activity cannot recover damages in the event of an injury.

Standard of care

The standard of care required by law varies with the situation. Specific liability situations can involve:

- ❖ Property owners
- ❖ Owners and operators of automobiles
- ❖ Governmental units and charitable institutions
- ❖ Employers and employees
- ❖ Parents and children
- ❖ Owners of animals

Current Tort Liability Problems

The tort liability system has numerous problems at the present time. It is beyond the scope of the text to discuss all tort problems in detail. However, three timely problem areas merit a brief discussion:

- ❖ Defective tort liability system
- ❖ Medical sector claims
- ❖ Liability arising from technological and societal change



Thank You