

**PRINCIPLES OF
INSURANCE
RIHAB ABDELLA**



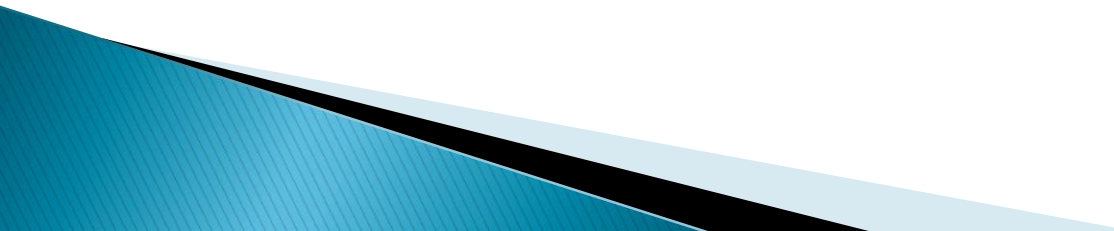
Meaning of Risk

- ▶ **Risk** is the potential that a chosen action or activity (including the choice of inaction) will lead to a loss (an undesirable outcome)

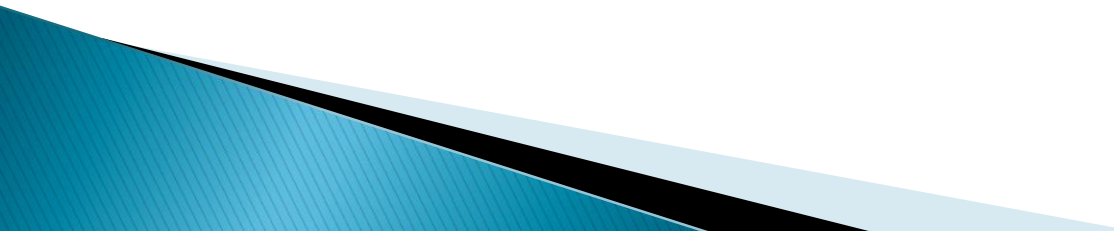
OR

- ▶ Risk is an uncertainty concerning the occurrence of a loss
- ▶ In insurance industry we define risk to identify the property or life being insured
- ▶ “that driver is a poor risk”, “cancer patient is an unacceptable risk”

Types of Risk

- ▶ Subjective Risk-an uncertainty in the individual's personal estimate of the chance of loss.
 - ▶ It can vary from one person to another.
 - ▶ For eg-Somebody who has lost a lot of money in the stock market will probably feel more risk investing in the market than someone who has profited handsomely.
 - ▶ Subjective risk may alter the behavior of the risk taker if it is an undesirable risk
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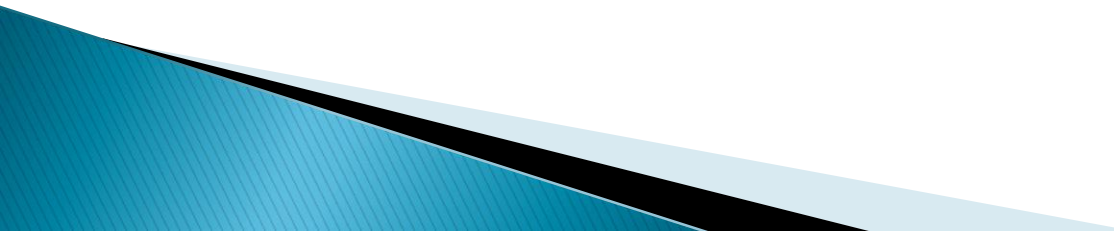
Types of Probabilities

- ▶ **Objective probability** is the probability of an occurrence, calculated by either deduction or induction
 - ▶ **Subjective probability** is a person's perception of the likelihood of an event.
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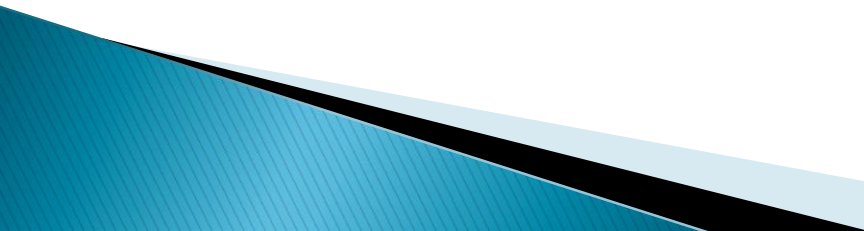
Peril and Hazard

- ▶ peril is something that can cause a loss. Examples include falling, crashing your car, fire, wind, hail, lightning, water, volcanic eruptions, choking, or falling objects
- ▶ Hazard is a condition that creates or increases the chance of loss

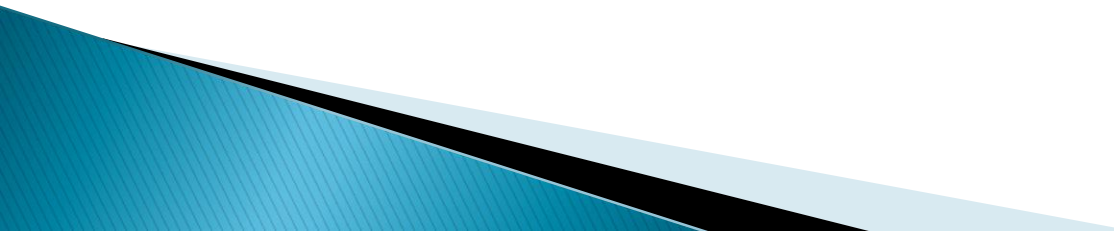
Types of Hazards

- ▶ Physical hazard
 - ▶ Moral Hazard
 - ▶ Morale hazard
 - ▶ Legal hazard
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Physical Hazard

- ▶ Physical condition that increases the chance of loss
 - ▶ Examples–
 - ▶ Icy roads that increase the chance of an auto accident
 - ▶ Defective wiring in a building that increases the chance of fire
 - ▶ working from heights, including ladders, scaffolds, roofs, or any raised work area
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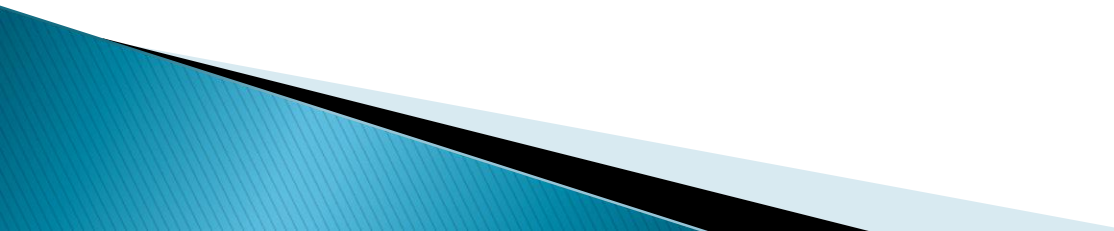
Moral Hazard

- ▶ Dishonesty or character defects in an individual that increase the frequency or severity of loss
 - ▶ Examples–
 - ▶ Submitting a fraudulent claim,
 - ▶ inflating the amount of a claim,
 - ▶ Intentionally burning unsold merchandise that is insured
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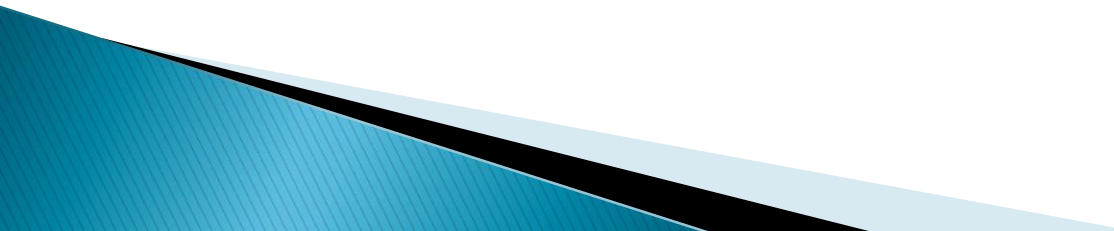
Morale Hazard

- ▶ Carelessness or indifference to a loss because of the existence of insurance
- ▶ Examples
 - ▶ Leaving car keys in an unlocked car which increases the chance of theft
 - ▶ Leaving a door unlocked that allows a burglar to enter
- ▶ “Its insured so why should I worry about safety of my house/property/own health. If anything goes wrong, insurer is there to indemnify me. So, Why should I worry about safety?”

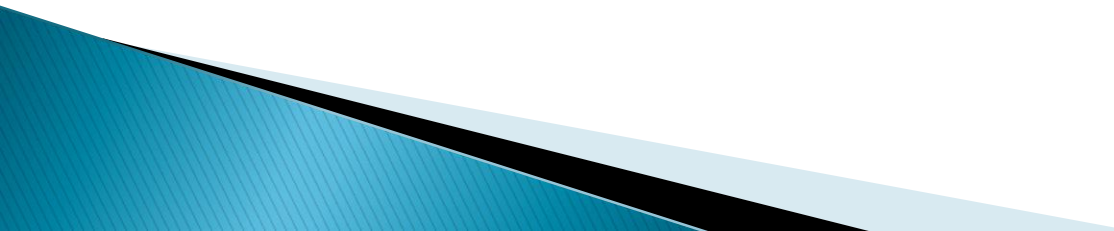
Legal Hazard

- ▶ Characteristics of the legal system or regulatory environment that increase the frequency or severity of losses
 - ▶ Examples:
 - ▶ Laws that require insurers to include coverage for certain benefits in health insurance plans, such as alcoholism
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Categories of Risks

- ▶ Pure and Speculative Risks
 - ▶ Fundamental and Particular Risks
 - ▶ Enterprise Risk
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Pure Risk & Speculative Risk

- ▶ Pure risk : there are only the possibilities of loss or no loss
 - ▶ Examples: Damage to property from fire, lightning, flood or earthquake etc
 - ▶ Speculative risk : either profit or loss is possible
 - ▶ Examples: investment in shares or real estate, betting on horse race
 - ▶ ONLY Pure Risks are insured but exceptions always exist.....
Like some insurers will insure institutional portfolio investments
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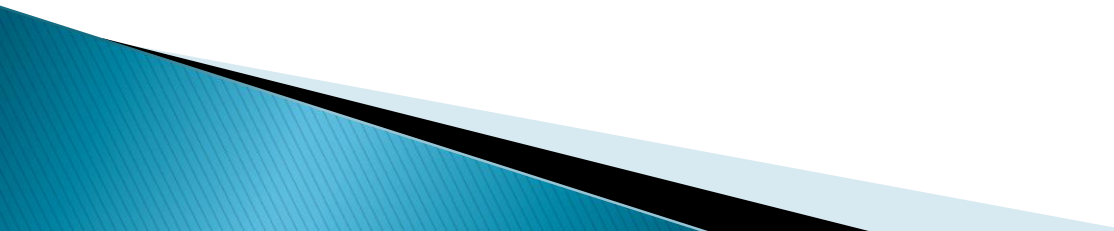
Fundamental & Particular Risks

- ▶ Fundamental risk affects the entire economy or large number of persons or groups within the economy – rapid inflation, cyclical unemployment, war, natural disaster, terrorist attack
- ▶ Particular Risk affects only individuals and not the entire community . For e.g.. Car thefts, bank robberies, dwelling fires

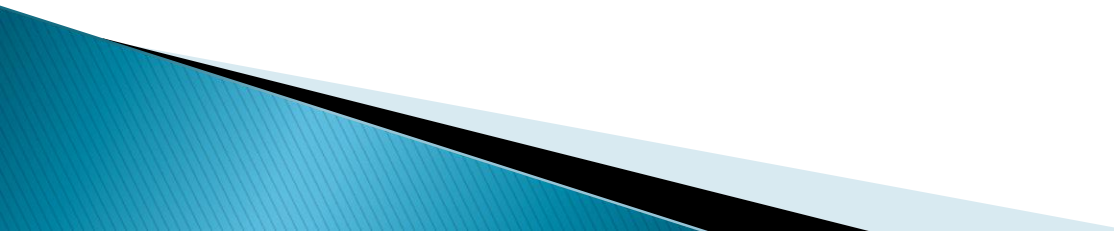
Enterprise Risk

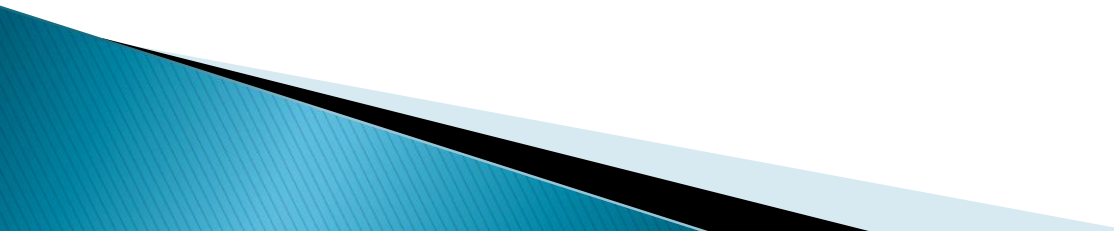
- ▶ Relatively new term that encompass major risks faced by a business firm
- ▶ Pure Risk
- ▶ Speculative Risk
- ▶ Strategic Risk: uncertainty regarding the firm's financial goals and objectives
- ▶ Operational Risk: results from the firm's business operations like a bank that offers new online banking services may incur losses if hackers break into the bank 's computers

Enterprise Risk contd...

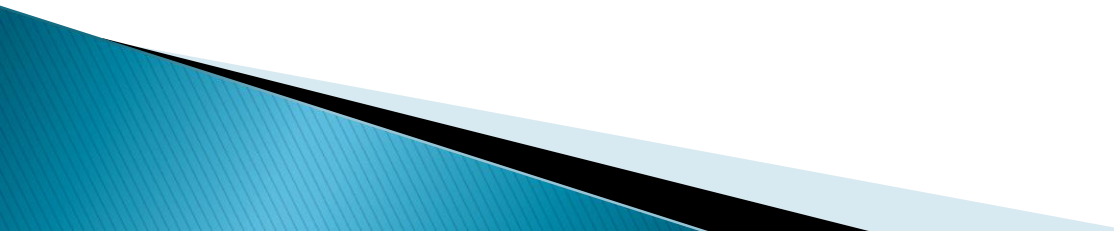
- ▶ Financial risk: refers to the uncertainty of loss because of adverse changes in commodity prices, interest rates, foreign exchange rates, and the value of money
 - ▶ Examples-
 - ▶ A food company that agrees to deliver a commodity at a fixed price to a supermarket in six months may lose money if grain price rises
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Types of Pure Risks

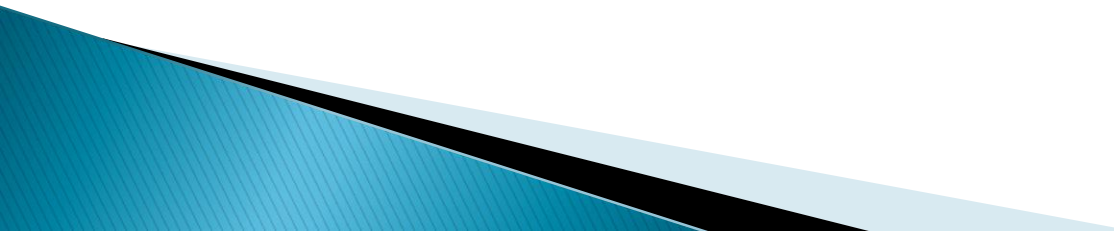
- ▶ Premature Death
 - ▶ Insufficient income during retirement
 - ▶ Poor health
 - ▶ Unemployment
 - ▶ Property risks
 - ▶ Liability risks
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- ▶ An agreement between two or more parties to do or abstain from doing an act
 - ▶ Create a legally binding relationship
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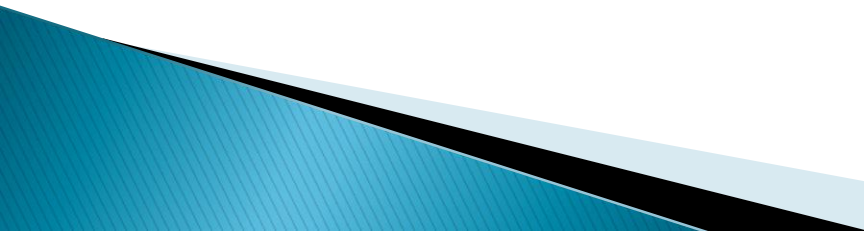
Essentials of a valid Contract-

- ▶ The intention to create legal relations
 - ▶ Offer and acceptance
 - ▶ Consideration
 - ▶ Certainty of terms
 - ▶ Consensus ad idem (a genuine meeting of minds)
 - ▶ Legality of purpose
 - ▶ Possibility of performance
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Requirements of an Insurance Contract

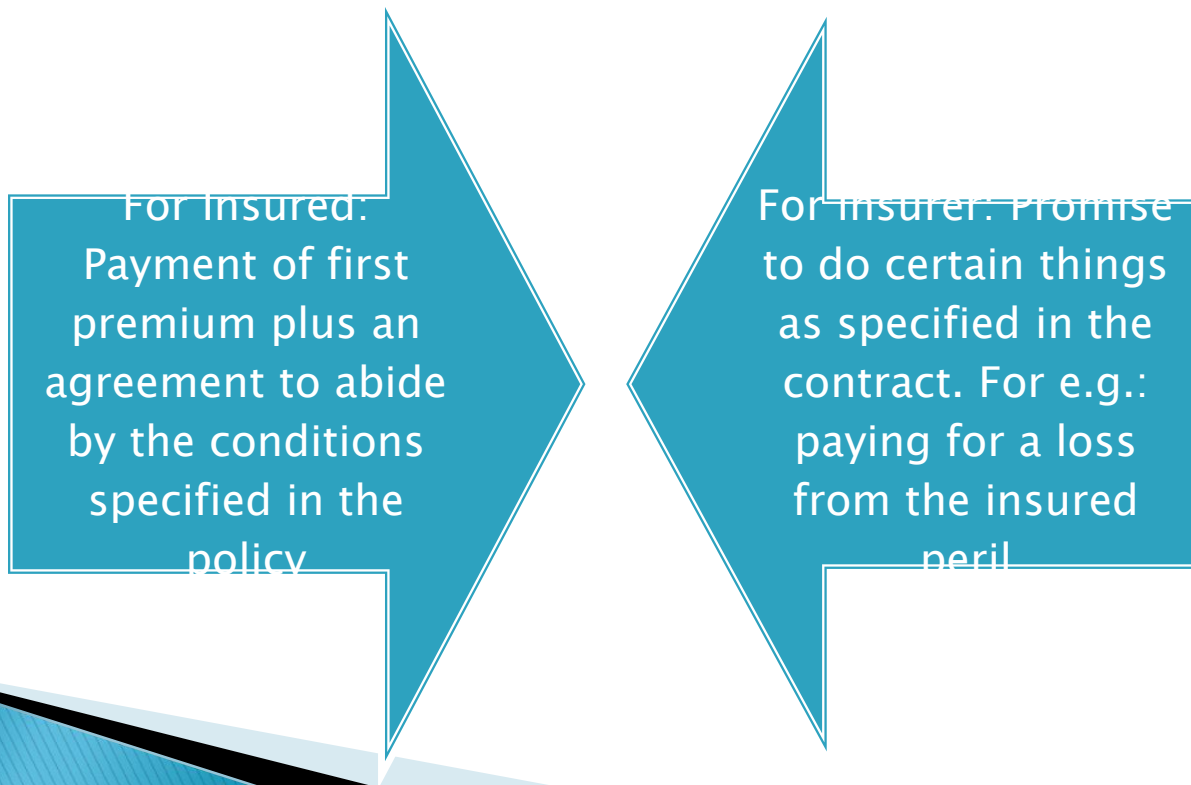
- ▶ Offer and acceptance
 - ▶ Consideration
 - ▶ Competent parties
 - ▶ Legal Purpose
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Requirements of an Insurance Contract

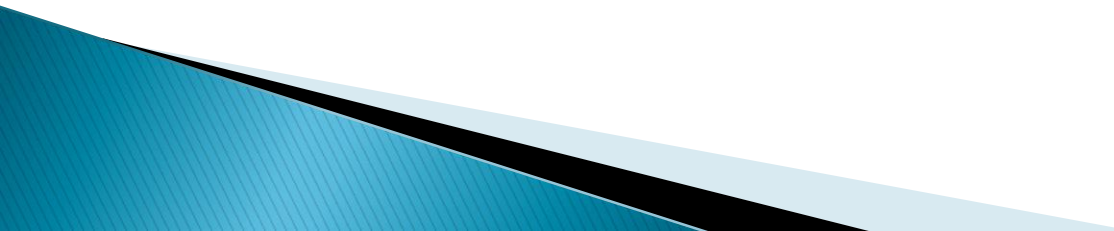
- ▶ **Offer and Acceptance:** Applicant for insurance makes the offer and the company accepts or rejects the offer
 - ▶ An agent merely solicits the prospective insured to make the offer
 - ▶ In property & Liability insurance especially personal line insurance – auto , home insurance , the agents typically have the power to bind the insurer through the use of binder.
 - ▶ Binder is a temporary contract for insurance
 - ▶ In life insurance, agent does not have the power to bind the insurer
 - ▶ A conditional premium receipt is given to the applicant after filling the application form
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Consideration

- ▶ Consideration is the value that each party gives to the other



Competent Parties

- ▶ Each party must be legally competent/ must have legal capacity to enter into a binding contract
 - ▶ Most adults are legally competent to enter into the insurance contracts but there are some exceptions like
 - ▶ Insane persons, intoxicated persons, minors
 - ▶ Also, insurer must be licensed to sell insurance in that country
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Legal Purpose

- ▶ An insurance contract that encourages something illegal or immoral is contrary to the public interest and can not be enforced
- ▶ For e.g. policy can not cover seizure of the drugs by the police

Basic parts of an Insurance Contract

- ▶ Declarations
 - ▶ Definitions
 - ▶ Insuring Agreements
 - ▶ Exclusions
 - ▶ Conditions
 - ▶ Miscellaneous provisions
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