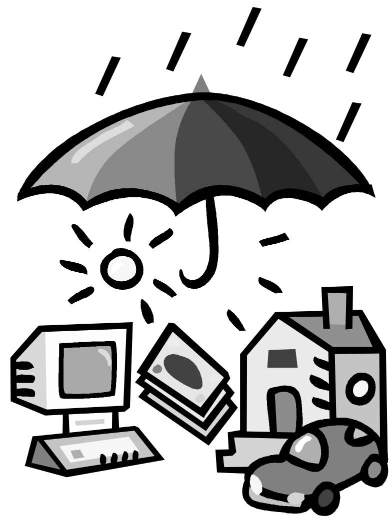
CHAPTER 1: BASICS OF INSURANCE



Let's Begin…

Introduction

Insurance is an important part of our economy. Without the protection insurance affords us, we would have to spend more time and money protecting ourselves from the risks of loss and less time in enjoying life and pursuing goals.

Insurance is a very old concept. Basically, it means many people paying a little money to create a bigger pool of money so that anyone who is unfortunate enough to suffer a loss is reimbursed financially for that loss.

First, insurance is designed to **make a loss whole**. In the simplest terms, a **loss** occurs when things you own are **destroyed or reduced in value**. If your house burns to the ground, insurance will provide the funds to rebuild it. The idea is to pay for your actual losses without allowing you to *make* money. This is what an insurer means by making the loss whole.

In addition, it's important to note that an insurance policy is a legally binding contract between **two parties**. One party is the insured person—you—and the other is the insurance company.

As is true with all contracts, an insurance policy describes the rights and obligations of each party. In addition, the policy identifies how much you must pay to receive those rights. This amount is known as the **premium**. The policy identifies how much the insurance company is obligated to pay, if certain events should occur. The maximum amount an insurance company will have to pay is the **limit of insurance**.

The study of insurance is full of jargon that is unique to the industry. It is important to know these important basic concepts since you will encounter them throughout this course and in your practice of insurance.

Insurance Is a Business

It's important to remember that **insurance is a business**. Some people may think of insurance as a service that helps people in times of need, insurance companies operate to produce a profit. Therefore, they want to collect more in premiums than they pay out in claims.

If all of an insurance company's "insureds" filed claims at the same time, the company would go bankrupt. Fortunately, the odds of this happening are incredibly slim. To improve their odds, insurers will make some kinds of insurance (such as earthquake insurance in California and homeowners insurance in parts of Florida and other hurricane-prone areas) very hard to get—or very expensive.

If you file a lot of claims, your insurance company is going to raise your rates—not to punish you, but to make sure it can still earn a profit. Because claims often lead to higher rates, it is important to avoid filing small claims.

Benefits and Costs of Insurance

Owning insurance provides many benefits. Individuals, families, groups, businesses, and society in general, all benefit. The ability to minimize loss from potential disaster provides a certain peace of mind that cannot be underestimated and is one of the largest benefits of insurance. Other benefits include, but are not limited to, investment income opportunities, meeting legal requirements, ability to secure credit for financing, the ability to control loss and many others that we will discuss as we move through the text.

Insurance is not free. These benefits do, however, come with a cost, but the benefits do outweigh the costs. Some of the costs involved with insurance are:

Premiums – amount of money paid by the insured to the insurer, or the amount the insured pays for each unit of coverage normally quoted as so many dollars per $1000 of coverage per year. This is the monthly, quarterly, semi-annually, or annually that is paid for insurance.

Operating Costs – the costs associated with the running of an insurance company which could include supplies, rents, commissions to agents, profits…etc. (Anything associated with the day-to-day expenses

Basic Concepts

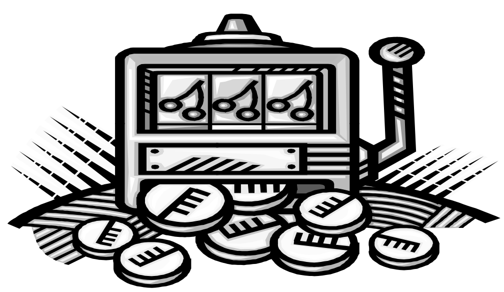
The study of insurance is full of jargon that is unique to the industry. It is important to know these basic concepts since you will encounter them throughout your study of insurance.

Who

- **Insured.** Any person organization or company or a member of these specifically designated by name as the one(s) protected by the insurance policy.
- **Insurer**. The party to an insurance arrangement who undertakes to indemnify for losses, provide pecuniary benefits or render services. The word "insurer" is often used instead of "carrier" or "company" since it is applicable without ambiguity to all types of individuals or organizations performing the insurance function. The word insurer is generally used in statutory law.

What

- **Loss.** Generally refers to (1) the amount of reduction in the value of an insured's property caused by an insured peril, (2) the amount sought through an insured's claim or (3) the amount paid on behalf of an insured under an insurance contract
- **Exposure**. The state of being subject to loss because of some hazard or contingency. Also used as a measure of the rating units or the premium base of a risk.
- **Proximate Cause**. The effective cause of loss or damage. It is an unbroken chain of cause and effect between the occurrence of an insured peril or a negligent act and resulting injury or damage
- **Insuring Agreement** (or Clause). That portion of an insurance contract which states the perils insured against, the persons and/or property covered, their locations and the period of the contract.
- **Claim.** A demand made by the insured or the insured's beneficiary, for payment of the benefits provided by the contract.
- **Indemnify**. To restore the victim of a loss to the same position as before the loss occurred.
- **Insurance**. A formal social device for reducing risk by transferring the risks of several individual entities to an insurer. The insurer agrees, for a consideration, to assume, to a specified extent, the losses suffered by the insured.
- **Insurable Events.** Any contingent or unknown event, whether past or future, which may damnify a person having an insurable interest, or create a liability against him, may be insured against, subject to the provisions of the code.
- **Indemnity**. To restore the victim of a loss to the same position as before the loss occurred.



- **Risk -** An uncertainty or chance of loss.
- There are two specific types of risk that are necessary to understand:
    1. **<u>Pure Risk</u>**: No chance of gain or profit, and ONLY chance of loss.
       Example: The risk of crashing a car and needing to replace it.
    2. **<u>Speculative Risk</u>**: A chance of BOTH a gain or a loss
       Example: The risk of gambling at a casino. Someone might win or lose.
       <u>NOTE</u>: Speculative risks are NOT insurable.

Risk Management

Ways to Deal with Risk

Life is risky, and insurance is not the only way to deal with risk. There are five basic ways to deal with risk. Think of the acronym STARR:

- **Sharing** – pooling the risk with a variety of other people who share the same risk
- **Transfer** – such as buying insurance
- **Avoidance** – removing the possible cause of a loss
- **Retention** – keeping all or part of the financial risk of loss
- **Reduction** – reducing the chance of loss with safety techniques

In order for an insurance company to be able to accept premiums and pool money to pay for particular types of losses, the insurance company has to have a large enough number of similar risks. This is called the ***law of large numbers***. This law makes it possible to statistically predict the probability of loss within the group, and therefore how much premium to charge.

Ideally, ***insurable risk*** must meet certain criteria:

- Losses to be insured must be definable
- Losses must be accidental
- Losses must be large enough to cause a hardship to the insured
- There must be a homogeneous group of risks large enough to make losses predictable (Law of large numbers)
- Losses must not be catastrophic to many members of the group at the same time
- The insurance company must be able to determine a reasonable cost for the insurance
- The insurance company must be able to calculate the chance of loss

In addition, insurance can only pay money to people who have an insurable interest in the property lost. **Insurable interest** is any interest a person has in a possible subject of insurance, such as a car or home, of such a nature that if that property is damaged or lost, that person will suffer a real financial loss. For property and casualty insurance, the insurable interest must exist at the time the loss occurs.

Also, an insurance company must guard against the tendency of poorer than average risks to buy and maintain insurance. **Adverse selection** occurs when insureds select only those coverages that are most likely to have losses. The underwriters also must not accept too many poorer than average risks, thus by balancing those poorer risks with preferred risks the losses then fall within an acceptable/normal range. This is called **spread of risk.**

Assumption of Risk is a legal defense that is used when a person willfully places themselves in a potentially dangerous situation and assumes the risk of injury. For example, a person that attends a baseball game is assuming the risk of being hit with a foul ball.

Identifying Loss Exposure

There are 4 methods of identifying loss exposure, Checklists & Surveys, Inspections & Interviews, Financial Statements, and Contracts & Agreements. Each method has it's advantages as well as disadvantages.

Checklists/Surveys – *Advantage*: Very organized method that keeps an agent from forgetting any areas to cover. *Disadvantage*: May not be thorough enough to note unique or uninsurable exposures that may exist.
Inspections/Interviews - *Advantage*: an on-site inspection allows the agent to see and ask questions that would be pertinent to the loss exposure the insured may face. *Disadvantage:* The agent may not be knowledgeable/experienced enough to uncover any exposure the insured is attempting to minimize or cover-up.

Financial Statements – *Advantage:* Since many premiums are based on Income/Sales/Receipts/Payroll this allows the agent to verify that information, *Disadvantage:* Financial statements adjust for depreciation

Contracts/Agreements – *Advantage:* Many contracts contain provisions for shifting responsibility for losses to another party such as hold harmless agreements. *Disadvantage:* Agent must be knowledgeable in reading contracts

Legal Elements of Insurance

Elements of a Contract

As we've said, an insurance policy is a legally binding contract between **two parties**. One party is the insured person or organization and the other is the insurance company. An insurance policy describes the rights and obligations of both parties.

It is important to understand the following legal terms that relate to insurance.

Agreement. When an **offer** made by one party has been **accepted** by the other, with mutual understanding by both, an agreement exists.

Legal Purpose. For a contract to be valid it must not be for an illegal subject or contrary to public policy. Insurance does not cover intentional loss or criminal acts for this reason.

Consideration. The exchange of values on which a contract is based. In insurance, the consideration offered by the insured is usually the premium and the statements contained in the application. The consideration offered by the insurer is the promise to pay in accordance with the terms of the contract.

Competency. This is one of the elements that must be present in order to have a legal contract. It relates to the fitness or ability of either of the parties to the contract. An example of incompetency would be a mental incapacity.

Legal Contract Principles Important to Insurance

Aleatory Contract. A contract in which the number of dollars to be given up by each party is not equal. Insurance contracts are of this type, as the policyholder pays a premium and may collect nothing from the insurer or may collect a great deal more than the amount of the premium if a loss occurs.

Contract of Adhesion. This is a characteristic of a unilateral contract which is offered on a "take it or leave it" basis. Most insurance policies are contracts of "adhesion," because the terms are drawn up by the insurer and the insured simply "adheres." For this reason ambiguous provisions are often interpreted by courts in favor of the insured.

Conditional Contract. There are conditions which must be met by both parties before the contract is legally enforceable. In an insurance contract conditions for both the insurer and insured are spelled out in the policy form.

Personal. A personal contract is between two specific parties and generally cannot be transferred to other parties, unless under conditions specified in the contract. Insurance policies are usually not transferable unless the insurer agrees to do so.

Unilateral Contract. A contract such as an insurance policy in which only one party to the contract, the insurer, makes any enforceable promise. The insured does not make a promise but pays a premium, which constitutes the insured's part of the consideration.

Utmost Good Faith. Acting in fairness and equity with a sincere belief that the act is not unlawful or harmful to others. The insurance contract requires that each party is entitled to rely upon the representations of the other without attempts to conceal or deceive

Other Legal Principles Important in Insurance Law

Concealment. The failure to disclose a material fact and may be intentional or un-intentional. If concealment occurs, the injured party may rescind the contract. Whether or not concealment is intentional or unintentional, the injured party has the right to rescind the insurance contract
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Materiality. In insurance, it refers to a fact which is so important that the disclosure of it would change the decision of an insurance company, either with respect to writing coverage, settling a loss, or determining a premium. Usually, the misrepresentation of a material fact will void a policy.

Fraud. Deceit, trickery or misrepresentation with the intent to induce another to part with something of value or surrender a legal right. (One party intentionally deceives the other in order to receive an unlawful gain) If fraud occurs, the injured party may rescind the contract.

Waiver. The act of giving up or surrendering a right or privilege that is known to exist. In property and liability fields, it may be effected by an agent, adjuster, company, employee, or company official, and it can be done either orally or in writing.

Estoppel. The legal principle whereby a person loses the right to deny that a certain condition exists by virtue of having acted in such a way as to persuade others that the condition does exist. For example, if an insurer allows an insured to violate one of the conditions of the policy, the insurer cannot at a later date void the policy because the condition was violated. The insurer has acted in such a way as to lead the insured to believe that the violation did not void the coverage.

Warranty. A statement made on an application for most kinds of insurance that is warranted as true in all respects. If untrue in any respect, even though the untruth was not known to the applicant, the contract may be voided/rescinded without regard to the materiality of the statement. By contrast, statements in life and health applications are not warranties except in cases of fraud, and the trend in more recent court decisions in other lines has tended to modify the doctrine of warranty to an application only when the statement is material to a risk or the circumstances of a loss.

- ✓ A warranty may be either expressed or implied. An expressed warranty is a written warranty while an implied warranty is not in writing.
- ✓ A warranty may relate to the past, present or future.
- ✓ A particular form of words is not necessary to create a warranty.

Representation. A statement made on an application for insurance that the applicant represents as correct to the best of his or her knowledge and belief . (CIC 350-361)

1. may be oral or written
2. may occur before or after a policy is issued
3. is to be interpreted by the same rules as contracts
4. may apply to the future
5. does not have to be in writing
6. may be altered or withdrawn before the insurance is effected, but not afterwards

For example, an agent tells a client that their policy has coverage for the peril of "earthquake." When the agent returns to the office, they discover "earthquake" is not covered in the policy, and calls the client to explain that "earthquake" is not covered in the policy and withdraws the representation. Had the agent not withdrawn the representation, "earthquake" would be covered under that policy due to the oral representation of agent.

7. are false when the facts fail to correspond with its assertions or stipulations
8. The materiality of representation is determined by the same rule as the materiality of concealment
9 if a representation is false in a material point, the injured party is entitled to rescind the contract from the time the representation becomes false.

A representation cannot qualify an express provision in a contract of insurance, but it **may qualify an implied warranty**. (CIC 354) A representation may be made at the time of, or before, issuance of the policy. A representation may be altered or withdrawn before the insurance is effected, but not afterwards. (CIC 355)

Misrepresentation. Purposely stating incorrectly a material fact with the intent to deceive another party (which could make a policy null and void)

Misrepresentations may pertain to: (CIC 780 – 784)

1. policy coverages
2. benefits or privileges guaranteeing future dividend payments
3. inducing clients to change policies with no benefit to the client
4. inducing clients to lapse, forfeit, change or surrender policies with no benefit to the client

If found guilty of a misrepresentation, agents may be fined, suspended and/or imprisoned, Restitution to the victim shall be paid before any fine is collected.

Any person may be compelled to testify and produce evidence at a trial or hearing of a person charged with misrepresentation, even if that testimony or evidence may be incriminating. That person shall not be prosecuted for any testimony or evidence in which they were compelled to provide except for perjury.

Types of Insurance

The charts below details the major types of insurance and insurance policies. There are many other specialty policies offered by insurance companies that are available, but are too numerous to cover here.

	Life	**Health/Disability**
Individual	Term Whole Life Universal Life Variable Life Variable Universal Life Specialty Policies Family Maintenance Family Income Joint Life Modified Life Split Life Adjustable Life Industrial Life Credit Life Annuitities	Medical Expense Disability Dental Expense Vision Care Long Term Care Accidental Death Travel Accident Credit Disability Specified Disease
Group	Term	Medical Expense Disability Dental Expense Vision Care

Policies can cover either **personal** or **commercial lines**; they can be intended to cover individual types of risks exposures such as for an individual's own car or home or they can be intended to cover risks faced by businesses.

They can also either be covering property or casualty risks. **Casualty** Insurance is primarily concerned with the legal liability for losses caused by injury to persons or damage to the property of others. **Property** Insurance indemnifies a person with an interest in physical property for its loss or the loss of its income producing abilities. Insurance can also cover life and health risks, but these are not the subject of this course.

Package Policies combine property and casualty coverages so that all the risks, both for property losses and liability losses are covered in one policy.

	Property Policies	**Casualty Policies**	**Package Policies (Both Property & Casualty)**
Personal	Dwelling	Personal Auto	Homeowners Personal Watercraft Specialty Vehicles Personal Umbrella
Commercial	Commercial Property Flood Earthquake Inland Marine Ocean Marine	General Liability Commercial Auto Workers Compensation Crime Professional Liability Excess Liability	Commercial Package Businessowners Boiler and Machinery

Insurance Policy Structure

Sections of a Policy

Most insurance policies have a common structure. For property and casualty policies there are standard forms that most insurance companies use that have been approved for use in most states. These are updated and changed periodically as the risks change over time. The group that puts these standard policies together is called the Insurance Services Office (ISO).

Most policies have the following sections that use language that has been tested for meaning over time by the court system. We will discuss what each section includes.

Application: This is the document in which an applicant answers questions and facts with regards to the insurance they are wishing to acquire.   The insurer will use the information on the application to decide whether or not to accept the applicant

Declarations. That portion of the insurance contract in which is stated such information as the name and address of the insured, the property insured, its location and description, the policy period, the amount of insurance coverage, applicable premiums, and supplemental representations by the insured.

Insuring Agreement (or Clause). That portion of an insurance contract which states the perils insured against, the persons and/or property covered, their locations, and the period of the contract.

Additional (or Supplementary) Coverage. That portion of the policy adding coverages to the major coverages defined in the insuring agreement, or adding back coverages at lower liability limits that have been specifically excluded.

Definitions. That portion of an insurance contract where important term used in the contract are defined.

Conditions. These are provisions of an insurance policy which state either the rights and duties of the insured or the rights and duties of the insurer. Typical conditions have to do with such things as the insured's duties in the event of loss, cancellation provisions, and the right of the insurer to inspect the property.

Exclusions. Contractual provisions that deny coverage for certain perils, persons, property, or locations.

Endorsements. A form attached to the policy which alters provisions of the contract to make it better fit the needs of the insured or the insurer for that particular risk.

Common Insurance Policy Provisions

Who is Covered by the Policy

Insured. The party to an insurance arrangement whom the insurer agrees to indemnify for losses, provide benefits for or render services to. This term is preferred to such terms as policyholder, policyowner and assured.

Named Insured. Any person, firm or corporation or any member thereof, specifically designated by name as the insured(s) in a policy. Others may be protected as insureds even though their names do not appear on the policy. A common application of this latter principle is in automobile policies where, under the definition of insured, protection is extended to cover other drivers using the car with the permission of the named insured.

"First" Named Insured. The first named insured appearing on a commercial policy. The latest forms permit the insurer to satisfy contractual duties by giving notice to the "first" named insured rather than requiring notice to all named insureds.

Additional Insured. A person other than the named insured who is protected under the terms of the contract. Usually, additional insureds are added by endorsement or referred to in the wording of the definition of "insured" in the policy itself.

Assignment/Transfer of the Insured's Interest. Assignment to another person cannot be made without insurer's written permission.

Removal: this provides insurance to property while it is removed from the residence premises to protect it from a covered peril. For instance, if furniture wasn't damaged in a home fire and was stored at a neighbor's garage, then stolen from the garage, the insurance will apply to the insured's property due to theft.

- **removal of debris** from covered property if the debris was caused by a covered peril (for instance, if the insured's house burns down and the debris needs to be removed before the insured can rebuild);
- reasonable repairs to protect the insured's home from **further damage** (this would include covering a hole in the roof, so rain or snow can't come in and cause further damage);

When and Where the Policy Covers

Policy Period (or Term). The period during which the policy contract affords protection, e.g., six months or one or three years.

Rescission. The termination of an insurance contract by the insurer when material misrepresentation has occurred. A contract may also be repudiated for failure to perform a duty. An insurance company may rescind a contract when they discover the following:

1. concealment whether intentional or unintentional (CIC 331)
2. a fraudulent omission (CIC 338)
3. if a misrepresentation is false in a material point (CIC 359)
4. violation of a material warranty (CIC 447)

Policy Territory. What geographic territory is or is not covered by the policy of insurance.

How Much Coverage is Provided

Limit of Liability. The maximum amount for which an insurer is liable as set forth in the contract.

Sublimit. Any limit of insurance which exists within another limit. For example, special classes of property may be subject to a specified dollar limit per occurrence, even though the policy has a higher overall limit.

Deductible. The portion of an insured loss to be borne by the insured before any recovery may be made from the insurer.

Unearned Premium vs. Earned Premium. The unearned premium is the portion of an insurance premium covering the unexpired term of the policy. Any premium paid in advance of the current period is considered unearned premium; for instance, a policyholder pays an annual premium. Earned premium is the premium paid for the expired or used portion of the policy.

Extended Coverage . This allows the policy to cover specific types of losses that are not named as perils on the policy but may cause major expense to an insured that suffers a loss. Usually these extensions of coverage are debris-removal expenses and fire department service charge

How a Policy Can Be Renewed or Ended

Renewal. The insurer agrees to continue the policy in full beyond the expiration date

Non-renewal. The insurer decides NOT to continue the policy beyond the expiration date.

Lapse. Termination of a policy due to nonpayment of premiums.

Insured's Right To Cancel. The client may cancel at any time by letting the insurer know in writing of the date of cancellation is to take effect.

Cancellation. Termination of a contract of insurance in force by voluntary act of the insurer or insured in accordance with the provisions in the contract or by mutual agreement.

Flat Cancellation. A policy which is cancelled upon its effective date. Usually under a flat cancellation no premium charge is made.

Pro Rata Cancellation. The termination of an insurance contract or bond with the premium charge being adjusted in proportion to the exact time the protection has been in force**.**

Short Rate Cancellation. A cancellation procedure in which the premium returned to the insured is not in direct proportion to the number of days remaining in the policy period. In effect, the insured has paid more for each day of coverage than if the policy had remained in force for the full term.

Grace Period. The period of time given to pay the premium after the premium due date has passed. Designed to prevent a policy from lapsing for non-payment. (**NOTE: Not all policies will have a grace period)**

Policy Provisions Covering the Rights and Duties of Insureds

Insureds must comply with particular policy provisions if they want the insurer to pay claims. These include:

- Prompt notice of loss or damage
- Taking reasonable steps to protect property from further damage
- Submitting claims
- Notifying the police if the claim is for a theft
- Cooperating with the insurer after a loss.

Here are some of the common definitions that related to the insured's duties.
Abandonment Clause. A clause in property insurance policies that prohibits the insured from abandoning partially damaged property to the insurer in order to claim a total loss.

Mortgage (or Mortgagee) Clause. A provision attached to a property policy that covers mortgaged property, specifying that the loss reimbursement shall be paid to the mortgagee as the mortgagee's interest may appear, that the mortgagee's rights of recovery shall not be defeated by any act or neglect of the insured, and giving the mortgagee other rights, privileges, and duties. For instance, one duty is that the mortgagee must report to the insurer any change in hazards that he becomes aware of.

Loss Payable Clause. A provision in property insurance contracts that authorizes payment to persons other than the insured to the extent that they have an insurable interest in the property. This clause may be used when there is a lien or loan on the property being insured, and it protects the lender.

Coinsurance Clause. A requirement that the insured must carry insurance to at least 80% of the property value at the time of loss to be fully paid for the loss without any penalty. For property policies the coinsurance clause requires insureds to carry insurance to value. Typically 80% of the value of the property.

Vacant. A term used in property insurance to describe a building that has neither occupants nor contents

Unoccupied. Refers to property which may be furnished or have furnishings in it but is not occupied or being lived in.

Concurrent vs Non-Concurrent Policies. *Concurrent policies* - Coverage under more than one policy when policies are alike or similar with the exception of the amount of coverage or length of time. The policy terms, perils, conditions, limitations, must be identical to be considered concurrent. *Non-Concurrent policies –* differ in policy terms, perils, conditions, limitations, etc.

Concurrent policies will each pay their proportionate share of the loss, based on their share of the total limit. Example: 1/3 of the total risk = pay 1/3 claim.

Non-concurrent policies do not share in the loss, they pay their respective losses or will pay on a primary or excess basis in regards to each other.

Policy Provisions Covering the Rights and Duties of the Insurer

Insurance companies must do several things as a result of the contract of insurance. These include:

- Pay for covered losses
- Provide a legal defense against liability claims
- Give advance notice of cancellation and return unused premiums

They also have rights regarding paying for losses or replacing the damaged or lost property.

In California, the insurer must always include the required specifications for ALL insurance policies (CIC 381):

1. parties of the contract
2. item(s) of property or the name of the life being insured
3. insurable interest
4. risk being insured
5. term of the policy
6. consideration (premium)
    a. a statement of the premium, or

b. if the insurance is the type where the exact premium can only be determined upon termination of the contract, a statement of the basis and rates upon which the final premium is calculated, determined, and paid (CIC 381)

NOTE: Property insurance policies contain many items EXCEPT the insured's address (CIC 2071)

Here are some important definitions regarding other rights and duties of insurers.

Subrogation Clause. A clause giving an insurer the right to pursue any course of action, in its own name or the name of a policyowner, against a third party who is liable for a loss which has been paid by the insurer. One of its purposes is to make sure that an insured does not make any profit from his or her insurance. This clause prevents collecting from both the insurer and a third party.

Liberalization Clause. A clause in property insurance contracts which provides that if policy or endorsement forms are broadened by legislation or ruling from rating authorities and no additional premium is required, then all existing similar policies will be construed to include the broadened coverage.

Other Insurance Clause. A provision found in almost every insurance policy stating what is to be done in case any other contract of insurance covers the same property and/or hazards.

Salvage. Property taken over by an insurer to reduce its loss.

First Party. The insured is the first party to a contract. Property policies are referred to as first party insurance since the insurer pays directly to the insured. The second party is the insurer. In liability, the insured is also referred to as the defendant

Third Party. In liability insurance the third party is the claimant or plaintiff. Liability policies are referred to as third party insurance because the insurer pays to a third party (claimant)

Supplementary Payments. Found in liability policies which are paid in addition to the policy limit, including such items as defense costs, premiums on bonds, post-judgement interest etc. Each company has specific items listed under supplementary payments.

Severability. is also known as "separation of insureds". This means that coverage applies separately to each insured, as if each insured is the only named insured. It does not increase the limits of the insurance

Important Property Insurance Principles

Losses

For insurance purposes, a loss is a reduction in the value of an insured's property caused by an insured peril. These definitions describe the types and causes of loss.

Peril. Actual cause of a possible loss (fire, theft, rain, etc.)

Named Perils. Perils specifically covered on property insured.

Open Perils/Special Form. Insurance against loss of or damage to property arising from any cause except those that are specifically excluded. (Used to be referred to as "all-risk") It is important to note the term all-risk is not used in the actual contract as there are some perils that will be excluded.

Concurrent Causation (Cause). A term that refers to situations where two or more perils act together (concurrently) or in a sequence to cause a loss. This becomes an issue when one peril is covered and the other excluded. For example, an earthquake (not covered by the homeowner's insurance policy) causes the gas stove to explode, which starts a fire and destroys the home. The fire is a covered peril in the policy. On some policies, if one of the perils is excluded, there is no coverage. In other cases only damage done by the covered peril may be repaired.

Direct Loss (or Damage). A loss which is a direct consequence of a particular peril. Fire damage to a refrigerator would be a direct loss.

Consequential Loss (or Damage). A loss not directly caused by a peril insured against, such as spoilage of frozen foods caused by fire damage to the refrigeration equipment.

Loss Reserve. Funds a company is required by law to set aside to cover claims. It is the amount equal to the losses that are due, but not yet payable; an estimate of losses that may have incurred but not yet reported.

Hazards

A specific situation that increases the probability of the occurrence of loss arising from a peril, or that influences the extent of the loss (i.e. slippery floors, unsanitary conditions, congested traffic, unguarded premises, uninspected boilers, etc). There are four main types of hazards.

- **Physical Hazard**. Any hazard arising from the material, structural, or operational features of the risk itself apart from the persons owning or managing it.
- **Moral Hazard**. A condition of morals or habits that increases the probability of loss from a peril. (i.e. An individual who previously burned his or her own property to collect the insurance.) Some insurance companies use the terms moral and morale interchangeably.
- **Morale Hazard**. Hazard arising out of an insured's indifference to loss because of the existence of insurance. (i.e. the attitude, "It's insured, so why worry.") If an insurer concludes that a person poses a morale hazard risk, they might decline the application.
- **Legal Hazard**. An increase in the likelihood that a loss will occur because of court actions.

<u>Valuing Insurance Coverage</u>

How much an insurance company will pay for a loss covered by the policy depends on what the policy says about how it will value losses, and how it will split the loss amount with the insured. The definitions below are common in insurance policies and determine how much will be paid for a loss.

Actual Cash Value. An amount equivalent to the replacement cost of lost or damaged property at the time of the loss, less depreciation. With regard to buildings, there is a tendency for the actual cash value to closely parallel the market value of the property.

Replacement Cost. The cost of replacing property without a reduction for depreciation. By this method of determining value, damages for a claim would be the amount needed to replace the property using new materials.

Market Value. The price for which something would sell, especially the value of certain types of assets, such as stocks and bonds. It is based on what they would sell for under current market conditions.

Stated Amount. An agreed amount of insurance which is shown on the policy, and which will be paid in the event of total loss regardless of the actual value of the property.

Valued Policy. A policy which states that in the event of a total loss, a specific amount will be paid, that being the amount stated in the policy. The effect is to eliminate the need for determining the actual cash value of an item of property in the event of a total loss. It is generally used with certain more valuable items, such as fine arts, antiques, and furs.

Open Policy. An open policy is one in which the value of the subject matter is not agreed upon, but is left to be ascertained in case of loss.

Agreed Amount Clause. Under this clause, the insured and the insurer agree that the amount of insurance carried will automatically satisfy the coinsurance clause. The effect is to eliminate the necessity of determining whether or not the amount carried is equal to the stated percentage of the actual cash value indicated in the coinsurance clause.

Blanket Insurance. A form of property insurance that covers, in a single contract, either multiple types of property at a single location or one or more types of property at multiple locations.

Specific Insurance. A policy which describes specifically the property to be covered. This is in contrast to a policy which covers on a blanket basis all property at one or more locations without specific definitions. In the case of overlapping coverages, specific insurance is considered the primary one.

Important Insurance Liability Principles

Liability Concepts

When the insured violates society's law, the insured has committed a crime. When the insured violates the rights of another person, the insured has committed a tort. The person committing a tort is known as the tortfeasor. These are also known as criminal law and civil law, respectively. Prosecuting and punishing criminal law violations is the responsibility of the government. Civil laws, however, deal with the rights between individuals/entities that do not fall under government jurisdiction and are dealt with in Civil Court.

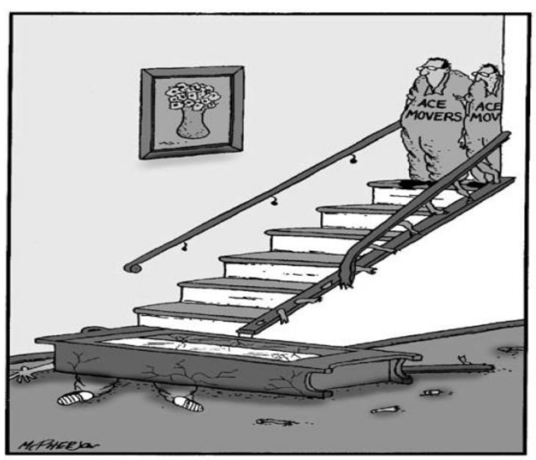
Contract law is a type of civil law that deals with legal agreements (or contracts). Since insurance policies are legal contracts, they are subject to the general law of contracts and disputes will be resolved in civil court. If one party is found to be in breach of contract, the other party may be entitled to monetary compensation for damages, costs, and attorney fees.

Tort law is a type of civil law that deals with wrongful acts between two parties *except a crime or breach of contract.* Legal liability is based on one of the following; 1. Intentional tort (deliberate) 2. Unintentional tort (negligence) 3. Absolute liability (inherently dangerous) (These types of torts will be covered more in depth at a later point in the course)

It is important to note that liability insurance applies only to the financial consequences of torts. The insured cannot buy liability insurance to protect against the consequences of crimes.

> If the insured is angry at his neighbor and intentionally burns down his house, the insured have committed the crime of arson—and liability insurance will not cover the damages. However, if the insured is having a backyard barbecue and accidentally start a fire that burns down the insured's neighbor's house, liability insurance may cover the damages.

Accident. An unplanned event, unexpected and undesigned, which occurs suddenly and at a definite place.



"I knew we were in trouble the second he yelled that old 'Look, Ma, no hands!' line."

Occurrence. An event that results in an insured loss. In some lines of insurance, such as liability, it is distinguished from accident in that the loss does not have to be sudden and fortuitous and can result from continuous or repeated exposure which results in bodily injury or property damage neither expected nor intended by the insured.

Unintentional Torts. The majority of personal liability cases involve **unintentional torts**. The basis for unintentional torts is usually negligence, so we had better have a working definition of **negligence**. In order for negligence to exist, four elements must be present:

- ***Duty to act.*** The duty to act in a reasonably prudent manner toward another (such as driving the insured's car safely down the street in a manner that avoids hitting other cars or pedestrians).
- ***Breach of the duty to act.*** The tortfeasor does not act in the prudent manner described above.
- ***Occurrence of injury or damage.*** Another party actually must suffer an injury or damage.
- ***Unbroken chain*** . The proximate cause of the injury or damage. The tortfeasor's breach of duty is actually what caused the injury or damage.

If any of these elements is absent from an event, negligence does not exist and the insured will not be held liable due to negligence. But when the required elements are present, the injured party usually has a valid claim for damages based on negligence.

Damages is an important term to understand in any discussion of liability. When someone is held liable for injury or property damage to another, that person can be required to pay compensation to the injured parties. For these types of claims, we need to be concerned with two broad types of damages:

- **Compensatory damages**—which simply means compensation for the loss incurred. These may include specific damages (the documentable, actual expenses incurred by the injured party, such as medical bills, wages lost and property replacement costs) and general damages (monetary awards for more subjective, less quantifiable aspects of the loss, such as pain and suffering, or loss of consortium).
- **Punitive damages**—these are damages that the court can compel the tortfeasor to pay in addition to the compensatory damages awarded. Punitive damages represent a fine, or punishment, for outrageous, severe or intentional conduct.

Negligence

Negligence. The failure to do what a reasonable and prudent person would do under normal circumstances.

- **Comparative Negligence**. In some states the negligence of both parties to an accident is established in proportion to the degree of their contribution to the accident. Several states have comparative negligence laws, and each one varies somewhat from the others.

- **Contributory Negligence.** If an injured party fails to exercise proper care and in some way contributes to his or her injury, the doctrine of contributory negligence will probably negate or defeat the claim, even though the other party is also negligent. Contrast with Comparative Negligence.

Please see Chapter 1 addendum (Page 1-27) for examples

Liability

Liabilities. Generally, a personal umbrella policy will not cover **business liability**. However, some business exposures may be covered by personal liability policies. For example, an umbrella policy may cover certain home office exposures.

Legal Liability. Liability under the law as opposed to liability arising from contracts or agreements. In insurance, it is most often used to refer to the liability that an individual has if he or she should negligently injure another party. For example, an owner of an automobile may be held legally liable if he or she is negligent in the operation of the automobile and injures another person or damages another person's property as a result of that negligence.

Absolute Liability. A type of liability that arises from extremely dangerous operations. An example would be in the use of explosives: A contractor would almost certainly be liable for damages caused by vibrations of the earth following an explosive detonation. With absolute liability it is usually not necessary for a claimant to establish that the operation is dangerous.

Strict Liability. Usually used when referring to products coverage. The liability that manufacturers and merchandisers may be subject to for defective products sold by them, regardless of fault or negligence. A claimant must prove that the product is defective and therefore unreasonably dangerous.

Vicarious Liability. The law says that under certain circumstances a person is liable for the acts of someone else. For example, in matters related to an automobile a parent might be held responsible for the negligent acts of a child. In such a case the parent would be vicariously liable.

Gross Negligence. Willful and wanton misconduct

No Fault Laws. **"Pure"** no fault laws do not exist today. In the past, some states had laws that provided payment of a loss from an insured's *own carrier* for damages, regardless of who was at fault. Each person was responsible for his or her own damages. Insureds bought insurance to protect themselves and their passenger's in case of an accident. This modified the tort liability system because no suit was brought against a negligent party.
"**Modified**" no fault laws allow for each driver's own policy to absorb a certain dollar limit of loss. If that threshold is exceeded by the claim, then the injured person can seek damages against the "at fault" driver at that point. California does not have a no-fault plan. In states with no-fault plans, the driver must accept responsibility for his or her own loss and must recover loss from his or her own insurer. Additionally, they cannot sue for general damages until specific damages, including medical expenses, exceed a minimum amount required by the state. The goal is to eliminate frivolous suits for general damages.

Intentional Torts. So far, we've discussed unintentional torts. **Intentional torts** can involve **infringement of property and privacy rights** (for example, trespassing). Property rights also can be violated by nuisance-type activities that interrupt a property owner's ability to use the property (for example, when the insured tests the volume limit on the his new 2500-watt CD player while the insured's neighbor is trying to relax on a Sunday afternoon). Other intentional torts involve **personal injury**, which includes bodily injury and damage to reputation through untrue statements, libel (in print) or slander (spoken).
These are by no means the only examples of personal liability exposures. The insured's children, the insured's pets, the insured's premises, the insured's hobbies, the insured's car and many of the insured's daily activities create exposure to personal liability.

Insurance Companies and Agencies

Insurance Companies

Insurance is mostly provided privately. In other words, most types of insurance available are offered by private companies. Companies may be organized in a variety of different ways, and may be limited as to where and what types of insurance they are authorized to provide.

As previously mentioned in this chapter, insurance is a business. The four main business functions of an insurance company are:

1. **Actuarial,**
2. **Sales & Marketing,**
3. **Underwriting, and**
4. **Claims handling.**

Although an agent operates primarily in the sales & marketing function, he or she may participate in at least three of the four functions at some point.

Rating Bureaus

Insurance Services Office (ISO) - The ISO is the largest rating bureau for property and casualty insurers that provides statistics and advice regarding most property and casualty policy forms. The (ISO) is the advisory organization that develops forms for the standard market.

Workers Compensation Inspection Rating Bureau (WCIRB) – (CIC 11750.3)
The California WCIRB is a consulting firm that provides reliable statistics, rating information, and advice for Workers' Compensation insurers. It also collects and tabulates information and statistics for the purpose of developing pure premium rates to be submitted to the commissioner for issuance or approval. The WCIRB also inspects risks for classification or rate purposes and to furnish to the insurer and upon request of the employer

An insurance company's **actuarial** function is often its least-understood function. Actuaries—who are certified by professional organizations—take an academic look at loss histories, laws and financial trends to develop the guidelines, terms and conditions under which an insurance company will write policies. This department is responsible for ratemaking (the process to determine the appropriate rates charge) for each line of business that the company insures, with the intent of making a profit. In some insurance companies, the actuarial staff is small and doesn't interact much with the other functions. You may hear actuaries referred to as "wizards" or "elves"—since they operate apart from the rest of the company and their decisions are sometimes confusing to others.

ACORD (Association for Cooperative Operations Research and Development - The insurance industry's nonprofit standards developer, a resource for information about object technology. Maintaining a large library of standardized forms for the insurance industry.

Sales & marketing is usually the most visible part of an insurance company (in this way, it's much different than the actuarial function). Sales & marketing is the company's "public face." For most of the insurance industry's history, independent agents were the main method of sales and marketing. And, in many ways, the independent agent remains the classic example of how policies are marketed and sold. However, in the last few decades, other marketing and sales channels have grown.

Captive agents—who only sell the policies of one insurance company—have become a significant alternative to independent agents.

Also, a number of companies have begun using **direct marketing** as their main method of selling coverage. Direct marketers don't use agents or brokers to sell their insurance; they sell through direct mail and telemarketing. Since they eliminate a sales staff—and a commission structure—these companies usually offer cheaper premium. The problem is: Some of those companies handle claims the same way they sell policies. In other words, the price break usually comes at the cost of service.

Underwriting is the application of actuarial guidelines to specific individuals and companies. It's the process by which premiums are determined…and insureds are judged to be preferred, standard, substandard or uninsurable. Preferred risks are entitled to premium discounts, while substandard risks may be declined, or they may have to pay an extra premium for the policy or have a policy issued with a rider omitting some element of the coverage.

Agents play an important role in gathering the information that a company's underwriters will use to make these determinations. In some cases, the agent will also be trusted to make some preliminary underwriting judgments in the field. The personal interaction with the applicant should allow the producer (solicitor, agent, broker) such as, signed and completed applications, asking in-depth questions to insure against concealment or misrepresentations, and observing potential risks or exposures while noting ways to avoid them, are all parts of field underwriting

These are determined by 4 basic steps of underwriting:

1. Gather all necessary information (completed application)
2. Process the information and decide whether or not to underwrite
3. Carry out the decision
4. Observation/review

<u>Limitations</u> – Insurers do have limitations on their underwriting by law, (Prop 103 for example) and are divided into 2 main categories:

1. Pre-selection – The underwriter follows the first 3 steps listed above, and decides whether or not to accept the risk.

2. Post-selection – After a policy is in force, a periodic review usually at renewal, is done to determine whether or not to cancel or non-renew the risk

Claims handling covers the entire process of evaluating and paying claims made under policies. This is the part of the insurance company that often draws the most attention from consumers, politicians and media outlets.

In some cases, the insurance company's customer service operations will fall under the supervision of the claims managers.

Market Conduct Regulations are the state laws that regulate insurer practices regarding underwriting, sales, ratemaking (actuarial) and claims handling

Arbitration – When the insurer and the insured dispute how much the insurer should pay on a claim, they agree to have a third party decide on how much will be paid

Other important aspects to insurance companies and agencies are as follows.

Stock Insurer. An incorporated insurer with capital contributed by stockholders, to whom the earnings are distributed as dividends on their shares.

Mutual Insurer. An incorporated insurer without incorporated capital owned by its policyholders. Although mutual insurers do distribute their earnings to their policyholders in the form of dividends, the term should not be used in a sense that makes it synonymous with participating. In most jurisdictions, a mutual insurer is free to issue nonparticipating insurance if it chooses and a stock insurer is free to issue participating insurance.

Fraternal Insurance. Insurance offered a special group of people, namely, members of a lodge or a fraternal order. Such insurance may be written on an assessment basis or on a legal reserve basis.

Reciprocal Insurance Exchange. An unincorporated group of individuals, called subscribers, who mutually insure one another, each separately assuming his or her share of each risk. Its chief administrator is an attorney in fact.

Risk Retention Groups. Liability insurance companies owned by their policyholders. Membership is limited to people in the same business or activity which exposes them to similar liability risks. The purpose is to assume and spread liability exposure to group members and to provide an alternative risk financing mechanism for liability.

Reinsurance. A type of insurance that involves acceptance by an insurer, called the reinsurer, of all or a part of the risk of loss covered by another insurer, called the ceding company. It is a way for an insurer to avoid having to pay for large or catastrophic losses.

Authorized Insurer. An insurer authorized by the state to transact business in that state for specific types of insurance.

Domestic Insurer. An insurer formed under the laws of the state in which the insurance is written.

Foreign Insurer. An insurer domiciled in a state of the United States other than the one in which the insured's insurance is written.

Alien Insurer. An insurer formed under the laws of a country other than the United States. A U.S. company selling in other countries is also an alien insurer.

Underwriter. A technician trained in evaluating risks and determining rates and coverages for them. The term derives from the practice at Lloyd's of each person willing to accept a portion of the risk writing his or her name under the description of the risk.

Claim Adjuster. A representative of the insurer who seeks to determine the extent of the firm's liability for loss when a claim is submitted.

Insurance Rates

Rate. The cost of a given unit of insurance. For property insurance, the rate per $100 of value to be insured. The premium, then, is the rate multiplied by the number of units of insurance purchased. There are different types "rating systems" some of the most commonly used are:

1. **Judgment Rating**: the individual risk is considered. The underwriter determines the premium using their intuition and experience instead of a rating manual.
2. **Merit Rating**: rates that begin with a class or manual rate, which is then modified, based on loss experience or other unique characteristics. Lower premiums are given to those insureds that have few or minimal losses.
3. **Manual Rating:** the underwriter simply refers to a rating plan or manual produced by the insurer to determine the premium.
4. **Retrospective Rating:** premiums are based on the actual losses that occurred during the policy term, and may be assessed or credited back at the end of the policy term.
5. **Experience Rating:** the rate is based off actual loss history.

The commissioner considers if the rate mathematically reflect the insurance companies investment income. A rate shall not be inadequate, excessive, or unfairly discriminatory.

Loss Cost Rating. In recent years, new laws and public demand have pushed the industry to adopt new methods of insurance rating. The ISO has developed the "loss cost rating", whereby prospective loss costs are developed based on losses or loss adjustment expenses, but not other typical components of the final rate. (i.e. insurer's general expenses and profit). Insurers arrive at the final rates by applying modifications and a lost cost multiplier, to take into account the individual expenses, underwriting profit and contingencies.

Rate Regulation. The Department of Insurance regulates rates to make sure they are reasonable and adequate. There are four methods used to obtain this objective:

1 **Prior Approval:** Rates must be approved by the state before it can be used. EXAMPLE: rates for auto and homeowners policies.
2 **File and Use:** Under this method, once the rate is filed with the state, it may be used. The state reviews the rate and determines if the rate is acceptable or not. If not, it would be rejected and it would no longer be used.
3 **Use and File:** Under this method, the companies use they rate they deem appropriate, then file that rate with the state
4. **Open Competition:** this method allows the insurers to compete with one another by change rates without state review. This is also known as "open rating" and is used for workers compensation

*The system used by the state of California to regulate rates for most property & casualty insurance written in California is "**Prior Approval**"

Loss Ratio. The losses divided by the premiums paid. The numerator (losses) can be losses incurred or losses paid, and the denominator (premium) can be earned premiums or written premiums, depending on what use is going to be made of the loss ratio.

Expense Ratio. The proportion of an insurer's written premiums that is being used to pay acquisition costs, general expenses and premium taxes. Expense ratio equals incurred insurance less related expenses divided by written premium

Combined Ratio. Indicates whether or not the company is earning a profit on the business it is writing. 1. If the loss ratio added to the expense ratio is less than 100, there is an underwriting profit. 2. If the loss ratio added to the expense ratio equals 100, the insurer is breaking even. 3. If the loss ratio added to the expense ratio is greater than 100 there is an underwriting loss.

Self-Insurance/Self-Funding. In addition to buying an insurance policy, risk may be managed by self-insuring or self-funding. These plans include employee medical benefits paid out of employer business revenue instead of being insured by an insurance policy. A major benefit of this would be that employees do not have to meet an insurers underwriting criteria in order to be insured (for example, no medical exams are required)

Lloyd's of London. "Lloyd's" is not an insurance company as such, but a market composed of individuals exposed to unlimited personal liability. In other words, it is a group of high-net worth individuals who share in the risk of the insured. Each group of individuals, known as syndicates, are responsible for the amount of insurance they write on different classifications of risk.

Insurance Agents

Insurance is sold both directly from companies to policyholders, and also through insurance agents. When an individual becomes an agent, he or she may be employed by an insurance company, or an independent contractor with his or her own company, selling policies for the insurance company. There are many aspects to "agency". Some of the common terms defining agency follow.

Agency. When one person acts on behalf of another person, an agency is created with the first person being the agent and the second person being the principal. The principal generally can be held responsible for acts of its agents.

Life and Disability Insurance Analyst. A person who, for a fee or compensation of any kind, paid by or derived from any person or source other than an insurer, advises, purports to advise, or offers to advise any person insured under, named as beneficiary of, or having any interest in, a life or disability insurance contract, in any manner concerning that contract or his or her rights in respect thereto. (CIC 32.5)

Life Settlement Broker: a person who, on behalf of an owner, and for a fee, commission, or other valuable consideration, offers or attempts to negotiate life settlement contracts between an owner and providers. A life settlement broker represents only the owner and owes a fiduciary duty to the owner to act according to the owner's instructions, and in the best interest of the owner, notwithstanding the manner in which the broker is compensated [CIC 10113.1(b), 10113.2(b)(1)(A) to (D)]

Limited Lines Automobile Agent: 1625.55. (a) A limited lines automobile insurance agent is a person authorized to transact automobile insurance, as defined in Section 660. A limited lines automobile insurance agent license is a license to so act

Agent (also called a Producer). One who solicits, negotiates or effects contracts of insurance on behalf of an insurer. The agent's right to exercise various functions, authority, and obligations and the obligations of the insurer to the agent are subject to the terms of the agency contract with the insurer, to statutory law, and to common law.

Independent Agency System. An insurance distribution system within which independent contractors, known as agents, sell and service property liability insurance solely on a commission or fee basis under contract with one or more insurers that recognize the agent's ownership, use, and control of policy records and expiration data.

Exclusive Agency System. An insurance distribution system within which agents sell and service insurance contracts that limit representation to one insurer and which reserve to the insurer the ownership, use, and control of policy records and expiration date.

Captive Agent. One who sells insurance for only one company as opposed to an agent who represents several companies.

Direct Selling System. A distribution system within which an insurer deals directly with its insureds through its own employees. This definition applies typically to property and liability insurance business. Included are mail-order insurance and the sale of insurance from vending machines at airport booths and elsewhere.

Agency Contract (or Agreement). The document which establishes the legal relationship between an agent and an insurer.

Express Authority. Authority of an agent that is specifically granted by the insurer in the agency contract or agreement.

Implied Authority. Authority of an agent that the public may reasonably believe the agent to have. If the authority to collect and remit premiums is not expressly granted in the agency contract, but the agent does so on a regular basis and the insurer accepts, the agent has implied authority to do so.

Apparent Authority. Authority of an agent that is created when the agent oversteps actual authority, and when inaction by the insurer does nothing to counter the public impression that such authority exists.

Fiduciary. A person holding the funds or property of another in a position of trust, and who is obligated to act in a prudent and ethical manner. An example would be an attorney, bank trustee, the executor of an estate, etc.

Commission. That portion of the premium paid to the agent as compensation for services.

Commingling. An illegal practice which occurs when an agent mixes personal funds with the insured's or insurer's funds.

Laws and Regulations Important in the Insurance Industry

Insurance Regulation

Insurance is regulated, for the most part, at the **state** level, meaning that each state has the right to determine what insurance policies are sold, how they are sold, by whom they are sold, and even what types of provisions are required in each type of policy.

There are also federal laws that affect the insurance industry. One of the most important is the Fair Credit Reporting Act.

Fair Credit Reporting Act

The FCRA is designed to protect the privacy of consumer report information and to guarantee that the information supplied by credit reporting agencies is as accurate as possible. Consumer reports may include information on an applicant's credit history, medical conditions, driving record, criminal activity, and hazardous sports. Amendments to the FCRA, which went into effect in 1997, increase the legal obligations of insurers who use consumer reports.

A consumer credit report cannot be used as the basis of a decline to insure or as a premium factor in California. When an adverse action is taken, it is based solely or partly on information in a consumer report, the FCRA requires the agent to provide a notice of the adverse action to the consumer. This applies to new applicants as well as current policyholders. The notice must include:

The name, address, and telephone number of the credit reporting agency that supplied the consumer report, including the toll-free telephone number for credit bureaus that maintain files nationwide

A statement that the credit reporting agency that supplied the report did not make the decision to take the adverse action and cannot give the specific reasons for it

A notice that the individual's right to dispute the accuracy or completeness of any information the credit reporting agency furnished, and the consumer's right to a free credit report from the credit reporting agency upon request within 60 days.

Disclosure of this information is important because some consumer reports may contain errors. The adverse action notice is required even if the information in the consumer report was not the main reason for the denial or rate increase. Even if the information in the report played only a small part in the overall decision, the applicant must still be notified.

There are legal consequences for insurers who fail to get an applicant's permission before requesting a consumer report containing medical information or who fail to provide required disclosure notices. The FCRA allows individuals to sue insurers for damages in federal court. A person who successfully sues is entitled to recover court costs and reasonable legal fees. The law also allows individuals to seek punitive damages for deliberate violations. In addition, the Federal Trade Commission, other federal agencies, and the states may sue insurers for non-compliance and obtain civil penalties.
Also see the Federal Trade Commission web site for a full copy of the Fair Credit Reporting Act at: http://www.ftc.gov/os/statutes/fcra.htm

Chapter 1 addendum

Examples of Comparative Negligence and Contributory Negligence

Comparative Negligence:

Bob is injured in a car accident. The other driver was determined to be 70% at fault for the accident and Bob's injury. The driver of the other vehicle was making an illegal left turn and was cited at the scene of the accident. However, Bob is considered 30 % at fault because he was cited at the scene for having tires that prevented him from stopping. Bob is claiming $20,000 for medical expenses, however he will only receive 70% of that amount, or $14,000, as he was 30 % responsible for his own injuries.

Contributory Negligence:

In the last example, Bob was considered to be 30% at fault. If the contributory negligence doctrine were imposed instead of comparative negligence, Bob would not be entitled to any compensation from the other driver as Bob was partly responsible for his own injury.