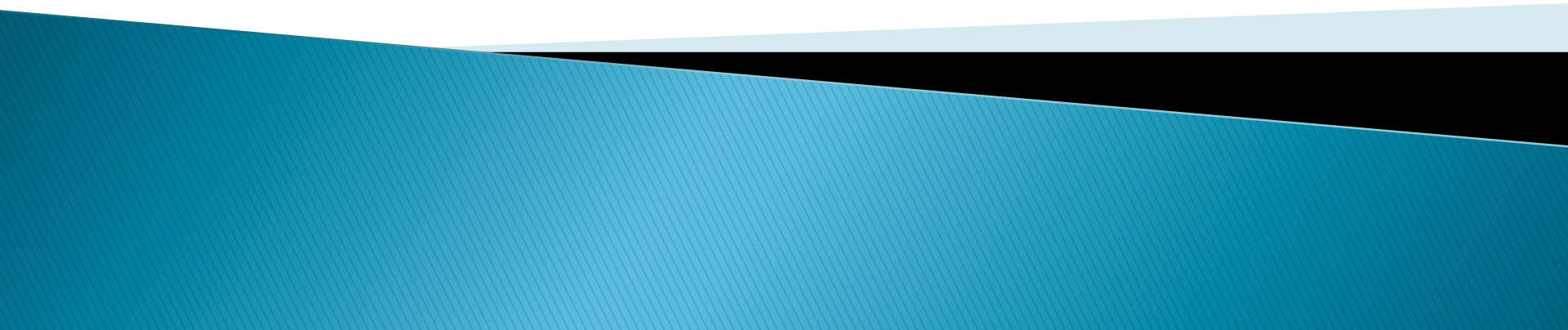
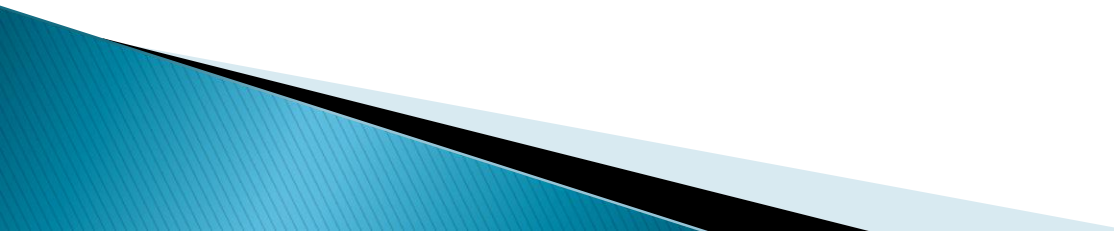


Chapter Seven

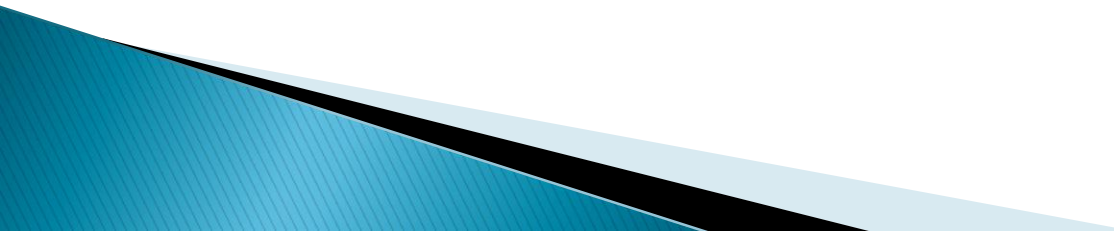
Insurance Contracts




Objectives

- ▶ Explain the four elements of any valid contract
 - ▶ Describe the special characteristics of insurance contracts.
 - ▶ Explain the purpose of some of insurance policy provisions
 - ▶ Describe the conditions commonly found in property and liability policies.
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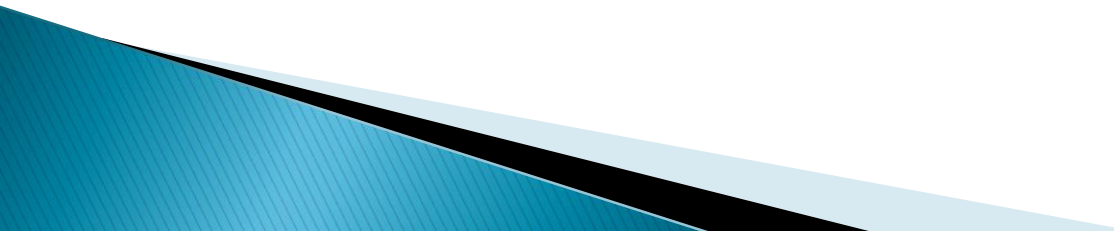
Insurance contracts

- ▶ The essence of insurance is the insurer's promise that it will pay claims in the future for losses that are covered under the policy.
 - ▶ The evidence of this promise is the insurance contract or policy.
 - ▶ The policy defines in detail the rights and duties of both parties to the contract: the insured and the insurer.
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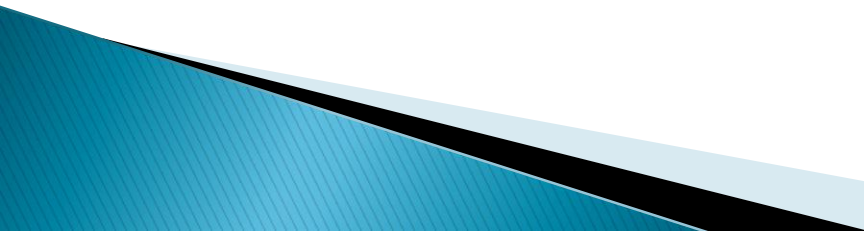
Elements of a contract

- ▶ **Policy:** “ A complete written contract of insurance.”
 - ▶ **Contract:** “ A legally enforceable agreement between two or more parties.”
 - ▶ The validity of a contract depends on the following **four** essential elements:
 1. Offer and acceptance
 2. Competent parties
 3. Legal purpose
 4. Consideration
- 

1. Offer and Acceptance

- ▶ One party will make an offer and another party must accept the offer.
 - ▶ In legal terms, there must be “mutual assent”.
 - ▶ Typically, the insured will make an offer and an underwriter (or an agent, acting on behalf of an insurer) accepts the application and agrees to provide the coverage requested at a premium acceptable to both the insurer and the applicant.
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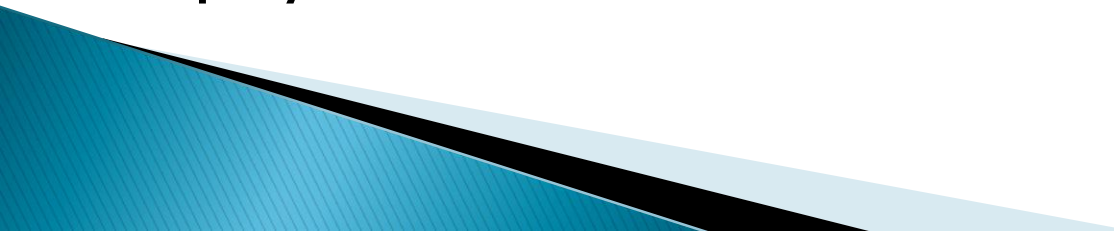
2. Competent Parties

- ▶ Each party must have the legal capacity to make the agreement binding. Individuals are generally considered to be competent and able to enter into legally enforceable contracts, unless they are one or more of the following:
 - Insane or otherwise mentally incompetent
 - Under the influence of drugs or alcohol
 - Minors (persons not yet of legal age)
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3. Legal Purpose

- ▶ The courts may consider a contract to be illegal if its purpose is against the law or against public policy.

4. Consideration

- ▶ “ Something of value given by each party to a contract.”
 - ▶ In the case of an insurance contract, the insurer’s consideration is its promise to pay a claim in the future if a covered loss occurs.
 - ▶ In insurance contracts, the following **two** types of consideration are involved:
 - ❖ The **insured’s consideration** is the payment of (or the promise to pay) the premium.
 - ❖ The **insurer’s consideration** is its promise to pay claims for covered losses.
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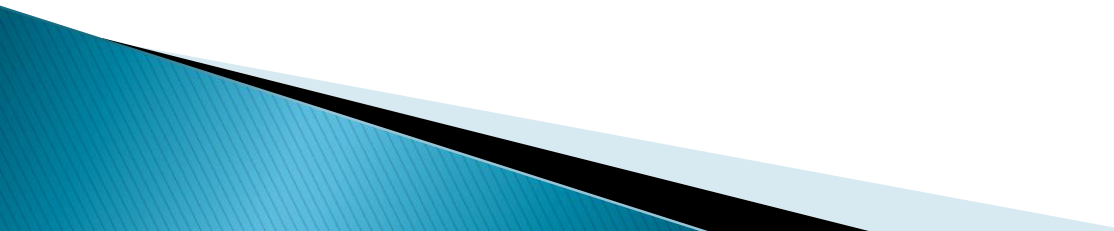
Special characteristics of Insurance Contracts

1. **Conditional Contract** : “ A contract in which one or more parties must perform only under certain conditions.”
2. ***Contract involving fortuitous events and the exchange of unequal amounts***
3. **Contract of utmost good faith**: “An obligation to act in complete honesty and to disclose all relevant facts.”

Concealment: “An intentional failure to disclose a material fact.”



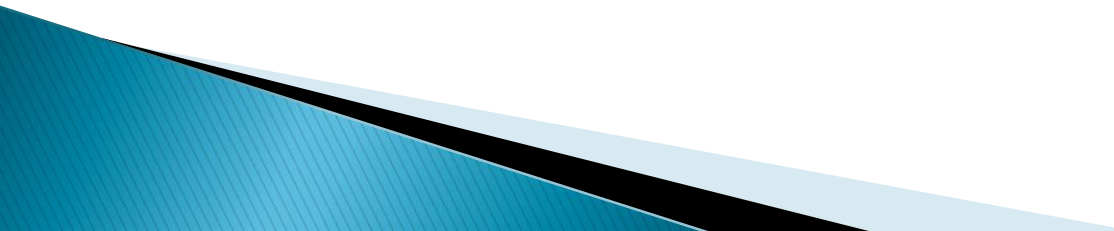
Special characteristics of Insurance Contracts

- ▶ ***Material fact:*** “ In insurance, a fact that would affect the insurer’s decision to provide or maintain insurance or to settle a claim.”
 - ▶ ***Misrepresentation:*** “ A false statement of a material fact on which a party relies.”
 - 4. **Contract of adhesion:** “ A contract to which one party (the insured) must adhere as written by the other party (the insurer).” If the policy wording is ambiguous, a court will generally apply the interpretation that favors the insured.
- 

Special characteristics of Insurance Contracts

5. **Contract of indemnity:** “ A contract in which the insurer agrees, in the event of a covered loss, to pay an amount directly related to the amount of the loss.” To indemnify is to restore a party who has had a loss to the same financial position that party held before the loss occurred.

Principle of indemnity: “ The principle that insurance should provide a benefit no greater than the loss suffered by the insured.”

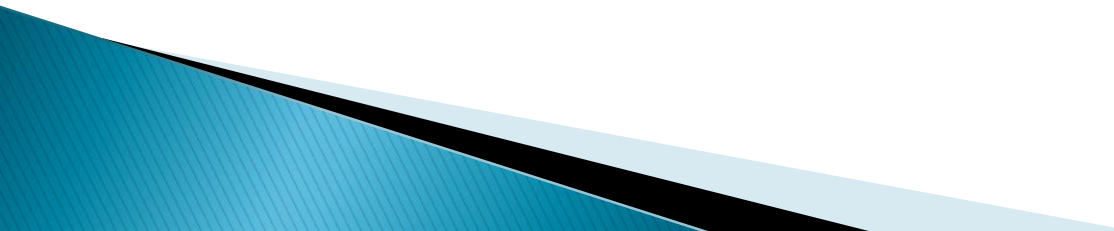


Special characteristics of Insurance Contracts

- ▶ ***Valued policy:*** “A policy in which the insurer pays a stated amount in the event of a specified loss (usually a total loss), regardless of the actual value of the loss.

6. **Nontransferable contract:** The identities of the persons or organizations insured are important to the insurer, which has the right to select those applicants with whom it is willing to enter into contractual agreements. After an insurance [policy is in effect, an insured may not freely transfer the policy to some other party. (a practice called an “assignment”)]

Content of insurance policies

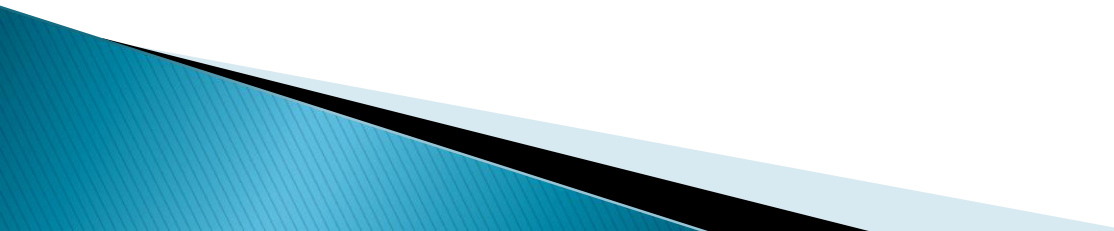
- ▶ Insurance policies must be drafted carefully. The parties must agree on how to handle many situations that could arise even if these situations are not likely to occur.
 - ▶ The policy's provisions are generally included in the following categories:
 1. **Declarations:** “An insurance policy information page or pages providing specific details about the insured and the subject of the insurance.”
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Special characteristics of Insurance Contracts


2. **Definitions:** most policies define words that have a specific meaning with regard to the coverage provided.

3. **Insuring Agreements:** “ An insurance policy statement indicating that the insurer will, under certain circumstances, make a payment or provide a service.”

4. **Exclusions:** “A policy provision that eliminates coverage for specified exposures.”
no insurance policy can reasonably cover all possible losses.



Special characteristics of Insurance Contracts

- ▶ Insurance policies contain exclusions for several **reasons** as follows:
 - ❖ To eliminate duplicate coverage
 - ❖ To assist in managing moral hazards
 - ❖ To avoid insuring other losses that are deliberate
 - ❖ To assist in managing attitudinal hazards
 - ❖ To avoid covering losses that are not economically feasible to insure
 - ❖ To eliminate coverage that most insureds do not need.
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Special characteristics of Insurance Contracts

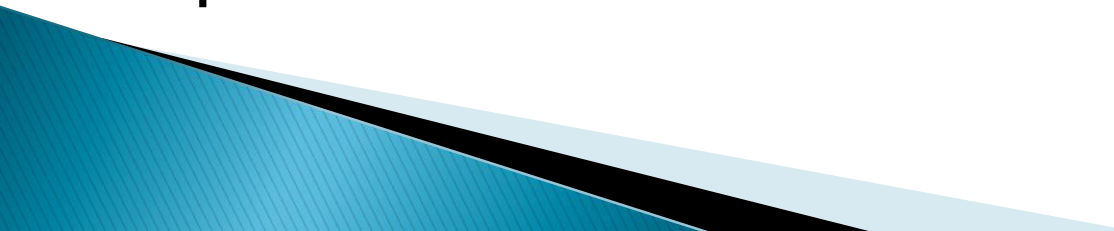
- ❖ To eliminate coverage for exposures that require special handling by the insurer.
- ❖ To keep premiums reasonable.

5. **Conditions:** “ Any provision that qualifies an otherwise enforceable promise of the insurer.”

The insured must generally comply with these conditions if coverage is to apply to a loss.

6. **Miscellaneous provisions:** They sometimes deal with the relationship between the insured and the insurer, or they may help to establish procedures for carrying out the terms of the contract.

Standard forms and manuscript policies

- ▶ After the policy wording has been drafted by the insurer or advisory organization and approved by state regulators, the insurer prints thousands of copies of each standardized form or stores the forms electronically.
 - ▶ When insurance is purchased, the appropriate documents are combined with the declarations to create the policy for that particular insured.
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Standard forms and manuscript policies

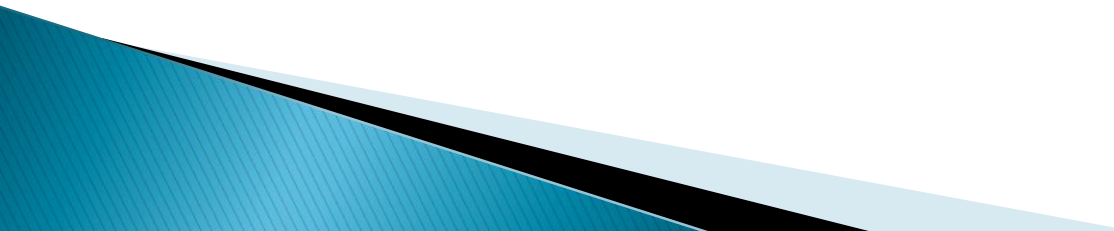
- ▶ Only in a special situation, usually involving a large amount of insurance, might negotiations between parties happen. When it does, the result is a manuscript policy or manuscript endorsement.
- ▶ **Manuscript policy:** “ An insurance policy that is specifically drafted according to terms negotiated between a specific insured (or group of insureds) and an insurer.”

Structure of insurance policies

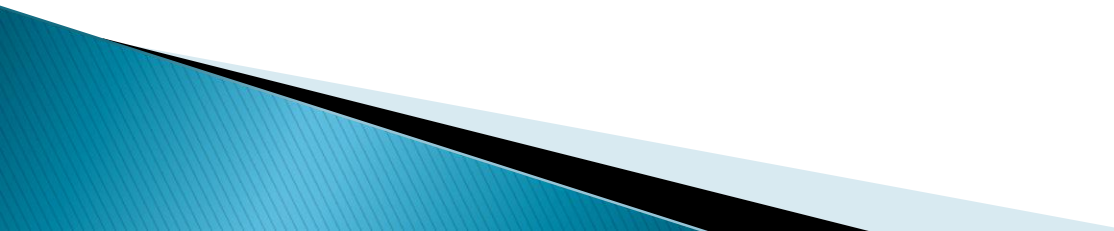
- a) **Self-contained policies:** “ A single document that contains all the agreements between the insurer and the insured; forms a complete policy by itself.”
 - it can be modified by the addition of one or more endorsements.
 - ***Endorsement:*** “ A document that amends an insurance policy.”

Structure of insurance policies


b) **Modular Policies:** “ A policy consisting of several different documents, none of which by itself forms a complete contract.”



Conditions commonly found in property and liability insurance policies

- ▶ An insurance policy describes the coverage the insurer provides and also stipulates the conditions under which the coverage is provided. These conditions provide the rules for the relationship between the insurer and the insured.
 - ▶ Conditions common to most property and liability insurance policies, both personal and commercial, address the following matters:
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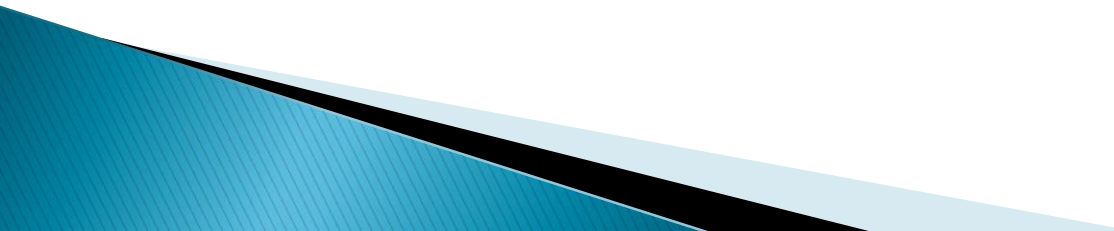
Conditions commonly found in property and liability insurance policies

- 1) **Cancellation:** “Termination of a policy, by either the insurer or the insured, during the policy term.”
- ▶ The cancellation provision states the procedures that must be followed when cancellation is initiated by the insured or by the insurer.
 - ▶ ***Cancellation by the insured:*** the insured may usually cancel the policy at any time. To do this, the insured may either return the policy to the insurer or provide the insurer with advance written notice of the date the policy is to be canceled.
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Conditions commonly found in property and liability insurance policies

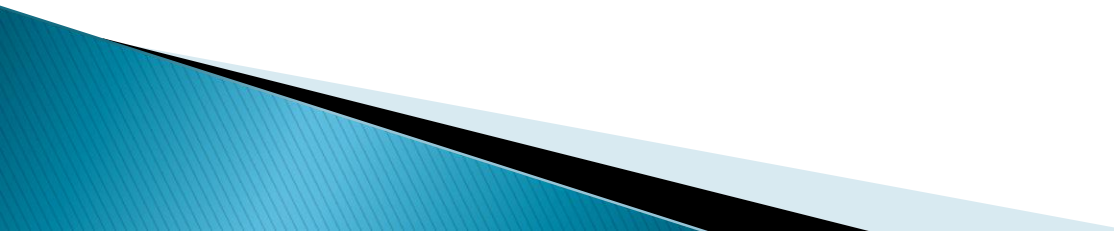
- ▶ ***Cancellation by the insurer:*** the insurer may also cancel most insurance policies, however, the procedures described in the policy provide the insured with some safeguards, such as a given number of days' written notice before the cancellation takes effect.
- ▶ When the policy is canceled, the insured may be entitled to a refund. If the insurer cancel the policy, the return premium is calculated on two basis:

Conditions commonly found in property and liability insurance policies

- ▶ ***Pro rata refund:*** “ The unused premium (based on the pro rata portion of the premium for the number of days remaining in the policy) returned to the insured when a policy is canceled.
 - ▶ ***Short rate refund:*** “ A refund of premium that is less than what the pro rata refund would be; sometimes used when the insured cancels a policy midterm.”
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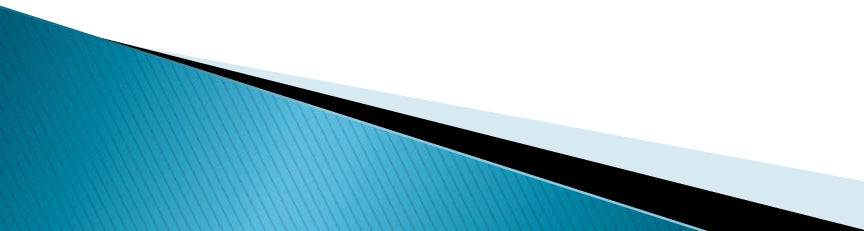
Conditions commonly found in property and liability insurance policies

2) **Policy changes:** many policies contain a policy changes condition stating that the written insurance policy contains all the agreements between the insurer and the insured and that the terms of the policy can be changed only by a written endorsement issued by the insurer.



Conditions commonly found in property and liability insurance policies

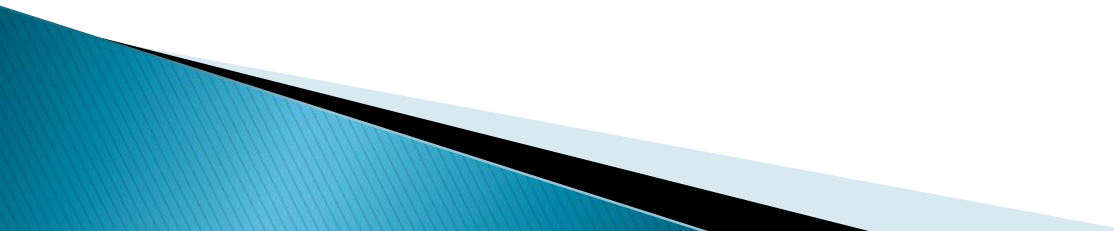
3) **Duties of the insured after a loss**: if a covered loss is to be paid, the insurer must be informed that the loss occurred. Therefore, under property and liability insurance policies, the insured must immediately notify the insurer of the loss; most policies state that notice be given “promptly” or “as soon as is practical”. Insureds also are required to cooperate with the insurer and to perform certain other duties in settling a loss.



Conditions commonly found in property and liability insurance policies

4) **Assignment**: “ The transfer of rights or interest in a policy to another party by the insured.”

The assignment provision makes it clear that assignment of the policy to another party is not permitted without the written consent of the insurer.



Conditions commonly found in property and liability insurance policies

5) **Subrogation**: when the insurer pays an insured for a loss, the insurer assumes the insured's right to collect damages from any other person responsible for the loss. The insurer is subrogated to the insured's right's of recovery. Most subrogation provisions require that the insured do nothing after a loss to impair the insurer's subrogation rights.

