

# CONTENTS

## Preface 15

### PART ONE

## BASIC CONCEPTS IN RISK MANAGEMENT AND INSURANCE

### CHAPTER 1 RISK AND ITS TREATMENT 19

Definitions of Risk 20

Chance of Loss 21

Peril and Hazard 22

Classification of Risk 23

Major Personal Risks and Commercial Risks 25

Burden of Risk on Society 30

Techniques for Managing Risk 30

Summary 33 • Key Concepts and Terms 34 • Review Questions 34 • Application Questions 35 • Internet Resources 36 • Selected References 36 • Notes 36

#### Case Application 33

INSIGHT 1.1: FINANCIAL IMPACT ON DISABLED INDIVIDUALS CAN BE STAGGERING,  
SAYS NEW STUDY 27

### CHAPTER 2 INSURANCE AND RISK 37

Definition of Insurance 38

Basic Characteristics of Insurance 38

Characteristics of an Ideally Insurable Risk 40

Two Applications: The Risks of Fire and Unemployment 42

Adverse Selection and Insurance 44

Insurance and Gambling Compared 44

Insurance and Hedging Compared 44

Types of Insurance 45

Benefits of Insurance to Society 49

Costs of Insurance to Society 50

Summary 53 • Key Concepts and Terms 54 • Review Questions 54 • Application Questions 54 • Internet Resources 55 • Selected References 55 • Notes 55

#### Case Application 53

INSIGHT 2.1: INSURANCE FRAUD HALL OF SHAME—SHOCKING EXAMPLES OF INSURANCE  
FRAUD 51

INSIGHT 2.2: DON'T THINK INSURANCE FRAUD IS COMMITTED ONLY BY HARDENED CROOKS 52

Appendix Basic Statistics and the Law of Large Numbers 57

### CHAPTER 3 INTRODUCTION TO RISK MANAGEMENT 61

Meaning of Risk Management 62

Objectives of Risk Management 62

Steps in the Risk Management Process 63

Implement and Monitor the Risk Management Program 72

Benefits of Risk Management 73

Personal Risk Management 73

Summary 76 • Key Concepts and Terms 77 • Review Questions 77 • Application Questions 77 • Internet Resources 78 • Selected References 79 • Notes 79

Case Application 75

INSIGHT 3.1: ADVANTAGES OF SELF INSURANCE 68

## CHAPTER 4

### ADVANCED TOPICS IN RISK MANAGEMENT 80

The Changing Scope of Risk Management 81

Insurance Market Dynamics 86

Loss Forecasting 89

Financial Analysis in Risk Management Decision Making 94

Other Risk Management Tools 96

Summary 99 • Key Concepts and Terms 100 • Review Questions 100 • Application Questions 100 • Internet Resources 100 • Selected References 101 • Notes 102

Case Application 98

INSIGHT 4.1: THE WEATHER DERIVATIVES MARKETS AT CME GROUP: A BRIEF HISTORY 91

## PART TWO

### THE PRIVATE INSURANCE INDUSTRY

## CHAPTER 5

### TYPES OF INSURERS AND MARKETING SYSTEMS 104

Overview of Private Insurance in the Financial Services Industry 105

Types of Private Insurers 106

Agents and Brokers 111

Types of Marketing Systems 113

Group Insurance Marketing 116

Summary 117 • Key Concepts and Terms 117 • Review Questions 117 • Application Questions 118 • Internet Resources 118 • Selected References 119 • Notes 120

Case Application 116

INSIGHT 5.1: SHOW ME THE MONEY—HOW MUCH DO INSURANCE SALES AGENTS EARN? 112

## CHAPTER 6

### INSURANCE COMPANY OPERATIONS 121

Insurance Company Operations 122

Rating and Ratemaking 122

Underwriting 123

Production 126

Claims Settlement 126

Reinsurance 128

Alternatives to Traditional Reinsurance 133

Investments 134

Other Insurance Company Functions 135

Summary 137 • Key Concepts and Terms 137 • Review Questions 137 • Application Questions 138 • Internet Resources 139 • Selected References 139 • Notes 140

#### Case Application 136

INSIGHT 6.1: BE A SAVVY CONSUMER—CHECK THE INSURER'S CLAIMS RECORD BEFORE YOU BUY 129

## CHAPTER 7 FINANCIAL OPERATIONS OF INSURERS 141

Property and Casualty Insurers 142

Life Insurance Companies 148

Rate Making in Property and Casualty Insurance 149

Rate Making in Life Insurance 153

Summary 154 • Key Concepts and Terms 155 • Review Questions 155 • Application Questions 156 • Internet Resources 156 • Selected References 157 • Notes 157

#### Case Application 154

INSIGHT 7.1: HOW PROFITABLE IS THE PROPERTY AND CASUALTY INSURANCE INDUSTRY? 147

## CHAPTER 8 GOVERNMENT REGULATION OF INSURANCE 159

Reasons for Insurance Regulation 160

Historical Development of Insurance Regulation 162

Methods for Regulating Insurers 163

What Areas Are Regulated? 164

State Versus Federal Regulation 169

Modernizing Insurance Regulation 174

Insolvency of Insurers 175

Credit-Based Insurance Scores 176

Summary 178 • Key Concepts and Terms 178 • Review Questions 179 • Application Questions 179 • Internet Resources 180 • Selected References 181 • Notes 181

#### Case Application 177

INSIGHT 8.1: QUALITY OF INFORMATION PROVIDED TO CONSUMERS ON AUTO AND HOMEOWNERS INSURANCE VARIES WIDELY AMONG STATE INSURANCE DEPARTMENTS 161

INSIGHT 8.2: WIDE RATE DISPARITY REVEALS WEAK COMPETITION IN INSURANCE 171

### PART THREE

## LEGAL PRINCIPLES IN RISK AND INSURANCE

## CHAPTER 9 FUNDAMENTAL LEGAL PRINCIPLES 183

Principle of Indemnity 184

Principle of Insurable Interest 187

Principle of Subrogation 188

Principle of Utmost Good Faith 190

Requirements of an Insurance Contract 192

Distinct Legal Characteristics of Insurance Contracts 193

Law and the Insurance Agent 195

Summary 197 • Key Concepts and Terms 198 • Review Questions 198 • Application Questions 199 • Internet Resources 200 • Selected References 200 • Notes 200

#### Case Application 197

INSIGHT 9.1: CORPORATION LACKING INSURABLE INTEREST AT TIME OF DEATH CAN RECEIVE LIFE INSURANCE PROCEEDS 189

INSIGHT 9.2: AUTO INSURER DENIES COVERAGE BECAUSE OF MATERIAL MISREPRESENTATION 190

INSIGHT 9.3: INSURER VOIDS COVERAGE BECAUSE OF MISREPRESENTATIONS IN PROOF OF LOSS 191

## CHAPTER 10 ANALYSIS OF INSURANCE CONTRACTS 202

Basic Parts of an Insurance Contract 203

Definition of “Insured” 205

Endorsements and Riders 207

Deductibles 207

Coinurance 208

Coinurance in Health Insurance 210

Other-Insurance Provisions 210

Summary 213 • Key Concepts and Terms 213 • Review Questions 214 • Application Questions 214 • Internet Resources 215 • Selected References 215 • Notes 215

#### Case Application 212

INSIGHT 10.1: WHEN YOU DRIVE YOUR ROOMMATE’S CAR, ARE YOU COVERED UNDER YOUR POLICY? 206

### PART FOUR

## LIFE AND HEALTH RISKS

## CHAPTER 11 LIFE INSURANCE 216

Premature Death 217

Financial Impact of Premature Death on Different Types of Families 218

Amount of Life Insurance to Own 219

Types of Life Insurance 226

Variations of Whole Life Insurance 231

Other Types of Life Insurance 239

Summary 243 • Key Concepts and Terms 244 • Review Questions 244 • Application Questions 245 • Internet Resources 246 • Selected References 247 • Notes 248

#### Case Application 242

INSIGHT 11.1: WHY DOES THE UNITED STATES LAG BEHIND MANY FOREIGN COUNTRIES IN LIFE EXPECTANCY? 218

INSIGHT 11.2: CASH-VALUE LIFE INSURANCE AS AN INVESTMENT—DON’T IGNORE TWO POINTS 230

INSIGHT 11.3: BE A SAVVY CONSUMER—FOUR LIFE INSURANCE POLICIES TO AVOID 240

## CHAPTER 12 LIFE INSURANCE CONTRACTUAL PROVISIONS 249

Life Insurance Contractual Provisions 250

Dividend Options 256

Nonforfeiture Options 257

Settlement Options 259

	Additional Life Insurance Benefits	264
	Summary	269 • Key Concepts and Terms 269 • Review Questions 270 • Application Questions 270 • Internet Resources 271 • Selected References 272 • Notes 272
	Case Application	268
	INSIGHT 12.1: IS THIS DEATH A SUICIDE?	252
	INSIGHT 12.2: SELECTION OF THE BEST DIVIDEND OPTION IN A PARTICIPATING WHOLE LIFE POLICY	258
	INSIGHT 12.3: ACCELERATED DEATH BENEFITS—REAL LIFE EXAMPLE	267
	INSIGHT 12.4: WHAT IS A LIFE SETTLEMENT? EXAMPLES OF ACTUAL CASES	267
<b>CHAPTER 13</b>	<b>BUYING LIFE INSURANCE</b>	<b>273</b>
	Determining the Cost of Life Insurance	274
	Rate of Return on Saving Component	278
	Taxation of Life Insurance	280
	Shopping for Life Insurance	281
	Summary	284 • Key Concepts and Terms 284 • Review Questions 285 • Application Questions 285 • Internet Resources 286 • Selected References 286 • Notes 286
	Case Application	284
	INSIGHT 13.1: BE CAREFUL IN REPLACING AN EXISTING LIFE INSURANCE POLICY	277
	Appendix: Calculation of Life Insurance Premiums	287
<b>CHAPTER 14</b>	<b>ANNUITIES AND INDIVIDUAL RETIREMENT ACCOUNTS</b>	<b>293</b>
	Individual Annuities	294
	Types of Annuities	295
	Longevity Insurance	300
	Taxation of Individual Annuities	301
	Individual Retirement Accounts	302
	Adequacy of IRA Funds	306
	Summary	309 • Key Concepts and Terms 310 • Review Questions 310 • Application Questions 310 • Internet Resources 311 • Selected References 311 • Notes 311
	Case application 1	308
	Case application 2	308
	INSIGHT 14.1: ADVANTAGES OF AN IMMEDIATE ANNUITY TO RETIRED WORKERS	296
	INSIGHT 14.2: BELLS AND WHISTLES OF VARIABLE ANNUITIES	299
	INSIGHT 14.3: TEN QUESTIONS TO ANSWER BEFORE YOU BUY A VARIABLE ANNUITY	302
	INSIGHT 14.4: WILL YOU HAVE ENOUGH MONEY AT RETIREMENT? MONTE CARLO SIMULATIONS CAN BE HELPFUL	307
<b>CHAPTER 15</b>	<b>HEALTH-CARE REFORM; INDIVIDUAL HEALTH INSURANCE COVERAGES</b>	<b>313</b>
	Health-Care Problems in the United States	314
	Health-Care Reform	321
	Basic Provisions of the Affordable Care Act	321
	Individual Medical Expense Insurance	327
	Individual Medical Expense Insurance and Managed Care Plans	329
	Health Savings Accounts	330
	Long-Term Care Insurance	331

Disability-Income Insurance	334
Individual Health Insurance Contractual Provisions	337
Summary	339 • Key Concepts and Terms 340 • Review Questions 340 • Application Questions 341 • Internet Resources 341 • Selected References 342 • Notes 343
Case Application	339
INSIGHT 15.1: HOW DOES U.S. HEALTH SPENDING COMPARE WITH OTHER COUNTRIES?	316
INSIGHT 15.2: MORE THAN SEVENTY PERCENT OF THE UNINSURED HAVE GONE WITHOUT HEALTH COVERAGE FOR MORE THAN A YEAR	318

## CHAPTER 16 EMPLOYEE BENEFITS: GROUP LIFE AND HEALTH INSURANCE 345

Meaning of Employee Benefits	346
Fundamentals of Group Insurance	346
Group Life Insurance Plans	348
Group Medical Expense Insurance	350
Traditional Indemnity Plans	351
Managed Care Plans	352
Key Features of Group Medical Expense Insurance	354
Affordable Care Act Requirements and Group Medical Expense Insurance	355
Consumer-Directed Health Plans	358
Recent Developments in Employer-Sponsored Health Plans	358
Group Medical Expense Contractual Provisions	361
Group Dental Insurance	362
Group Disability-Income Insurance	363
Cafeteria Plans	364
Summary	366 • Key Concepts and Terms 367 • Review Questions 368 • Application Questions 368 • Internet Resources 369 • Selected References 370 • Notes 370
Case Application	366
INSIGHT 16.1: WHAT ARE THE FINANCIAL IMPLICATIONS OF LACK OF COVERAGE?	357

## CHAPTER 17 EMPLOYEE BENEFITS: RETIREMENT PLANS 371

Fundamentals of Private Retirement Plans	372
Types of Qualified Retirement Plans	375
Defined-Benefit Plans	376
Defined-Contribution Plans	378
Section 401(k) Plans	378
Profit-Sharing Plans	381
Keogh Plans for the Self Employed	382
Simplified Employee Pension	383
SIMPLE Retirement Plans	383
Funding Agency and Funding Instruments	383
Problems and Issues in Tax-Deferred Retirement Plans	384
Summary	386 • Key Concepts and Terms 387 • Review Questions 387 • Application Questions 388 • Internet Resources 388 • Selected References 389 • Notes 389
Case Application	386
INSIGHT 17.1: SIX COMMON 401(k) MISTAKES	379

**CHAPTER 18 SOCIAL INSURANCE 390**

- Social Insurance 391
- Old-Age, Survivors, and Disability Insurance 393
- Types of Benefits 394
- Medicare 402
- Impact of the Affordable Care Act on Medicare 407
- Problems and Issues 408
- Unemployment Insurance 410
- Workers Compensation 413
- Summary 417 • Key Concepts and Terms 418 • Review Questions 418 • Application Questions 419 • Internet Resources 420 • Selected References 421 • Notes 421

**Case Application 417**

INSIGHT 18.1: TAKING SOCIAL SECURITY: SOONER MIGHT NOT BE BETTER 399

INSIGHT 18.2: WHAT ARE YOUR SOLUTIONS FOR REFORMING SOCIAL SECURITY? 410

**PART FIVE****PERSONAL PROPERTY AND LIABILITY RISKS****CHAPTER 19 THE LIABILITY RISK 423**

- Basis of Legal Liability 424
- Law of Negligence 425
- Imputed Negligence 427
- Res Ipsa Loquitur* 428
- Specific Applications of the Law of Negligence 428
- Current Tort Liability Problems 430
- Summary 439 • Key Concepts and Terms 439 • Review Questions 440 • Application Questions 440 • Internet Resources 441 • Selected References 442 • Notes 442

**Case Application 438**

INSIGHT 19.1: JUDICIAL HELLHOLES 2011–2012 433

**CHAPTER 20 HOMEOWNERS INSURANCE, SECTION I 444**

- Homeowners Insurance 445
- Analysis of Homeowners 3 Policy (Special Form) 449
- Section I Coverages 450
- Section I Perils Insured Against 455
- Section I Exclusions 458
- Section I Conditions 460
- Section I and II Conditions 465
- Summary 466 • Key Concepts and Terms 467 • Review Questions 467 • Application Questions 468 • Internet Resources 469 • Selected References 470 • Notes 470

**Case Application 466**

INSIGHT 20.1: LESSON TO BE LEARNED FROM APARTMENT FIRE 448

INSIGHT 20.2: HOW DO I TAKE A HOME INVENTORY AND WHY? 461

INSIGHT 20.3: THE BIG GAP BETWEEN REPLACEMENT COST AND ACTUAL CASH VALUE  
CAN EMPTY YOUR WALLET 462

**CHAPTER 21 HOMEOWNERS INSURANCE, SECTION II 471**

- Personal Liability Insurance 472
- Section II Exclusions 475
- Section II Additional Coverages 478
- Section II Conditions 480
- Endorsements to a Homeowners Policy 480
- Cost of Homeowners Insurance 483
- Summary 491 • Key Concepts and Terms 491 • Review Questions 491 • Application Questions 492 • Internet Resources 493 • Selected References 493 • Notes 494

**Case Application 490****INSIGHT 21.1: DOG BITES HURT, SO DO LAWSUITS 473****INSIGHT 21.2: TRYING TO SAVE MONEY? AVOID THE FIVE BIGGEST INSURANCE MISTAKES! 489****CHAPTER 22 AUTO INSURANCE 495**

- Overview of Personal Auto Policy 496
- Part A: Liability Coverage 497
- Part B: Medical Payments Coverage 501
- Part C: Uninsured Motorists Coverage 503
- Part D: Coverage for Damage to Your Auto 507
- Part E: Duties After an Accident or Loss 515
- Part F: General Provisions 516
- Insuring Motorcycles and Other Vehicles 517
- Summary 518 • Key Concepts and Terms 518 • Review Questions 518 • Application Questions 519 • Internet Resources 521 • Selected References 521 • Notes 522

**Case Application 517****INSIGHT 22.1: RECESSION MARKED BY BUMP IN UNINSURED MOTORISTS 503****INSIGHT 22.2: TOP 10 REASONS TO PURCHASE THE RENTAL CAR DAMAGE WAIVER 509****INSIGHT 22.3: NO CALL, NO TEXT, NO UPDATE BEHIND THE WHEEL: NTSB CALLS FOR NATIONWIDE BAN ON PEDS WHILE DRIVING 512****CHAPTER 23 AUTO INSURANCE AND SOCIETY 523**

- Approaches for Compensating Auto Accident Victims 524
- Auto Insurance for High-Risk Drivers 534
- Cost of Auto Insurance 535
- Shopping for Auto Insurance 540
- Summary 545 • Key Concepts and Terms 546 • Review Questions 546 • Application Questions 547 • Internet Resources 547 • Selected References 548 • Notes 548

**Case Application 545****INSIGHT 23.1: FILING AN AUTO CLAIM WITH THE OTHER PARTY'S INSURANCE COMPANY 528****INSIGHT 23.2: PROTECT YOURSELF: INSURING YOUR TEEN DRIVER 538****INSIGHT 23.3: INCREASING THE COLLISION DEDUCTIBLE TO SAVE MONEY—SOME IMPORTANT CONSIDERATIONS 541****CHAPTER 24 OTHER PROPERTY AND LIABILITY INSURANCE COVERAGES 550**

- ISO Dwelling Program 551
- Mobile Home Insurance 553
- Inland Marine Floaters 553
- Watercraft Insurance 554



Government Property Insurance Programs	556
Title Insurance	561
Personal Umbrella Policy	563
Summary	566 • Key Concepts and Terms 567 • Review Questions 567 • Application Questions 568 • Internet Resources 569 • Selected References 569 • Notes 570
Case Application	566
INSIGHT 24.1: DISPELLING MYTHS ABOUT FLOOD INSURANCE	559
INSIGHT 24.2: TITLE INSURANCE: PROTECTING YOUR HOME INVESTMENT AGAINST UNKNOWN TITLE DEFECTS	562

## PART SIX

## COMMERCIAL PROPERTY AND LIABILITY RISKS

## CHAPTER 25 COMMERCIAL PROPERTY INSURANCE 572

Commercial Package Policy	573
Building and Personal Property Coverage Form	575
Causes-of-Loss Forms	577
Reporting Forms	578
Business Income Insurance	579
Other Commercial Property Coverages	582
Transportation Insurance	585
Businessowners Policy (BOP)	589
Summary	592 • Key Concepts and Terms 593 • Review Questions 593 • Application Questions 594 • Internet Resources 595 • Selected References 596 • Notes 596
Case Application	591
INSIGHT 25.1: EXAMPLES OF EQUIPMENT BREAKDOWN CLAIMS	584

## CHAPTER 26 COMMERCIAL LIABILITY INSURANCE 598

General Liability Loss Exposures	599
Commercial General Liability Policy	600
Employment-Related Practices Liability Insurance	606
Workers Compensation Insurance	607
Commercial Auto Insurance	610
Aircraft Insurance	612
Commercial Umbrella Policy	613
Businessowners Policy	615
Professional Liability Insurance	615
Directors and Officers Liability Insurance	617
Summary	619 • Key Concepts and Terms 620 • Review Questions 620 • Application Questions 621 • Internet Resources 622 • Selected References 622 • Notes 622
Case Application	618
INSIGHT 26.1: BASIC FACTS ABOUT WORKERS COMPENSATION	608

## CHAPTER 27 CRIME INSURANCE AND SURETY BONDS 624

ISO Commercial Crime Insurance Program	625
Commercial Crime Coverage Form (Loss-Sustained Form)	626
Financial Institution Bonds	631
Surety Bonds	632

Summary 635 • Key Concepts and Terms 636 • Review Questions 636 • Application Questions 637 • Internet Resources 637 • Selected References 638 • Notes 638

Case Application 634

INSIGHT 27.1: SMALL BUSINESS CRIME PREVENTION GUIDE 628

Appendix A Homeowners 3 (Special Form) 639

Appendix B Personal Auto Policy 664

Glossary 678

Index 696