

Principles of Risk Management & Insurance

COURSE OUTLINE

June – July 2016

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Chapter 1

Risk and Its Treatment

Overview

With this chapter you begin your study of risk management and insurance. This chapter provides a working definition of risk and a discussion of the various types of risk. Some risks that we face are uncertain losses caused by perils. Hazards are conditions that increase the chance that a loss will occur. Our concern in this course primarily will be pure risks—risks in which the possible outcomes are loss and no loss. As an individual, you face personal risks, property risks, and liability risks. There are a number of methods for handling risk: avoidance, retention, loss control, noninsurance transfers, and insurance.

Chapter 2

The Insurance Mechanism

Overview

Insurance is an important method of transferring pure loss exposures to an entity better positioned to handle these risks. But what is insurance and how does insurance work? This chapter analyzes the insurance mechanism. You will learn the important characteristics of insurance and what conditions must be present for a risk to be privately insurable. This chapter also provides an overview of private and government insurance. Private insurance can be divided into two divisions: property and liability insurance and life and health insurance. Government insurance programs are designed to insure risks that may not be insurable by a private insurance company. Although insurance provides many benefits to society, there are some costs associated with the use of insurance. These costs and benefits are discussed at the conclusion of this chapter.

Chapter 3

Fundamentals of Risk Management

Overview

You've probably practiced personal risk management without even realizing it. You may have decided to purchase auto insurance (risk transfer), decided not to drive on an icy road (risk avoidance), decided to use your seat belt (loss control) and your physical damage insurance may have a deductible (risk retention). Just as individuals practice risk management, so do small businesses, universities, municipalities, and corporations. This chapter provides an introduction to risk management in general and a discussion of personal risk management in particular. After defining risk management and discussing the objectives of risk management, the risk management process is examined. The risk management process consists of: identifying loss exposures, analyzing the loss exposures, and selecting appropriate techniques for treating the loss exposures, and implementing and monitoring the risk management program.

Chapter 4

Additional Topics in Risk Management

Overview

In the previous chapter, you were introduced to the field of risk management and personal risk management. This second chapter on risk management covers some advanced risk management topics. The chapter discusses the evolution of corporate risk management to include financial risks and all risks facing the business. The impact of the underwriting cycle, insurance industry consolidation, and the securitization of risk are discussed, as well as loss forecasting, financial analysis in risk management decision-making, and the application of some other risk management tools.

Chapter 5

Legal Principles in Insurance

Overview

Insurance contracts are complex documents embodying years of industry tradition, case law, and general practices. This chapter examines the legal environment of insurance contracts, including: fundamental legal principles, requirements to form an insurance contract, legal characteristics of insurance contracts, and insurance law as it applies to agency. Although you may have been introduced to some of these concepts in a business law course, there are unique aspects of insurance contracts that you should know.

Chapter 6

Analysis of Insurance Contracts

Overview

In this chapter we turn our attention to insurance contracts. Even though many different insurance contracts are offered, there are certain elements that are common to all insurance contracts. This chapter examines the basic parts of an insurance contract, endorsements and riders, deductibles, coinsurance, and loss settlement when more than one insurance policy covers a loss. The material presented in this chapter will be of great assistance to you as you begin to examine individual insurance contracts. In addition to the “usual” exercises, a problem set and a review of coinsurance are provided.

Chapter 7

The Liability Risk

Overview

This chapter begins a block of material on property and liability risks, and the personal and business insurance coverages designed to address these risks. In this first chapter, we consider the liability risk. The number of lawsuits and the magnitude of settlements have increased significantly over time. In this chapter we examine the basis for most of these lawsuits, negligence. The elements of a negligent act are discussed as well as legal defenses in cases where negligence is alleged. Next, applications of the law of negligence are presented; and several problem related to liability are discussed. Finally, defects in the present civil justice system and tort reform ideas are discussed.

Chapter 8

Homeowners Insurance: Section I Coverages

Overview

With this chapter we begin our study of property and liability insurance contracts. The first coverage we will examine is a popular personal lines coverage, homeowners insurance. Homeowners insurance is called a “package policy” because it combines more than one line of coverage in a single contract. A variety of homeowners forms are available, providing coverage for homeowners, renters, and condominium owners. Because of its widespread use, we will examine the Insurance Services Office (ISO) Homeowners 3 contract in greater detail. Section I of the homeowners policy provides coverage for damage to the dwelling, damage to other structures, losses to personal property, and loss of use coverage if an insured peril makes the property unusable. Section II of the homeowners policy (covered in Chapter 9) provides personal liability insurance and medical payments to others coverage.

Chapter 9

Homeowners Insurance: Section II Coverages

Overview

This chapter examines Section II of the ISO Homeowners insurance contracts. Section I of the Homeowners 3 policy was examined in the previous chapter. While there are variations in the Section I coverages for the various forms, Section II is identical in each form. Section II provides personal liability insurance that will respond to liability claims. Section II also includes medical payments to others coverage. As both of these coverages are provided on an all-risk basis, the exclusions applicable to these coverages are examined. Some additional coverages provided under Section II are discussed, as well as some endorsements that can be added to your homeowners policy to broaden the coverage. The chapter closes with some important suggestions to follow when shopping for homeowners insurance. The appendix to Chapter 9 provides tips on how to save money when buying homeowners insurance.

Chapter 10

Auto Insurance in Rwanda

Overview

If you hit a pedestrian, another car, a large animal or bird, or another object while driving your car, damage is likely to result. You could injure or kill someone and damage his or her property. You could also injure yourself and your passengers and damage your own vehicle. Fortunately, automobile insurance is available to cover these losses. Like homeowners insurance, automobile insurance is a package policy designed to provide coverage for several types of losses. In this chapter we examine the provisions of the Personal Auto Policy (PAP). The PAP provides coverage for bodily injury and property damage liability, physical damage protection, medical payments coverage, uninsured motorists protection, and a number of other coverages.

Chapter 11 Auto Insurance in Rwanda (continued)

Overview

Compensating innocent motorists who have been injured in auto accidents is an important issue for society. Private insurers are not anxious to insure high-risk drivers. But it is in society's interest that all motorists are financially responsible. This chapter examines a number of issues relating to auto insurance and society. Four major topics are addressed. First, approaches that are used to compensate innocent automobile accident victims are discussed, including no-fault insurance as an alternative to the traditional tort-based system. Second, methods of providing automobile insurance to high-risk drivers are examined. Third, factors affecting the cost of automobile insurance are discussed. Finally, some suggestions to follow when shopping for automobile insurance are offered.

Chapter 12

Other Property and Liability Insurance Coverages

Overview

This chapter examines a wide range of personal property and liability insurance coverages. It opens with a discussion of coverage for dwellings that don't qualify for coverage under the homeowners program and for situations where less coverage than that provided by a homeowners policy is desired. Next, coverage for mobilehomes and special coverage for personal property are examined. As homeowners and dwelling forms usually exclude boats exceeding certain length and horsepower limits, coverage is needed for recreational boats. This coverage can be provided through the boatowners package form and yacht insurance.

In addition to private insurers, the federal government is involved in providing property coverages. Federal flood insurance and FAIR plans are discussed in this chapter. The chapter concludes with a discussion of title insurance and personal umbrella policies. Title insurance protects the insured from defects in clear title to property. The personal umbrella policy is designed to provide protection against catastrophic liability claims and to fill gaps in underlying liability coverages.

Chapter 13

Commercial Property Insurance Coverages

Overview

Business enterprises make a large investment in property—plant, equipment, vehicles, inventory, furniture, and other property. This property may remain at a fixed location or may be moved between several locations. The business also may take possession of a customer's property temporarily. Obviously, the business suffers a loss if its property is damaged or destroyed. In addition to direct physical damage to property, businesses can also incur indirect (consequential) losses if physical damage renders property unusable. This loss is a combination of continuing expenses and lost profits. This chapter discusses a wide range of commercial property insurance coverages. Coverages examined include: the commercial package policy (CPP), business income insurance, inland and ocean marine insurance, the business owners policy (BOP), and a variety of other property coverage forms. Commercial property insurance is an important part of a business entity's risk management program.

Chapter 14

Commercial Liability Insurance Coverages

Overview

Property risks have a common characteristic—the amount of the loss is capped by the value of the property lost and any indirect loss. Unlike commercial property risks, liability exposures are not limited in amount. In this chapter we turn our attention to business liability risks and their treatment. Business enterprises and professionals face a wide variety of liability exposures developing out of premises and operations, products and completed operations, contractual liability, contingent liability, errors and omissions, and other exposures. A number of commercial liability insurance coverages have been developed to address these risks, including commercial general liability insurance, workers compensation and employers liability insurance, business auto coverage, commercial umbrella policies, professional liability insurance, and other liability coverages. A thorough understanding of commercial liability loss exposures and insurance coverages is required for a successful risk management program.

Chapter 15

Crime Insurance Coverages and Surety Bonds

Overview

In addition to the property and liability risks faced by businesses, losses can also occur as a result of crime. Losses attributable to crime take many forms, including burglary, employee theft, arson, shoplifting, embezzlement, robbery, and other types of crime. In response to the need for coverage of such losses, the Insurance Services Office (ISO) has developed a number of crime insurance forms that are discussed in this chapter. This chapter also examines surety bonds. These bonds provide monetary compensation if a bonded party fails to perform a promised obligation. A variety of surety bonds, each designed for a special purpose, are discussed.

Chapter 16

Fundamentals of Life Insurance

Overview

This chapter begins a block of material on several important personal risks: premature death, poor health, and excessive longevity. This chapter examines premature death and the financial services products designed to address this risk. We will consider the economic impact of premature death upon various types of families, methods of determining how much life insurance to purchase, and the various life insurance products available to address this important personal risk, including: term insurance, whole life insurance, universal life insurance, variable life insurance, and some other life insurance products.

Chapter 17

Contract Provisions in Life Insurance

Overview

Given the nature of the risk insured, the possible lengthy duration of the contract, the

breadth of coverage provided, and the investment nature of some life insurance products; life insurance contracts are remarkable documents. To protect the interests of insurers, policyowners, insureds, and third-party beneficiaries, numerous contractual provisions have been developed and incorporated into life insurance contracts over the years. This chapter examines these important contractual provisions. Life insurance contracts also offer optional methods of using dividends (dividend options), using the cash value if the policy is surrendered (nonforfeiture options), and receiving policy proceeds upon the death of the insured (settlement options). A thorough understanding of life insurance contractual provisions is necessary for policyowners, insureds, and beneficiaries to maximize the benefits offered by these contracts.

Chapter 18

Life Insurance Purchase Decisions

Overview

Would you purchase a major appliance, new home, or a new car without shopping around first? Many of the same consumers who would answer this question “of course not” purchase life insurance without considering the true cost of the coverage. Even though life insurers are pricing the same risk, there are significant variations in the cost of life insurance. In addition to cost, there are a number of other important considerations in purchasing life insurance. This chapter discusses the fundamentals of life insurance purchasing. Major topics covered include: methods of determining the cost of life insurance, methods of determining the rate of return on the cash value, taxation of life insurance, and suggestions to follow when purchasing life insurance. The appendix at the end of the chapter explains how life insurance premiums are calculated. A problem set is included with the usual exercises.

Chapter 19

Retirement Products: Annuities and Individual Retirement Accounts

Overview

Thus far we have examined life insurance in great detail. Life insurance companies also market a product that addresses another important personal risk. That personal risk is the risk of outliving the income and assets that you have accumulated. The

product that addresses this personal risk is called a life annuity. Life annuities provide periodic income to an individual for as long as he or she is living. These products help many retirees to achieve economic security. In addition to annuities, individuals have another retirement savings vehicle available to them. An individual may establish a tax-advantaged savings plan called an individual retirement account (IRA). In this chapter we will examine the characteristics of individual annuities and IRAs (traditional and Roth). Group retirement plans and retirement plans for the self-employed are discussed in Chapter 22.

Chapter 20

Individual Health Insurance Coverages

Overview

In this chapter we examine individual health insurance coverage. After a discussion of major problems with the present health care system, the various forms of individual health insurance are examined. The most important individual health coverages include: major medical insurance, health savings accounts, long-term care insurance, and disability-income insurance. Next, important policy provisions found in individual health insurance coverage are examined. Finally, a number of important guidelines are discussed for purchasing individual health insurance coverage.

Chapter 21

Employee Benefits: Group Life and Health Insurance Coverages

Overview

This chapter and the next chapter are devoted to employee benefits. Employee benefits are often taken for granted and you may be surprised by the magnitude of these plans.

In this chapter, we examine group life and health insurance coverages. As an introduction, group insurance underwriting principles and eligibility requirements are discussed. Next, group life and health insurance coverages are examined, as well as group health insurance providers, managed care plans, and group health insurance policy provisions.

Chapter 22

Employee Benefits: Qualified Retirement Plans

Overview

People spend a longer period of their lives in retirement. The early retirement trend combined with increasing life expectancy makes income during retirement a critical concern. There are three primary sources of retirement income: Social Security old-age benefits, income generated from personal investments and savings, and private retirement plans. This chapter examines the basic features of private retirement plans, the distinctions between defined benefit plans and defined contribution plans, the funding instruments used to finance retirement plans, and the features of several types of retirement plans.

Chapter 23

Social Insurance Programs in Rwanda

Overview

“A multitude of errors in thinking surround our social insurance programs.” – George E. Rejda*

These “errors in thinking” are unfortunate, given the importance of social insurance programs. These programs, which are enacted to solve complex social problems, provide a base of economic security to the population. In this chapter we examine social insurance programs. As an introduction, we examine why social insurance programs are needed and basic characteristics of social insurance programs. Next, we examine the provisions and issues relating to social insurance programs.

Chapter 24

Types of Private Insurers and Marketing Systems

Overview

There are a number of types of insurance organizations: mutual companies, stock

companies, fraternal, etc. There are also a variety of insurance marketing systems. The individual marketing insurance may be an independent agent, an exclusive agent, a direct writer, or a general agent. Coverage also may be purchased through an employer-based group plan or in response to phone or mail solicitation. The prospective purchaser might enlist the services of an insurance broker to purchase insurance. In this chapter, we examine the types of private insurers, distinctions between agents and brokers, and types of marketing systems employed by property and liability insurers and life and health insurers.

Chapter 25

Functional Operations of Private Insurers

Overview

Up until now, your contact with individuals who work in the insurance industry has most likely been with sales and claims personnel. Both of these important operations require interaction with the general public and these functions are performed away from the company's headquarters. Have you ever seen an insurance company home office or regional office? In case you haven't, these buildings tend to be very large structures. Insurance companies need this space because there are many other vital operations that go on "behind the scenes." In addition to discussing the claims and marketing operations of insurance companies, this chapter discusses other important functional areas of insurance companies, including: rate-making, underwriting, reinsurance, investments, loss control, and a number of other functions. There are many interesting job opportunities available in the insurance industry. A reinsurance settlement problem set is included for this chapter.

Chapter 26

Financial Operations of Private Insurers

Overview

This chapter examines the financial operations of insurance companies. In the first portion of the chapter, two important financial statements, the balance sheet and the income and expense statement, are discussed. Important entries on these financial statements are examined, as well as profitability measures. The remainder of the chapter is devoted to rate making. After a discussion of business and regulatory rate

making objectives, rate making methods used in the property and casualty insurance industry are examined. Life insurance ratemaking is covered in the appendix to Chapter 18.

Chapter 27

Government Regulation of Private Insurers in Rwanda

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