

Risk and risk management

- ✓ **Risk** is uncertainty about the possibility of loss:
 - **Pure:** loss or no loss, never gain — the only insurable kind
 - **Speculative:** loss or gain both possible (gambling, investing) — uninsurable
- ✓ Five ways to manage a risk:
 - **Avoid:** drop the exposure entirely (don't drive)
 - **Reduce:** lower the chance or severity of loss (sprinklers, deadbolts)
 - **Retain:** carry the cost yourself — a deductible is retention
 - **Share:** spread the exposure across several parties (business partners)
 - **Transfer:** shift it to someone else; insurance is the usual transfer
- ✓ **Law of large numbers:** the more exposure units in the pool, the more accurately the insurer predicts the GROUP's losses. It never predicts the loss of any one unit

⚠ Perils, hazards and insurable risk

- ✓ **Peril:** the cause of loss — fire, theft, collision, windstorm
- ✓ **Hazard:** a condition that makes a peril likelier or worse
 - **Physical:** a condition of the property or person (faulty wiring, icy steps)
 - **Moral:** dishonesty — lying on an application, staging a loss
 - **Morale:** carelessness because the property is insured
- ✓ Six marks of an insurable risk:
 - The loss must be **uncertain** — a certain loss is not insurable
 - A **large number of similar exposure units**
 - The loss must pose real **economic hardship**
 - The loss must be **ascertainable** — measurable in money
 - The loss must be **accidental and unintentional**
 - The loss must **not be catastrophic** to the insurer

📄 The four policy sections — DICE

- ✓ **D — Declarations:** who and what is insured
Named insured, the property and its location, limits, deductible, policy period, premium and mortgagee.
- ✓ **I — Insuring agreement:** the insurer's promise, the parties to it, and the perils covered
- ✓ **C — Conditions:** what each party must do
Break one, such as failing to report a new swimming pool, and the insurer may deny the claim or refuse to renew.
- ✓ **E — Exclusions:** the property and perils not covered — what keeps one catastrophe from taking the insurer down

📄 Insurance contracts

- ✓ Four essential elements:
 - **Consideration:** the applicant's premium for the insurer's promise to pay
 - **Offer and acceptance:** the application is the offer; the insurer accepts it as written or counteroffers. Acceptance is unconditional — the "meeting of the minds"
 - **Legal capacity:** the insurer must be admitted; a minor, an incompetent person or someone intoxicated cannot contract
 - **Legal purpose:** the contract may not be against public policy
- ✓ **Insurable interest:** a financial stake in the property or person insured
For property and casualty it must exist at the TIME OF LOSS; for life insurance, only at application.

📄 What every insurance contract is

- ✓ **Adhesion:** the insurer writes it and the applicant takes it or leaves it, so ambiguity is read in favor of the insured
- ✓ **Aleatory:** the values exchanged are unequal and turn on chance
- ✓ **Unilateral:** only the insurer makes an enforceable promise
- ✓ **Conditional:** benefits are owed only once the conditions are met
- ✓ **Utmost good faith:** each may rely on the other's statements; neither may conceal a material fact
- ✓ Statements on the application:
 - **Representation:** true to the best of the applicant's knowledge
 - **Warranty:** guaranteed true; a material breach can void the policy
 - **Misrepresentation:** false — and if the insurer proves it was intentional, it may void the contract and be prosecuted as fraud