Presentation

Certificate in the Business of Insurance

St. John's University

Topics

Day One

9:15. Insurable Risk.

10:45. Insurance Principles.

1:00. Structure of Insurance Industry.

2:45. Insurance Distribution and Claims Mgmt.

Day Two

9:15. Insurance Law.

10:45. Insurance Contracts.

1:00. Insurance Underwriting.

2:45. Property Insurance.

Topics

Day Three

9:15 General Liability.

10:45. Tort Liability.

1:00. General General Liability Insurance.

2:45. Professional and Medical Liability.

Day 4

- 9:15. Specialty Lines.
- 10:45. Reinsurance.
- 1:00. Homeowners and Auto Insurance.
- 2:45. Modern Risk Management.

Presentation

Session 1

Insurable Risk

Question

Suppose someone offered you:

- $1 million if you would climb Mount Everest and reach the top.
- $500,000 if you stopped at the base camp at 24,000 feet.
- Expenses would be covered in either case.

Would you accept the offer?

Sources of Risk

Exposure. A condition that can cause a downside loss.

Uncertainty. A negative variance from expectations.

Missed Opportunity. The failure to accept risk when we have the chance to improve a situation or condition.

Question

Assume that twenty-five people are gathered in a room. What is the probability that two of them will have the same birthday?

Speculative and Pure Risk

We can identify two broad categories of risk:

- **Speculative Risk**. The chance where both loss and gain are possible.
- **Pure Risk**. The chance of an unexpected or unplanned loss without the accompanying chance of a gain.

Question

Which of the following are pure risks?

- Placing a bet on a horse at a racetrack.
- An explosion in a power plant.
- A decline in the value of a nation’s currency.
- A microwave oven emitting harmful messages from the devil.

Dimensions of Pure Risk

Likelihood of Loss. A high probability of the occurrence of a loss may be considered to be a higher degree of risk.

Size of Loss. A large potential loss may be perceived as possessing a high degree of risk.

Severity and Frequency

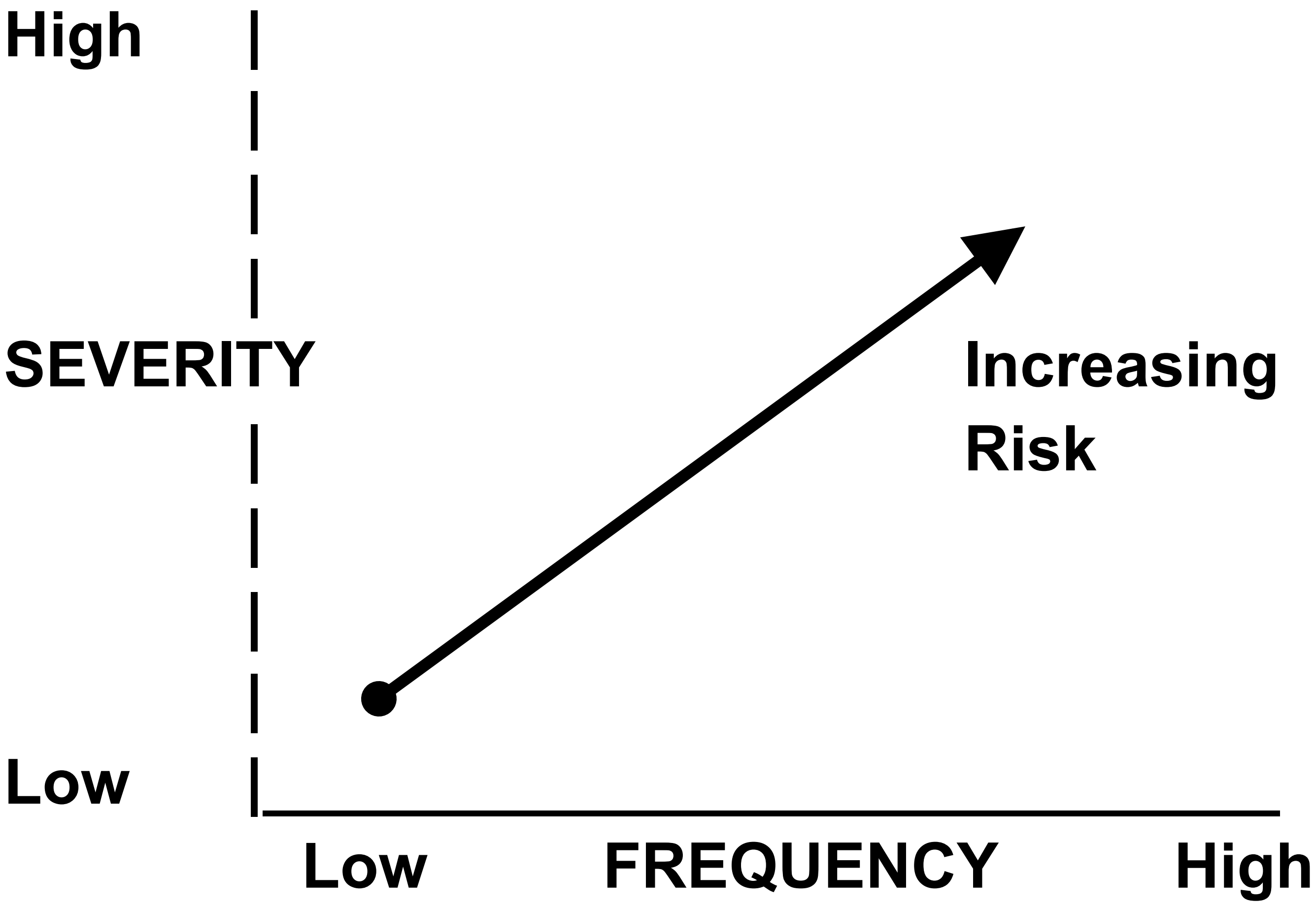
Individuals and companies are concerned primarily with insuring important risks measured by either:

- **Severity.** The intensity of a peril.
- **Frequency.** The likelihood of the occurrence.

Risks can be graphed, as shown on the next slide.

As we move up and to the right, we move into the area of critical risks.

Graphing Risk



Question

Black Beauty (BB) is twice as likely to win a horse race Charley's Child (CC).

Charley's Child is twice as likely to win as Desert Dawn (DD).

These are the only horses in a race.

A $2 bet on Black Beauty will pay $5.

Is this a good risk to accept?

Tests of Insurable Risk

Financial Loss. possibility of a decrease in money or a decline in monetary value.

Definite Loss. We must know conclusively that a loss took place.

Fortuitous Loss. The loss must occur as a result of chance from the perspective of the insured. This is also called a *contingent loss.*

Question

An individual wants to purchase fire insurance to cover a house located in a dense forest. Is this an insurable risk under the following conditions:

- If forest fires are common in the area?
- If a fire is approaching the house?
- If a child of the owner sets a fire?

History of Risk

Two events hundreds of years apart cleared the way for a better understanding of risk:

- **Hindu-Arabic Numbering System**. It came to the West in 1202 when the *Book of the Abacus* appeared in Italy. It added the concept of "zero." Previously, the abacus was the only tool for arithmetic calculations.
- **Protestant Reformation.** It weakened the idea that the future was in the hands of God.

Question

In the Roman numbering system, numbers were:

I = 1

V = 5

X = 10

L = 50

C = 100

D = 500

M = 1000

How much is CXVI + XXIV?

Contribution of Paccioli

In 1494, Luca Paccioli published a book:

- **Algebra.** The principles.
- **Accounting.** Double-entry bookkeeping.
- **Arithmetic.** Multiplication tables up to 60 x 60.
- **Probability.** A puzzle of how to divide an unfinished game started new thinking.

Question

Paccioli set up a game.

- A score of 60 wins $1,000.
- One person has 50 and the other has 20.
- The game cannot be finished.
- How do they share the money?

Question

One of our goals is to remove as much unnecessary risk as possible from our lives.

- Either you believe in God or you do not.
- It is a 50-50 proposition.
- Can you believe in God and remove all risk from having the wrong belief?

Exposure, Peril, and Hazard

An insurable risk can cause a financial loss and/or disrupt the operations of a business. Three terms help dimension it:

- **Exposure**. A condition where risk could cause a loss.
- **Peril**. Immediate cause of a loss.
- **Hazard**. A condition increasing the likelihood of a loss from a peril.

Question

A company purchases a building. With respect to the possibility of fire, what is:

- An exposure?
- A peril?
- A hazard?

Hazard Categories

We can identify four kinds of hazards:

- **Physical.** A condition of the real world that creates a danger.
- **Moral.** A tendency of a person to lack integrity or be dishonest.
- **Behavioral.** A tendency of a person to be careless. (also called morale hazard)
- **Legal.** Characteristics of legal system that increase frequency or severity of losses.

Question

Identify each as physical, moral, behavioral, or legal.

- A workman leaving a ladder propped against a house.
- A witness to a bus crash who hops on the bus and later claims an injury.
- An individual who rides to work on a motorcycle even on rainy days.
- A business person who rents a low-cost office in a building with antiquated electricity wiring.

Question

In violation of company policy, an employee entered a company at night and took a truck without permission to move some furniture.

- The regular driver never checked the brake fluid. The brakes failed.
- The truck hit a car. The employee and car driver were injured.
- Identify risks, exposures, perils, hazards.

Question

What have been the largest **insured** losses in the world in the period from 1963 to 2012?

- Floods.
- Hurricanes (typhoons).
- Volcanoes.
- Earthquakes.
- Other.

Presentation

Climbing Mount Everest

Question

Name an exposure, peril, and hazard associated with climbing Mount Everest.

Question

When did someone first climb Mount Everest?

Question

Who was the first to reach the peak and return safely?

Question

How many people reached the peak between the first ascent and 2012?

Altitudes

The journey from Nepal:

Base Camp	17,000 ft	5.300M
Camp I	20,000 ft	6,000M
Camp II	21,000 ft	6,500M
Camp III	23,500 ft	7,000M
Camp IV	26,000 ft	7,900M
Peak	29,000 ft	8,900M

May 19, 2012

At the bottleneck just below the peak:

Hillary Step:	40-foot rock wall.
Hillary Step Delay	2 hours
Reached the Top:	234 climbers.
Died:	4 climbers.

Deaths 1921-2013

Fall	65
Avalanche	48
Exhaustion	18
Altitude Sickness	24
Ground collapse	24
Exposure	26
Other	35
Total	**240**

Deaths 2014

April 2014.

Avalanche in the Khumbu Ice Fall.

16 Sherpas dead or missing.

Season ended with 6 weeks remaining of good climbing weather.

Claudio Tessarolo:

"We made Everest a circus. This year the Sherpas decided the show will not go on."

Question

Risk and the risk appetite are framed by people's attitudes. What happened to David Sharp and Lincoln Hall while climbing Mount Everest in 2006?

Presentation

Session 2
Insurance Principles

Indemnification

Indemnity refers to a reimbursement that compensates exactly for a loss.

- After a loss, an insured is returned to the approximate financial position prior to the loss.
- The insurer avoids allowing an insured to make a profit from a claim.

Indemnity Calculation

Direct Costs. Damage or harm in its basic and most visible context. The money to repair or replace the asset.

Indirect Costs. Financial damages that are not so obvious or visible. Example is loss of use until an asset is repaired.

Consequential Expenses. Extra costs as the result of a loss.

Question

An owner keeps a Ferrari in a wooden barn behind his house.

- The Ferrari cost $200,000 five years ago.
- It is worth $300,000 today.
- The owner has asked Lloyd's of London to insure it for $400,000.
- Is Lloyd's likely to offer this insurance?

Question

Three Christian women requested an insurance policy to cover expenses they would incur if one of them immaculately conceived a baby and could prove that it was the child of God. The women, who were in the age range of 50 years, were members of a Christian group. Would an insurance company issue such a policy?

Insurable Loss

Risks are insurable when the loss has the following characteristics:

- **Arises from a Pure Risk.** Speculative risks are not insurable.
- **Loss not Trivial.** The administrative costs make it too expensive to insure minor losses.
- **Affordable Premiums.**
- **Acceptable Policy Limit.**

Question

If a homeowner snaps under pressure and sets fire to his house.

- A court-appointed psychiatrist certified that the person suffered from temporary insanity.
- Would damages to the house be covered by fire insurance?

Question

A company wanted to purchase insurance to send employees to a restful resort if they suffered serious depression for more than 60 days.

- The insurance would cover travel and living expenses.
- Is this an insurable risk?

Risk Strategies

Organizations use a mixture of four strategies to deal with frequency and severity of risk. They always use:

- **Reduction**. Lower the frequency or severity.

The other strategies are:

- **Avoidance.** Do not accept it.
- **Retention**. Keep it.
- **Transfer**. Shift the financial burden to another party.

Question

Of the risk strategies (1) avoid, (20 retain, and (3) transfer, which one is used for each of the following?

- Low frequency, high severity.
- Low frequency, low severity.
- High frequency, high severity.
- High frequency, low severity.

Layering of Insurance

A layer refers to a level of retention or transfer of an insurable exposure when coverage occurs above a lower level of insurance.

- Each layer is the responsibility of a different party.
- Insurance layers provide higher levels of coverage that might be obtainable without multiple parties.

Policy Layering

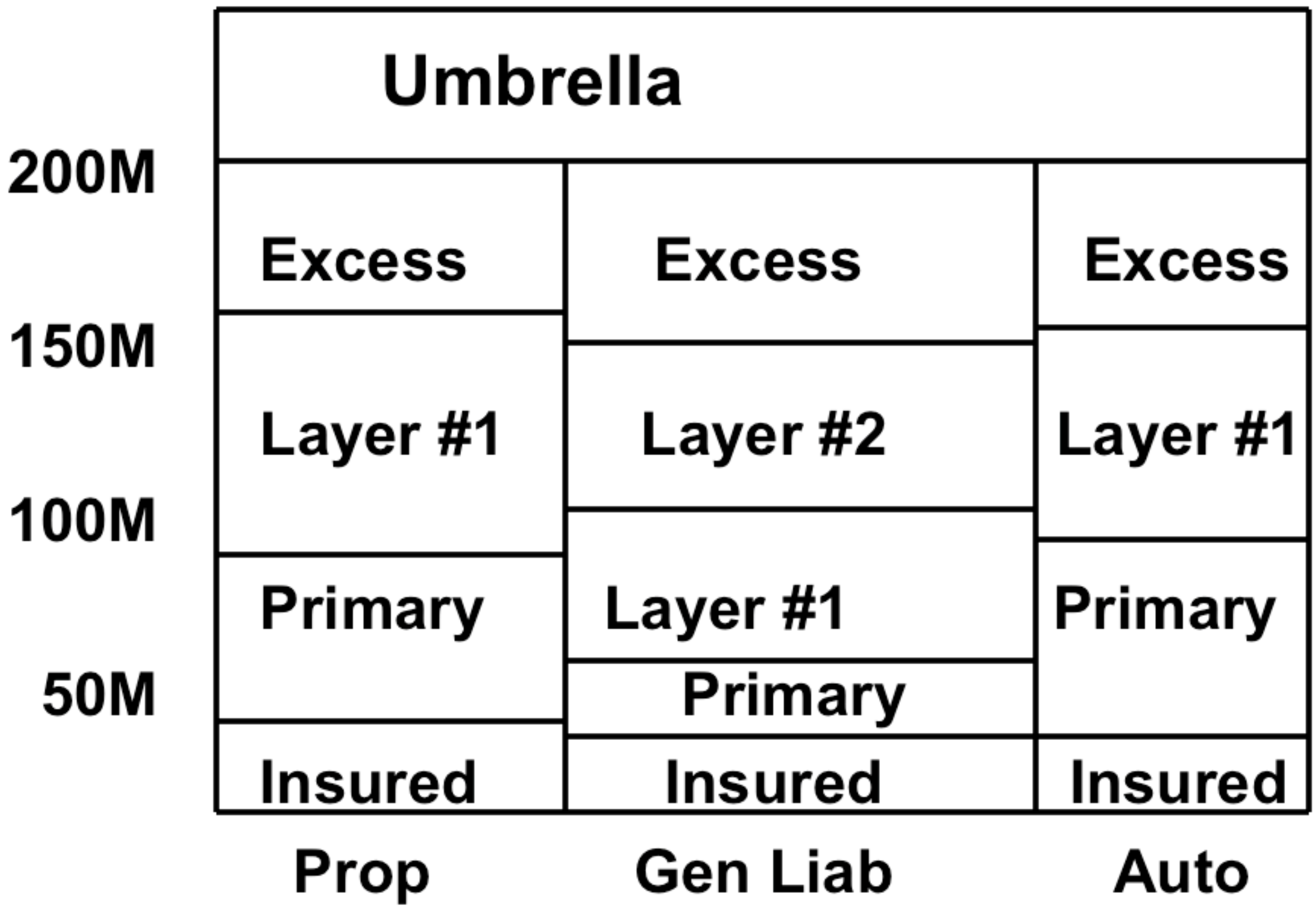
Insured Retention. The insured pays the first portion of any loss. This is the deductible.

Primary Insurance. All losses from the retention to the policy limit are in this layer.

Excess Insurance. The insured can buy coverage above the primary limit.

Umbrella Insurance. An insured can buy broad coverage above all limits to protect against catastrophic loss.

Single Policy Layering



Insurance Company Layering

Insured Deductible. Level retained by insured.

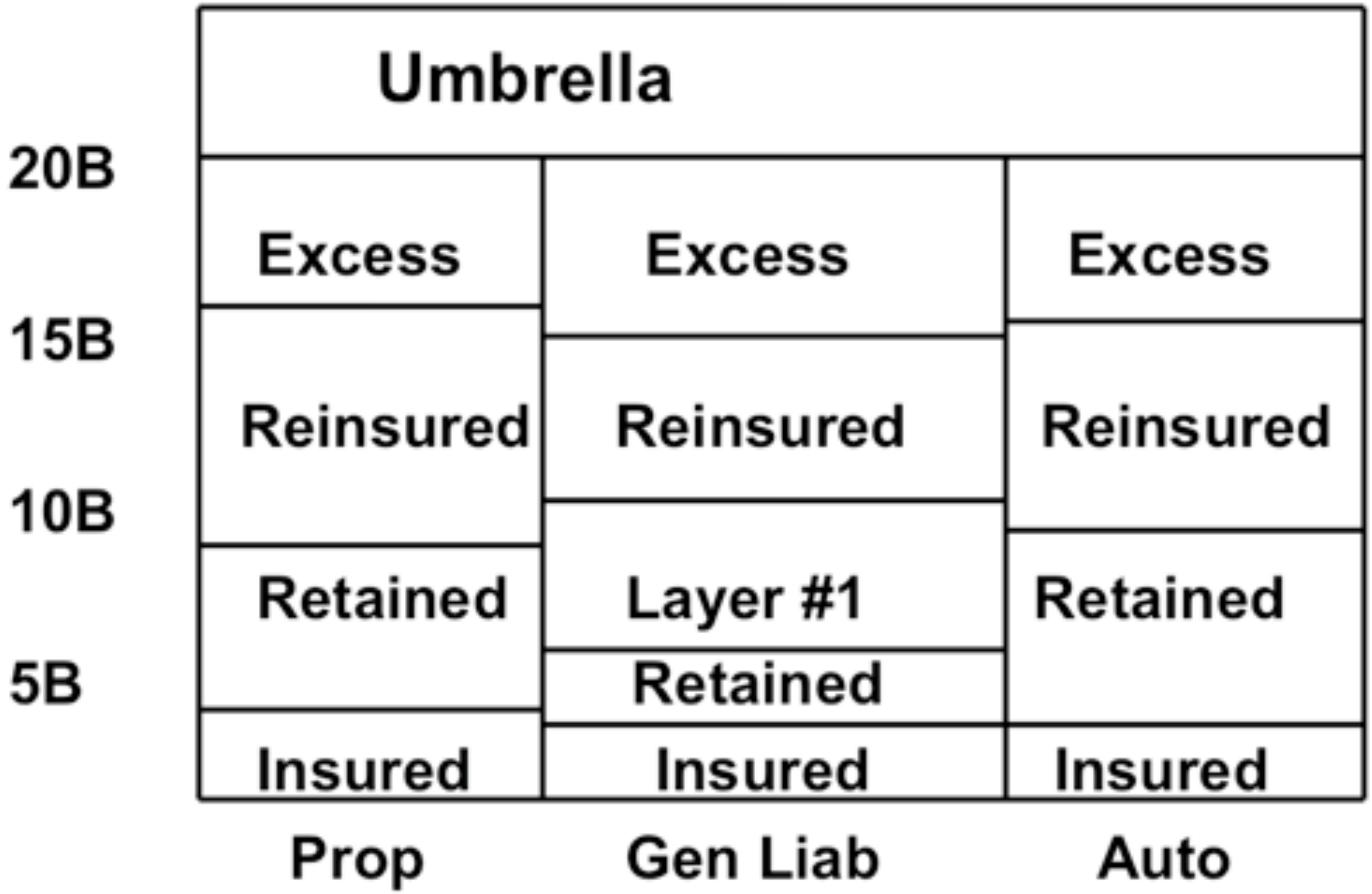
Primary Insurance. First layer retained by the insurer.

Reinsurance. The insurance company can reinsure a portion of the primary layer.

Excess Insurance. This level covers accumulated large above reinsurance.

Umbrella Insurance. This protect broadly against unforeseen catastrophes.

Insurer Layering



Question

An insured had insurance coverage for a major office complex. Is it a good structure?

- $39 million market value of property.
- $25 million replacement cost.
- $8 million primary coverage with a $2 million deductible.
- $5 million above loss of $11 million.
- $9 million above loss of $20 million.

Question

A city has 500 buses serving residents.

- 40 passengers per bus in rush hour.
- 6 passengers per bus in mid-day.
- 22 passengers per bus in a mid-day accident in one section of the city.

Many injured parties file claims for injuries. How should the city handle this risk?

Question

A company unloads ships transferring electronic products into a public warehouse in a port. In the past year, theft and missing items equaled 5% of all shipments. How should the company handle this risk?

Question

A company pays medical costs for workers injured on the job and salary during any period of disability.

- 95% of injured workers return to the job within 21 days, even after serious injury.
- Local laws occasionally require employers to provide lifetime total pay and medical costs for injured workers.

How should the company handle this risk?

Presentation

Session 3
Structure of the Insurance Industry

Forms of Insurance Companies

Private insurers in terms of legal organization and ownership can be categorized as:

- Stock Insurer.
- Mutual Insurer.
- Lloyd's Association.
- Reciprocal Exchange.

Property Insurance

Provides protection against most risks to property. Includes:

- Fire flood, earthquake
- Houses.
- Commercial Buildings
- Boilers and equipment.
- Vehicles.
- Aircraft.

Liability Insurance

Liability insurance indemnifies insured against third party claims. It covers:

- Lawsuit judgments.
- Cost of settlement of claims.
- Legal expenses.

Casualty Insurance

Casualty insurance is a problematically defined term not concerned with life insurance, health insurance, or property insurance. However, the "elastic" term has also been used to describe:

- Property insurance for aviation, boiler and machinery, glass breakage, and crime.
- Marine insurance for shipwrecks or losses at sea.
- Fidelity and surety insurance.
- Earthquake.
- Political risk and terrorism.

NAIC in 1946: Defined legal liability except marine, disability and medical care, and some damage to physical property.

Carrier Knowledge

- **Product Knowledge.** What risks are covered by different types of policies?
- **Availability Knowledge.** What insurance products are available?
- **Carrier Strength.** How strong and reliable is the carrier?
- **Carrier Services.** What is the quality of the carrier's underwriting, claims processing, and other services?

Sources of Knowledge on Carriers

- **Rating Agencies.** Solvency. Financial strength. (Standard & Poor's, A.M. Best, and others).
- **Advisen**. Product lines. Policy terms. Governance. More.
- **Insurance Information Institute**. Trends. Financial information. More.

Insurance Market Cycle

A **cycle** refers to a course or series of events or operations that recur regularly and usually lead back to the starting point.

- U.S. property and liability insurance has a tendency of insurance coverage to follow a cyclical pattern with pricing and coverage availability.
- In this context we identify hard and soft markets.

"Soft" Insurance Market

Exists when insurance coverage is relatively plentiful and offers attractive pricing.

- **Buyers' Market.** Insurance companies are highly responsive to clients.
- **Excess Capacity.** Insurers have premium and revenues goals that exceed the needs of buyers.
- **Market Share Pricing.** Insurers price coverage to retain or increase their market share.

“Hard” Insurance Market

Exists when insurers withdraw and become more selective when offering coverage.

- **Sellers’ Market.** Insurance companies restrict exposure and seek out only the best risks.
- **Restricted Capacity.** Organizations struggle to incorporate insurance into risk management programs.

Drivers of the Cycle

State of the Economy. Are economic conditions good or bad?

Insurer Resources. Do insurers have enough capital?

Underwriting Results. Are insurers profitable?

Cash Flow Underwriting. Are insurers lowering premium prices to expand business?

Long and Short Tail Losses. What kind of business is being written?

Cash Flow Underwriting

This is a practice of granting coverage based on rates that are designed to increase an insurance company's cash flows during periods when losses and expenses are likely to exceed premiums.

Cash Flow Financial Results

Underwriting Results	-36000
Investment Income	24000
Taxable Income	12000
Tax Rate	0%
Taxes	0
Net Loss	**-12000**

Long and Short Tail Losses

- **Long-tail Loss**. Exists when an insurance company expects to pay a claim many months or even years after a loss.
- **Short-tail Loss.** Exists when a claim is likely to be paid immediately after a loss.

Government Regulation of Insurance

Characteristics of insurance regulation in the U.S.:

- **State Level.** Every state has an insurance department. The federal government does not regulate insurance companies.
- **NAIC.** Regulation is coordinated by the National Association of Insurance Commissioners.

Goals of Regulation

Regulation pursues goals including:

- Increase the likelihood of insurer solvency.
- Protect consumers.
- Increase the availability of insurance.
- Encourage reasonable costs for consumers and adequate return for insurers.

Legislation

Insurance laws regulate:

- Formation of insurance companies.
- Financial requirements for insurers.
- Insurance rates.
- Financial distress of insurers.
- Sales and claims practices.
- Taxation of insurers.
- Licensing of agents and brokers.

Licensing of Insurers

Insurance companies must be licensed to do business in a jurisdiction. Three forms are:

- **Domestic.** Insurer is domiciled in the state.
- **Foreign.** An out-of-state insurer licensed in the state.
- **Alien.** A non U.S. insurer licensed in the state.

Admitted and Nonadmitted Insurers

Admitted. An insurance company that is licensed to do business in certain product line in the jurisdiction in which the policy is purchased.

Nonadmitted. An insurance company not authorized to issue insurance policies in a jurisdiction.

Domestic, Foreign, and Alien Insurers

The United States only:

- **Domestic**. An admitted insurer domiciled and licensed in the state.
- **Foreign**. An out-of-state insurer licensed in the state.
- **Alien**. An insurance company chartered outside the United States and licensed in the state.

Insurer Solvency

Financial Solvency. Exists when the company can meet all financial responsibilities and pay all claims fully and on time.

Technical Solvency. Occurs when the insurer has adequate assets to provide a cushion of support for future claims.

Technical Insolvency. Describes a situation where the insurance company fails to meet the minimum capital requirements established by regulators.

Continuing Solvency

Adequate Cash Flows. Cash from operations is sufficient to cover operating expenses and losses incurred.

Adequate Equity. Insurer's capital is sufficient to support the level of premiums and other activities.

Factors Affecting Solvency

Sound Underwriting. Evaluate risks and set premiums to have funds to pay claims.

Sound Investments. Invest carefully in safe and liquid assets.

Cost Control. Manage operating and other costs.

Strong Internal Auditing. Ensure all activities match company policy.

GAAP and Statutory Accounting

Regulators pay particular attention to the financial position of insurers. Two forms of accounting are used:

- **GAAP Accounting.** For reporting financial results to investors and the general public.
- **Statutory Accounting.** For reporting financial results to regulators.

Generally Accepted Accounting Principles

Separate Entity. Organization is a distinct and recognizable entity.

Going-concern Basis. Expected to continue to operate for an indefinite period of time.

Accrual Basis. Match transactions with their economic effects.

Cost Basis. Purchase of assets, payment of expenses, and settlement of claims are at actual cost.

Statutory Accounting

Statutory accounting is more conservative than GAAP:

- **Liquidation Viewpoint.** Recognizes relatively-liquid assets available to pay claims. GAAP accounting recognizes all assets.
- **Conservative Capital.** Because some assets are not accepted, equity will be smaller than GAAP accounting.
- **Conservative Realization.** Under GAAP accounting, realization occurs when revenues are earned, expenses are incurred, and losses are expected. Regulatory accounting is more conservative.

Admitted Asset

A high-quality asset that meets requirements of regulators and appears on a regulatory balance sheet.

- **Liquidity.** Easily converted to cash in a short period of time.
- **Certainty.** Highly likely to be converted to cash at their reported values if they are needed to pay claims.

Only admitted assets appear on regulatory balance sheets.

Nonadmitted Asset

Fails to meet the regulatory standard to be an admitted asset. Examples are:

- **Furniture, Equipment, and Computers.** Not very marketable at accounting values.
- **Funds Deposited with Unauthorized Parties.** Insurers not licensed locally for example.
- **Uncertain Collectibles.** Includes overdue receivables, balances due from agents or brokers, and overdue interest and dividends.

Categories of Accounts

Asset. A financial resource.

Reserves. Obligations to pay claims.

Liability. A debt or money owed to others.

Capital. A source of assets from owners or past profits.

Revenue. An inflow of assets, not limited to cash, in exchange for coverage or services rendered.

Expense. A consumption of any asset while conducting business.

Insurer Balance Sheet

The most important financial statement for an insurance company.

- **Assets**. Cash, investments, equipment.
- **Reserves**. Reflect losses occurred but not paid.
- **Liabilities**. Debts or obligations.
- **Capital.** Difference between assets and obligations. “Surplus” is title for account with retained earnings.

Care with Statutory Balance Sheet

Missing Assets. Overdue assets may be quite liquid and reliable.

Reserves. Based on past history and future expectations.

Boasting about Reserves. They show high level of assets to pay claims.

Capital. An accounting entry, not extra “money” in addition to assets.

Insurer Income Statement

Revenue. Money from normal business activities.

Losses. Associated with policies written during the period.

Nonfinancial Expenses. Operating costs.

Financial Expenses. From borrowing or leasing assets.

Before-tax Income.

Income after Taxes.

Question

Watch out for account titles.

- Insurance analyst says, “I am concerned about overdue premiums?”
- What type of account is that?

Reply

Overdue Premiums:

- Asset if the company is entitled to collect the premiums.
- Liability if premiums are owed to another party.

Question

Underwriter says,

- “What is our strategy for deferred taxes?”
- What type of account?

Question

Deferred Taxes:

- Asset if it will reduce a subsequent period's income taxes.
- Liability if result of temporary differences between tax rates and taxes payable for the current year.

Accrual of Losses

Known Losses.

- A claim has been filed or otherwise known. Actuary estimates the cost.

Incurred But Not Reported (IBNR) Losses.

- Not aware of specifics. Will be reported.

Also known and IBNR adjusting expense liability accounts.

Question

"Surplus" reflects assets not committed to pay future claims. With the following data, what will be the change in balance sheet surplus account?

Net income	14000
Dividends	7,400
Accounting reduction to surplus	-600

Reply

Net income	+14000
Dividends	-7400
Change in surplus (no adjustment)	+6,600
Accounting reduction to surplus	-600
Change in surplus	**+6,000**

Question

With the following data, what was the accounting adjustment to surplus?

Net income	9000
Dividends	4600
Starting surplus	22500
Ending surplus	29000

Reply

Net income	+9000
Dividends	-4600
Expected change in surplus	4400
Actual change in surplus	6500
Accounting increase to surplus	+2100

Question

Statutory accounting is more conservative than GAAP accounting because insurance companies have a greater need than other companies to be conservative. Do you agree?

Question

The balance sheet shows history and current strength. It is much more valuable than the short-term income statement. Do you agree?

Question

An insurance company should maximize surplus to show financial strength. Do you agree?

Presentation

Session 4
Insurance Distribution and Claims Management

Industry Parties

- **Broker**. Arranges insurance coverage and advises on risk management.
- **Agent**. Performs many of the same services as brokers.
- **Claims**. Adjusters, lawyers, engineers, and others who investigate insurance claims.

Broker

- **Licensed**. By insurance regulators
- **Independent**. Can work with a variety of insurance buyers and insurers.
- **Representative of Buyer**. Accepts responsibility to understand risks facing organizations seeking insurance.

Agent

Licensed. Like a broker.

Represents Insurer. Not legally accountable for identifying the best insurance coverages for specific risks.

Exclusive or Independent. Works for a single insurer or multiple insurers.

Agent Binding. Can make a policy effective. Called binding the policy.

Question

Susan Powers sells insurance but is not an agent for Blue Creek Insurance.

- Susan tells Arnold Jenkins that his truck fleet is covered immediately by a policy.
- Arnold called the insurer.
- A Blue Creek receptionist said “Susan Powers sells insurance for Blue Creek.”
- A loss occurred the next day.
- Is the loss covered by Blue Creek?

Question

The Gilbert Insurance Services Company arranges insurance coverage for wind and glass damage to commercial buildings and structures.

- Most of the coverage is placed with three insurers, one each in London, Birmingham, and Paris.
- How would you tell whether Gilbert is a broker or agent?

Claims Adjusting

Steps settling a claim for a covered loss.

- **Notification.** Insured must file a claim.
- **Review of the File.** Examine information about loss.
- **Verification of Coverage.** Is loss covered.
- **Assess Loss.** What happened?.
- **Assess Indemnity.** Determine the reimbursement.

Claims Adjusters

Multi-Line Adjusters. Both property and liability claims. Often employees of the insurer.

Third Party Administrator (TPA). An independent adjuster that can work for different insurance companies or for the insured.

Public Adjusters. Work exclusively for the policyholder.

Marketing Systems

Insurance companies use different approaches to marketing :

- **Broker.** A person who works for a buyer and helps the buyer obtain coverage.
- **Agent.** A person who works for the insurer and sells coverage to buyers.
- **Direct Writer.** An employee of the insurer who sells coverage to buyers.
- **Direct Answer.** Using advertising, the media, or the Internet to sell to buyers.

Question

Brokers find, request, and negotiate commercial insurance coverage.

- They work for the insured.
- They maintain good relations with the insurer.
- They may accepts contingency fees from insurers.
- Does this create a conflict of interest?

Marketing Strategies

With respect to a line of business, insurers pursue marketing strategies such as:

- **Segmentation.** Offer a single product to a specific portion of a market.
- **Diversification.** Introduce new products into an existing market.
- **Market Development.** Bring an existing product to a new market.
- **Penetration.** Lower the price and aggressive seek a larger share of an existing market.

Question

When is it appropriate for an insurer to use a segmentation strategy?

Reply

Use a segmentation strategy to:

- **Reduce Customization Cost.** The product does not have to be modified for a variety of buyers.
- **Reduce Competition.** If a segment is chosen carefully, competitors may not yet have entered it.
- **Create a Distinctive Image.** A unique identity can be developed across the segment

Question

When is it appropriate for an insurer to use a diversification or market development strategy?

Reply

Use a diversification or market development strategy to:

- **Spread the Risk.** If losses appear in one product category or market, they can be offset by profits in another.
- **Growth.** Companies can move into other lines or markets that are growing fast.
- **Profits.** Companies can seek high profit business.

Question

When is it appropriate for an insurer to use a penetration strategy?

Reply

A penetration strategy is not recommended. Drawbacks are:

- **Pricing Risk.** The company drops prices to build volume and then raises them later after building market share. It is difficult to do this.
- **Greater Risk.** The company is likely to reduce underwriting discipline and accept riskier exposures.

Specialty and Surplus Lines

High Risk. Large policy limit or history of higher than expected losses.

Unique Coverage. No previous experience.

Rare Coverage. A limited number of carriers.

Capacity Limitations. Exceeds capacity of conventional markets.

Risk Expertise. Not familiar to local underwriters.

Question

A specialty lines broker is often call a wholesale broker. Is this accurate?

Excess Insurance

Attachment Point. The lower limit of excess coverage. Once it is reached, the excess can begins to reimburse a loss.

Coverage Follows Form. Excess policy contains the same exact provisions as lower layer.

Coverage Gaps.

- Attachment point higher than the policy limit.
- Exclusion because coverage does not follow form.

Question

A primary insurance policy covers environmental damage with a per occurrence limit of $2 million and a deductible of $100,000. An excess policy covers annual aggregate losses above $2.5 million up to a maximum of $12 million. Is this a good structure for an insurance arrangement?

Presentation

Session 5
Insurance Law

Insurance Law

Common Law. Laws created by the decisions of courts. Developed in Great Britain and brought to the U.S. One-third of world's jurisdictions.

Civil Law. Laws approved by a legislative body or government agency. Most widespread system around the world.

Religious Law. Legal system is subordinate to laws that arise from religious beliefs.

Basic Requirements of Contracts

All contracts require the following:

- **Offer and Acceptance.** One party must make an offer. Another must accept it.
- **Consideration.** An inducement to enter into an agreement. Value to each party.
- **Competent Parties.** Must have legal capacity to enter binding contract.
- **Legal Purpose.** Cannot violate a law or be contrary to public interest.

Question

A company requested insurance and was given a quote of $22,000 for the premium.

- The company requested a reduction to $15,000.
- The insurer responded with an offer of $18,000. Before the company could respond, a loss occurred that was covered by the policy.
- Is the policy in effect?

Question

A company purchased a $300,000 fire insurance policy on a warehouse and paid a premium of $3,000.

- After binding the contract, the agent said the company would also cover $20,000 of the inventory stored in a nearby barn.
- Later, the barn burned down.
- Does the insurer have to pay for the inventory loss?

Material Fact

This is an aspect of a risk that is significant when assessing the exposure in an insurance policy. The risk can be:

- Sufficient to affect the terms of an insurance policy.
- Sufficient to cause an insurer to deny coverage.

Representation

Utmost good faith requires the insurer and insured to disclose material facts affecting insurance coverage. Representation is:

- A statement concerning a material fact made by an applicant in the process of obtaining an insurance policy.
- Made to induce the insurer to provide coverage.
- Oral or written, it must be true to the **best knowledge of applicant**.

Misrepresentation

This is a statement that is false with respect to a material fact. If intentional, it can be the basis for an insurer to void a policy at a future time.

Concealment

This is the failure to voluntarily disclose a material fact.

- It goes beyond simply answering questions that are asked.
- Insured has affirmative burden to disclose material facts that can affect coverage.
- Concealment is basis for voiding policy.

Warranty

This is a statement made to secure insurance coverage that must be absolutely and strictly true.

- It is not enough to be true to the best knowledge of the insured.
- It does not have to involve material fact.

Fraud

This is an intentional deception to cause a party to give up property or a lawful right:

- Fraud exists when an insured makes willful false representation, concealment, or deliberate action to harm the insurer.
- It is the basis to void a policy.
- If a serious harm is possible, fraud may violate criminal as well as civil law.

Utmost Good Faith

Contracts may have two different legal standards for disclosure:

- **Let the Buyer Beware.** Each party to a contract should investigate the situation and be responsible for knowing all terms and conditions.
- **Utmost Good Faith.** Both parties must make a full and fair disclosure of all facts affecting a contract. **This is the requirement for insurance policies.**

Question

A company has refineries in Kuwait and Qatar.

- It applied for insurance on the Qatar facility and completed a form provided by the insurer.
- The form did not ask about the safety record of other refineries.
- The company did not report the suspension of Kuwait refinery due to poor safety practices.
- An explosion resulting from apparent employee negligence damaged the Qatar refinery.
- Is the policy voidable?.

Question (1)

A company president purchased burglary insurance on 24 rare paintings on the walls of the corporate headquarters.

She told the insurer she believed the office building had 24-hour security. This was not true, although she saw a watchman every evening when she left the office.

The policy included 3 paintings at the home of the president. She warranted that a working alarm system was installed at the house and was connected to a local security firm.

Question (2)

Two of the paintings in a carriage house 200 meters from the home of the president. The president failed to tell the insurer that the carriage house could not be locked.

Last year, the president wrote a memo reporting the loss of 3 paintings and suggested insurance might recover their value.

One night a fine arts burglary ring stole all the paintings while the president was on vacation.

Question (3)

Subsequently, the insurer learned:

- The office did not have 24-hour security.
- The alarm system on the house was not working because of a dead battery.
- The carriage house had no lock.
- Non-existent paintings were listed on the policy.

Does the policy cover the loss?

Adverse Selection

This refers to the tendency of persons with high chances of loss to seek insurance at average rates.

- Insurers investigate whether a party fits the criteria for coverage.
- It seeks to exclude adverse selection.

Question

A woman had sharp pains for a full year.

- She went to a hospital for medical tests.
- She received a phone call but did not answer.
- She increased her life insurance.
- She did not tell the insurer she had visited the hospital.
- A month later, she died.
- Does the insurer have to pay the death benefit?

Assignment

An insurance policy is a personal contract:

- **Assignment**. The right of a party to transfer a claim, right, or property to another party. **Consent.** Permission to assign a contractual right.
- **Personal Contract.** Assignment of the rights under an insurance policy requires consent of other party.

Waiver

The relinquishing of a known right. Two forms:

- **Intentional.** An individual or organization can consciously surrender a right to which it is entitled.
- **Unintentional.** By taking actions that a court would consider the failure to protect a right, a party can waive the right without a conscious decision to do so.

Question

A large airport is considering the purchase of a policy to reimburse it for disruption lawsuits as a result of bad weather.

- The insurance company offered a lower premium if the airport would waive coverage for any interruption other than weather.
- Is this a good idea?

Void and Voidable Contracts

Void. An agreement that has no legal force.

Voidable. An agreement that can be made void

- At the option of one of the parties.
- When circumstances make it impossible to perform the contract.

Question

How do we determine whether a contract is voidable? Whether it is void?

Question

A company purchased fire coverage on an office building. The policy prohibited the use of any part of the building as a restaurant. When delivering the policy, the insurance agent ate lunch in a pizza parlor on the ground floor of the building. Nine months later, a fire in the restaurant and damaged the building. Can the insurer void the policy?

Strict Compliance Rule

States that a contract is enforced in accordance with its terms.

- If terms are clear, meaning may not be distorted by interpretations.
- Rule covers insurance policies.

Question

A chemical company purchased a liability insurance policy.

- The risk manager specifically requested medical coverage for contractors on the property.
- He did not notice that second-party coverage was an exclusion.
- Three employees of a catering company were hospitalized from a toxic leak on the premises.
- Does the insurer have to cover medical costs?

Parole

Oral evidence offered to vary the terms of a written contract. Usually not permitted to modify an insurance contract. Exceptions might be:

- Obvious Factual Error.
- Fraudulent Statement.
- Factual Conflict.

Question

Prudential provided financing for eight ships owned by United States Lines. The individual who processed the agreement wrote down $92,885 instead of $92,885,000. USL went bankrupt and sold the ships for $67 million. How much of the $67 million could be claimed by Prudential based on the contract.

Question

An individual purchased an expensive Italian sports car.

- The insurance policy excluded racing the car.
- The individual and his insurance agent watched the car racing three times.
- Then, the car was involved in an accident while being driven home from work.
- The insurer voided the policy.

Will a court uphold the insurer?

Contract of Adhesion

An agreement prepared by one party and accepted or rejected by another party without modification.

An agreement not reached by negotiation.

As insurance companies draw up the insurance policy, it will be treated as a contract of adhesion.

Expectations Principle

Refers to the interpreting of a contract of adhesion to meet the expectations of the party that did not draw it up.

Impact. Fine print or tricky language will not invalidate insurance coverage.

Question

A city buys $500,000 of standard fire coverage. On page 19, the policy contains the wording *"Coverage will not be provided if the employer hires anyone with a prior criminal conviction."*

A fire occurs. It was started by a convicted felon who was employed by the city. Will the insurance company have to pay for the loss?

Question

A hotel had labor problems and locked out employees. Union members picketed the hotel and engaged in aggressive actions with guests, security guards, and police.

After 23 days, an employee tossed a bottle of gasoline into the kitchen. A fire destroyed the restaurant. The insurer denied coverage because the loss was caused by intentional behavior of an employee of the insured. Does the policy covers the loss?

Subrogation

Refers to the right of an insurance company to be reimbursed for payments when a loss is caused by a third party.

Question

A man is visiting a family member who is a patient in a hospital.

- The man has harsh words with another patient and hits him causing a fall that requires surgery.
- The insurance company must pay for the surgery as part of the injured patient’s health care policy.
- Can the insurer obtain reimbursement for its payments?

Question

A woman was in an accident with another car.

- The other driver leaped out of the car and smashed the window of the woman’s car.
- When she filed her claim, the insurance company asked the woman to testify about the damage inflicted by the other party.
- The woman refused.
- Does the insurer have to pay the claim?

Insurable Interest

Insurance may not be purchased without an insurable interest, defined as a relationship where a person would be affected by a loss. Examples are:

- **Ownership.** A financial loss.
- **Leasehold.** Can lose if rented property is damaged.
- **Financial.** Loan or investment is affected.
- **Family or Oneself.** Based on love and affection.
- **Business.** Financial or other ties.

Question

A company lends $300,000 to a key executive to help her finance a new house after being transferred by the company. She lends $30,000 of the money to her son to buy a new car. The company applies for a life insurance policy on each individual, one for $300,000 and the other for $30,000. Will the insurer issue the two policies?

Question

A marketing, financial, and technical executive formed a company to develop a computer system for a hospital. In three years, the group plans to sell the finished system to IBM for $6 million. All three people are needed to build it correctly but none will receive any money for work during the three years. What is the insurable interest of each person in each other person?

Presentation

Session 6
Insurance Contracts

Contract of Indemnity

An insurance contract seeks to restore a prior financial position before a loss.

- Life insurance policies are an exception.
- U.S. health care policies are also an exception.

Question

A yard delivered a new vessel to an owner:

- **Cost and Time.** $40 million and 3 years to construct.
- **Current Market Value**: $25 million.
- **Mortgage:** $35 million.
- **Construction Cost:** If ordered today, it would cost $45 million.

How much insurance would be available under the indemnity principle?

Role of Deductibles

Deductibles and Participation Clauses reduce:

- **Premiums.** The larger the sharing, the larger the discount on the cost.
- **Administrative Costs.** Deductible also eliminates processing costs for small claims.
- **Moral Hazard.** Reduces the temptation to intentionally cause a loss and benefit from it.
- **Behavioral Hazard.** Encourages careful behavior if the insured pays part of the loss

Contract Parties

Three parties to an insurance contract:

Insured. Has coverage for personal, property, liability, or other unexpected loss.

Insurer. Provides coverage for the exposures.

Premium Payer. Pays for the promise of compensation if a loss occurs. Most commonly, this is the individual or organization that is insured.

Named Insured

- **First-named Insured.** Party responsible for managing a property policy on the behalf of the insured organization.
- **Other Insureds.** Partners, associated companies, and other entities with an ownership or other interest in the policy.

Question

A group of investors purchased a hotel and owned it in a stand-alone corporation.

- The first-named insured, cancelled the policy without notifying the other insureds.
- A fire damaged the hotel.
- A minority owner demanded reimbursement for his share of the damage directly from the insurer.

Does the insurer have to honor the request?

Sections of Insurance Policy

Declarations. Statements that provide information about the person or property covered by the policy.

Definitions. Key terms used in the policy.

Insuring Agreement. Summary of major requirements imposed on the insurance company.

Exclusions. Losses or causes of loss (perils) not covered.

Conditions. Provisions that change scope of coverage.

Miscellaneous Provisions. Clauses or sections with terms that affect coverage.

Endorsements. Provisions that expand, reduce, or otherwise modify coverage.

Question (1)

Ralph Dominguez purchased a building and garage at 14 Main Street, Calhoon, Ontario, on January 15 and paid $600,000 in cash and gave a promissory note for the balance of $1.2 million.

The National Insurance Company agreed to insure the building against all loss except flood damage.

Question (2)

The Insurer issued a policy with the following Declarations Section. Do you see any problems with it?

- Insured: R. Dominguez.
- Insurer: National Insurance Company, 140 Baylor Street, Toronto, Canada.
- Location of Insured: Main Street, Calhoon.
- Time Period:12-months.
- Premium: One percent of the purchase price.
- Limit: Purchase price.

Reply

Problems:

- Insured: Needs property identifier, not owner.
- Location of Insured: Needs exact address including province.
- Time Period: Needs start and end of coverage.
- Premium and Limits Needs dollar amounts, not verbal identifier.

Insuring Agreement

Payment for losses. The insurer will pay for losses from certain causes.

Restrictions on Payments. Identifies limitations on coverage.

Provision of Services. Identifies actions other than the payment of losses.

Categories of Exclusions

Excluded Loss. Damage not covered by the policy.

Excluded Peril. Damage covered by the policy but caused by a peril that is not covered by the policy.

Excluded People and Property. Insurer must know who and what are covered.

Question

A company bought fire insurance to cover a factory.

- It also purchased earthquake insurance to cover structural damage from seismic tremors.
- An earthquake caused a fire that burned down the facility.
- Which policy covers the loss?

Question

A fire destroys a covered car dealership during a time when the owner is temporarily holding $500,000 of jewelry that is normally stored in a bank safety-deposit box. Is the jewelry covered by the fire policy?

Conditions

Insurable Interest. Payment is made only up to the limit of the insured's interest in property (indemnification principle).

Duties After a Loss. Requirements for insured to take certain actions after a loss.

Loss Settlement. Conditions for settling disagreements between insurer and insured.

Cooperation with Insurer. Requirements for insured to help insurer mitigate the loss.

Endorsements

Expanded Coverage. Additional property or perils covered.

Reduced Coverage. Property or perils eliminated from or restricted in extent of coverage.

Modified Provision. An adjustment to any basic term of the policy.

Question

HPR property has special characteristics. Which of the following apply to it?

- **Danger of Loss.** It has a much higher probability of loss as compared to most other property.
- **Lower Probability of Loss.** It is less likely to suffer loss than would happen in “normal” circumstances.

Presentation

Session 7
Insurance Underwriting

Goals in Underwriting

Insurers seek to achieve the following:

- **Simplicity.** Easy to understand coverage and rates.
- **Consistency.** Stable rates over time.
- **Flexibility.** Can adjust to changing conditions.
- **Loss Control.** Encourage mitigation of losses.
- **Profitability.** Earn a return on capital.

Steps in Underwriting

The process followed by an underwriter includes:

- **Evaluate the Exposure.** Evaluate the perils presented by the application and the hazards that can increase the change of loss.
- **Compare the Exposure with Guidelines.** The company may prohibit some exposures, restrict others, or limit coverages.
- **Recommend or Deny Coverage.** After assessing situation, accept or reject application.

Insurance Ratemaking

Historical Data. What is the history of prior losses and costs?

Frequency. What is the likelihood of r partial or total losses?

Severity. What is the likely size of major claims?

Approaches to Ratemaking

Class. This effort does not involve merit rating.

Schedule. An indirect and partial approach to merit rating.

Experience. Solidly based on merit rating.

Judgment. Largely based on merit rating.

Retrospective. Solidly merit rating.

Class Rating

Base Rate. This is a single rate per $1,000 of coverage for similar exposures.

Average Experience. Reflects average losses and claims for the class.

Schedule Rating

Base Rate. Starts with a class rate.

Adjustment. Upward or downward based on the factors in the pool compared to the general population.

Example. Male driver under the age of 25.

Question

Dallas has 30,000 employees covered by a health plan.

This includes 3,000 fire fighters.

An insurance company is bidding for the medical plan contract.

Should it use a class rating or schedule rating to recognize the increased health exposure represented by the fire fighters?

Experience Rating

Base Rate. Starts with a class rate.

Historical. What is the claims experience?

Example: Male driver with 3 accidents.

Question

Would an underwriter approve the following request for insurance?

- Auto coverage for an 18 year old male with two accidents in the past two years.
-

Question

Would an underwriter approve the following request for insurance?

- Homeowners and flood insurance for an ocean-front clapboard home in Panama City, Florida.

Question

Would an underwriter approve the following request for insurance?

- Liability insurance for a pet owner with two Komodo dragons in an outside pen.

Judgment Rating

When:

- Difficult to determine a class rate.
- No experience with prior losses.
- Unique exposures.

Question

An insurer has different policies to rate an insurance request. What is each of the following?

- 10 percent discount for no losses in past five years.
- 25 percent increase for a driver under the age of 20.
- Rates for a line of business are set based on the reputation of the company.

Question

Peabody Coal Company is the largest private-sector coal company in the world. An insurer is designing a liability plan for its environmental exposures. One insurer proposed an experience plan based on industry statistics while another offered only a judgment based on forecasted policies of the Environmental Protection Agency (EPA). What would you recommend?

Retrospective Rating

Provisional Rate. A rate set initially based upon class, schedule, or experience rating.

Final Rate. After all costs are known, a final rate is calculated.

Basis for the Rate. The final rate rewards the insured or charges additional premiums.

Minimum and Maximum Rate. The insurer and organization agree to a floor and ceiling on the rate.

Role Of The Senior Underwriter

While property and liability insurers have thousands of underwriters, the role of the senior underwriter is critical to the success of an insurance company's solvency. This individual plays a key management role across all lines of business for the company.

Financial Issues in Underwriting

Adequate Cash Flows. An insurance product must cover losses, adjusting and operating expenses, and provide a return on capital.

Adequate Equity. A product must have sufficient contributed capital and surplus to support the level of underwriting.

Adequate Profits. The product must generate an appropriate after-tax reported income.

Desirable Product Lines

Sound Underwriting Practices. Premiums and other income should provide adequate funds to pay claims.

Sound Investments. Insurer should invest funds in a balanced relationship of risk and return.

Cost Control. Departments need processes to control marketing and other costs.

Internal Auditing. The insurer should monitors payments and claims.

Underwriting Risks

Underwriting Itself. The act of issuing an insurance policy involves costs and claims in an uncertain world.

Investment Risks. Premiums are invested with variable expected earnings.

Changing Circumstances. What will happen with economic levels, climate, pollution, and other factors.

Changing Legal Conditions. Legislation and regulation pose risks.

Financial Risks

Liquidity. This viewpoint seeks highly safe and liquid assets to cover claims, and meet other obligations for issuing and serving policyholders and paying or otherwise resolving claims.

Profitability. This viewpoint encourages the insurance company to monitor its ability to achieve adequate returns for accepting risks.

Senior Underwriter Background

Work Area	Percent
Insurance carrier	60%
Insurance broker	10%
Other insurance services	10%
Consultant	10%
Finance	10%

Senior Underwriter Mobility

Years at Current Firm	Percent
Up to 5 years	15%
5 to 10 years	30%
11 to 20 years	20%
Over 20 years	35%

Senior Underwriter Education

Credential	Percent
Undergraduate Degree	100%
Graduate Degree	70%
Professional Designation	90%
Took continuing education seminars in past 3 years	80%

Question

What is the significance of the estimates on the educational credentials of senior underwriters?

Advanced Underwriting Skills

Financial Qualifications. Cash flow management, profit planning, and the investment of capital in a risk and return framework.

Technical Skills. Role of probability and statistics.

Broad Business Skills. Understanding of management, marketing, and business operations.

Question

What is the significance of the statistics on the compensation of underwriters after 10 years and 25 years of underwriting experience?

Question

What do large insurance companies seek when they hire entry-level underwriters?

Presentation

Session 8

Property Insurance

Property Risk

Property contracts cover two categories of risk:

- **Direct Loss.** This occurs when the property suffers the loss. A fire that damages a building is a direct loss.
- **Indirect Loss.** This occurs when the loss results from the consequences of property loss. A factory is damaged and the company suffers a loss because it is unable to manufacture and ship goods.

Disruption Risk

Disruption risk refers to losses that arise from an interruption to normal business activity. It takes two forms:

- **Lost Profits.** The company cannot deliver products or services and suffers a drop in earnings.
- **Extra Expenses.** The company must pay additional costs to operate after a loss.

Managing Property Risk

The most common risk management approach to property risk has the following components:

- **Loss Control.** Take steps to make the property safe for employees, others, and the asset itself.
- **Deductible.** A requirement under an insurance policy that limits coverage to a loss above a specified minimum level. Also called a **retention.**
- **Insurance.** Transfer large exposures.

Real and Personal Property

Real Property. Rights, interests, and benefits inherent in the ownership of land or buildings, including houses, sheds, fences, landscaping, air rights and easements.

Personal Property. Other property such as furniture, machinery, vehicles, inventory, and movable assets.

Question

A policy insures real and personal property at an insured location.

- The owner rented a bulldozer to repair the parking lot.
- He knocked down a wall of the building.
- The accident destroyed a computer owned by a tenant in the building.
- The bulldozer was also damaged.

What damage is covered by the policy?

Commercial Property

Broad categories of assets:

- **Buildings.** Structures and their permanently installed contents.
- **Fixtures.** Assets firmly attached to a building as a permanent structural part. High-cost fixtures may or may not be covered.
- **Business Personal Property.** Individual items owned by or in the control of the company.

Buildings

Completed Building. Structures that are occupied or ready for occupancy.

Partial Building. A structure under construction.

Business Personal Property

- **Furniture.** For use in the business.
- **Equipment.** For use in the business.
- **Removable Fixture.** Not permanently attached to the building.
- **Controlled Property.** Assets owned by others but in the control of the property owner.

Question

Identify each of the following as "building" or "business personal property:"

- Built-in bookcase.
- Owned computer.
- Leased computer.
- Central air conditioning unit.
- Cubicle.
- Sign in front of office.

Question

A company is located next door to a college that offers evening courses. The company allows students to park their vehicles in its garage after office hours. No charge is made to the students. The roof collapsed and damaged six cars. Are they likely to be covered by the company’s insurance?

Question

A factory has a crane that is attached to the ceiling and can move components among different assembly lines. It can serve assembly lines that are movable in flexible configurations. Are the crane and assembly lines covered as part of the completed building?

Property Insurance Forms

All-risk. All losses to the identified property are covered, unless excluded.

Named Perils. Limits coverage to losses from specified causes.

Question

An insurance contract protects a construction warehouse from fire and other perils.

- A separate flood policy covers water damage.
- Both policies exclude earth movement.
- Hurricane Sandy caused mud to slide down a hill and damage the warehouse.
- The insurer denied the claim based on the earth movement exclusion.

Would a court uphold the exclusion?

Property Insurance Coverage

Property insurance coverage can be:

- **Specific Coverage.** A policy may apply to a single property.
- **Blanket Coverage.** Applies to multiple units.

Question

Insurance covered 280 Oak Street and its 12 units with a policy limit of $600,000.

- Units were identified as units 1A, 1B, 1C, 1D, 2A, 2B, 2C, 2D, 3A, 3B, 3C, AND 3D.
- A storm caused damage of $250,000 to unit 1C, $300,000 to unit 2B, $150,000 to unit 2D, and $400,000 of damage to unit 3A.

How much can the owner collect from the insurer?

Question

An insurance policy covers the contents of a warehouse identified as lawnmowers and gardening equipment.

- The contents changed to snowmobiles and snow throwers.
- Three months later the building burned down.
- The insurer denied the claim.

Will a court uphold the denial?

Property Indemnification

- **Actual Cash Value.** Replacement cost minus ordinary wear and tear.
- **Replacement Value.** Cost of replacing a damaged asset with a comparable asset.
- **Agreed Upon Value.** Amount of insurance coverage when the insured and insurer agree on a reasonable amount for the coverage.

Weaknesses of Actual Cash Value

Actual cash value method is not recommended.

- **Indemnity Principle.** It may not restore the pre-loss condition.
- **Calculation.** The insured does not know in advance the post-loss position.
- **Settle of Claim.** It set up a possible disagreement with an insurer after a loss.

Question

A computer system is destroyed by a power surge.

- It is insured for its actual cash value.
- It was purchased for $3 million 5 years ago when it had an estimated service life of 15 years.
- Replacement cost today will be $6 million including upgrades.

What is the actual cash value?

Question

A painting by a 16th century Italian artisan was purchased 12 years ago for $1.2 million plus a 10% auction commission.

- Three works by the same painter recently sold at auction for $2.6, $3.2, and $6.5 million.
- The company wants $7 million in insurance coverage.
- Is it likely an insurer would provide it?

Policy Limits

The policy limit for a property insurance policy may be expressed two ways:

Per Occurrence. The policy limit applies separately to each cause of loss.

Aggregate Policy Limit. The policy limit applies to the total of all losses within the policy period.

Question (1)

An insurance policy covers 15 hotels in 6 cities:

- $600,000 limit of liability in single occurrence.
- $1.2 million annual aggregate limit of liability.
- $200,000 deductible per occurrence.

Question (2)

A windstorm in Brazil causes the following damage covered by the policy:

Hotel #1: $400,000.   Hotel #2: $500,000

A tidal wave in Argentina causes the following damage covered by the policy:

Hotel #3: $800,000.   Hotel #4: $350,000.

What is the likely reimbursement from the policy?

Reply

#1:	$200,000	($400 loss - $200 deductible)
#2:	$400,000	(No deductible same occurrence)
#3:	$600,000	($800 – $200 deductible)
#4:	Zero	(already at $1.2 limit)

Question

A full-year policy covers a building with a limit of $200,000 and a deductible of $25,000.

- In May, a fire causes damage of $150,000.
- In October, a second fire causes additional damage of $250,000.

How much will the policy reimburse?

Reply

On an aggregate basis, reimbursement is the $200,000 policy limit.

If per occurrence, the reimbursement is $300,000:

- May fire: $125,000 (150,000 – 25,000)
- October fire: $175,000 (200,000 – 25,000)
- **Total: $300,000**

Property Excluded

Common exclusions :

- **Liquid Assets.** Securities, and precious metals.
- **Unimproved Land.**
- **Living Objects.** Animals, trees, crops.
- **Mobile Units**. Vehicles, watercraft, and aircraft.
- **Separate Risks.** Mines, shafts, dams.
- **Transit Property.** Passing through or temporarily stored on the premises.

Question

The owner of an insured location drove his car into the parking lot of the location.

- He was pulling a boat on a trailer.
- In the cabin on the boat was a rare and threatened species of parrot and a Rolex watch valued at $7,000.
- A gas line explosion destroyed the boat, bird, and watch.
- Are the items covered?

Debris and Demolition Insurance

Additional coverages in property insurance policies:

- **Debris Removal.** Transporting and disposing of damaged property.
- **Contamination.** Restoring property to a safe condition.
- **Demolition.** Destroying parts or all of the property prior to rebuilding it.
- **Mandated Upgrades.** Improving the property to meet new laws or government regulations.

Question

An insurance policy on a refinery covers removing debris and decontamination of from an insured loss at the insured location.

A fire caused debris in the refinery and also on a pier owned by the port administration.

Burning chemicals polluted the refinery and two ocean-going ships docked at the refinery.

Does the policy cover these losses?

Business Interruption Insurance

A **consequential loss** refers to an indirect economic loss resulting from a different and direct loss. Business interruption is an example. Insurance can cover two indirect losses:

- **Loss of Income.** A portion of income while property is being repaired.
- **Extra Expense.** Additional costs as a result of the consequential loss.

Question

A company lost $3.5 million last year. It hopes for a profit of $7-10 million this year.

- It suffered a fire on its main manufacturing plant.
- The company calculates its lost income at $1.2 million and its extra expenses at $500,000.
- The company has a business interruption policy with a limit of $3 million per occurrence.

How much should the insurer pay?

Contingent Interruption

Consequential damage from loss to property not owned or controlled by the insured. Categories:

- **Supplier.** Damage stops a supplier from providing goods to be sold by the insured.
- **Customer.** Damage stops a customer from buying goods or services from the insured.
- **Other.** Damage to a related business that attracts customers to the insured.

Question

A manufacturer of souvenirs has an inventory of $2 million for a sporting event.

- Likely sales should exceed $3 million.
- A labor strike delayed the event.
- Then, a fire caused it to be cancelled.
- The manufacturer has a contingent interruption policy with a limit of $1 million per occurrence.

Is the loss covered by the policy?

Question

In October 2010, a New Jersey company experienced a crash of the hard drive of its primary business computer. The files were totally backed up at an off-location site. The company contacted Dell and ordered a rush shipment of a new drive. What was the promised delivery date for the computer component?

Presentation

Phillips, Nokia, & Ericsson

Presentation

Session 9
General Liability

Legal Liability

An exposure to compensate another party for a loss or damage:

- **General Liability**. Facing everyone from individual agreements and business operations.
- **Professional Liability**. Exposures that arise from possessing unique skills and training.
- **D&O Liability**. Facing officers and board members of organizations.
- **Employer Liability**. Created by the employer and employee relationship.

General Liability

- **Contractual Liability**. Covers oral and written agreements that can be enforced in the courts. Party that fails to perform is exposed to the payment of damages or requirement to perform.
- **Tort Liability**. Covers alleged wrongful act or omission that violates another party's rights or causes that party damage. The aggrieved party can sue for compensation.

Contractual Liability

Failure to adhere to the terms of a contract.

Agreement. Two parties mutually agreed to engage together.

Consideration. They exchange assets or other elements that have value.

Performance. A disagreement arises.

Enforcement. One party sues for compensation or performance.

Breach of Contract

A breach of contract occurs when one party does not fulfill obligations under a contract.

- **Minor Breach**. This level of failure to perform can be remedied in various ways while the bulk of the contractual commitments remain in place.
- **Material Breach**. This is more significant. If upheld by a court, it allows one party to compel performance or collect damages.

Remedies for Breach of Contract

Monetary Damages.

- If possible, the judicial remedy is to award money.

Specific Performance.

- When money is not sufficient, a court may order the breaching party to perform a specific act.

Question

A contractor was building a home for a man who just lost his mother.

- The owner gave him $1,000 and an urn that contained his mother's ashes. "She loves this property. I want her ashes buried in the concrete."
- The contractor agreed but forgot to do it.
- He gave the ashes back to the owner.
- The owner sued for breach of contract.
- How will a court rule?

Question

In the previous question, could the court also award additional money because the contractual violation caused emotional distress?

Discharge of Contracts

Discharge refers to the point at which all contractual obligations end. It arises from:

- **Operations of Conditions.** A change in the situation.
- **Performance.** Task is finished.
- **Breach.** One party fails to perform.
- **Impossibility.** Cannot be performed.
- **Agreement.** Parties change their minds.
- **Operation of Law.** Legal stoppage.

Question

Following Hurricane Katrina, an insurer received thousands of claims for storm damage.

- The policies required insurers to begin adjusting claims within 30 days.
- The company failed to comply.
- 18,000 insureds filed for immediate payment.
- Should the court require immediate payment of all claims without verifying the losses?

Legal Fees

The legal fees involved with settling insurance claims can be prohibitive. As a result, many lawsuits are settled before they proceed to court even when the claim is not likely to produce a positive result for the plaintiff.

Question

Two twin sister faculty members caused so much trouble the college suspended them with one year left on their contract.

- The college offered to pay each of them for the full contract year.
- They refused the money and sued.
- Dozens of depositions were taken.
- The case went to a jury verdict.

What happened?

Question

A plaintiff filed a lawsuit alleging bad faith because the defendant's insurer spent nearly $1 million on attorney's fees defending the claim for less than $100,000.

- The plaintiff argued that the insurer pursued a "bad faith litigation strategy" seeking to discourage the filing of small value claims.
- Will the court agree?

Question

Police raided a medical marijuana greenhouse and seized 15 large marijuana plants.

- The landscaper filed an insurance claim alleging “theft” of inventory.
- The insurer denied the claim.
- The landscaper filed a bad faith claim against the insurer.

What happened?

Presentation

Cardboard in China

Situation

A French company built a factory to produce televisions in China. A Chinese company agreed to a 3-year contract to supply cardboard as packing material. A month before the start of the contract period, the Chinese company sent a letter indicating it would not supply the cardboard. It had a more profitable contract to sell the cardboard in Australia.

Question

The French company signed a new 3-year cardboard agreement at a higher price with a Korean company. Six months later the Chinese company advised the French company that it would start delivery under the contract in one week. The French company balked and the matter was referred to the office of the governor of the province. What was the outcome?

Question

Assume the governor took the position that the contract was valid and the French company must accept and pay for the cardboard from the Chinese company. What should be the reply of the French company?

Question

Assume the French company ran out of options and had to accept and pay for the cardboard. Further assume that the French company told the Korean supplier that the cardboard was no longer needed and the Korean supplier sued for performance or damages. Can it collect?

Question

Assume the French company went to a Chinese court and lost the case on legal grounds. What legal ground exists in China to support the position of the governor?

Presentation

Session 10

Tort Liability

General Torts

Common torts are:

- **Negligence**. A party accidentally or unintentionally causes harm .
- **Intentional Tort**. A party deliberately violates the rights of another party.
- **Strict Liability**. A violation of a legal obligation to exercise care.
- **Privacy or Defamation**. A violation of the privacy rights or reputation of another party.

Question

A woman was sitting in a car in a parking lot with her blinker flashing.

- She was waiting for a car to pull out.
- Another car pulled in front and took the space.
- The other driver laughed and walked away.
- She rammed her car into the newly parked car.
- The man sued her for negligence.

Will he win?

Business Torts

Common business torts are:

- **General.** Losses incurred from business operations.
- **Employer.** Injuries incurred by workers in the course of performing their duties.
- **Product.** Failure of a product or service to perform as advertised.
- **Professional.** Harm from faulty services.

Quirks in U.S. Tort Liability

Accompanying legal liability in the United States has been a tendency to use the courts to pursue goals not strictly related to reimbursing tort losses. We have many examples of odd behavior.

Question

Two lawyers in a Florida federal courtroom were unable to agree on the location to depose a witness. The choices were a building where both had offices and conference rooms or the nearby office of a court reporter. They brought the issue to the judge for a ruling. What action do you think was taken by the judge?

Question

Nebraska state senator Ernie Chambers sued God to prove a point about frivolous lawsuits. He wanted legislation to prohibit filing certain types of suits. He sought a permanent injunction against God saying He has inspired fear and caused "widespread death, destruction and terrorization of the Earth's inhabitants." Did the court award the injunction?

Question

A man was eating escargot in the Seafood Peddler restaurant in San Rafael, California.

- He injected his cocktail fork into a snail.
- A spray of hot garlic butter hit him on the face.
- He continued eating a fish filet and lobster dinner.
- Then he alleged suffering temporary vision impairment.
- He claimed to be humiliated on his birthday and demanded damages from the restaurant.

Does it have to pay?

Sovereign Immunity

In common law jurisdictions:

- The government cannot commit a legal wrong.
- It is immune from civil suit or criminal prosecution.
- In many cases, the government has waived this immunity.

Question

Springfield State Hospital and St. Joseph's Hospital jointly administered a well-baby clinic.

- A health care provider administered the wrong medication to an expectant mother causing severe disability to a newborn child.
- The mother sued both hospitals for negligence.
- Is it likely that the hospitals will be ordered to pay damages awarded by a court?

Negligence

This is a failure to behave with the level of care that someone of ordinary prudence would have exercised under the same circumstances.

It is causing damage to another party as a result of **carelessness,** not intentional harm

Conditions of Negligence

- **Behavior.** An individual or organization failed to behave in a reasonable manner.
- **Duty.** The party had the duty to perform reasonably and did not exercise a proper degree of care in a given situation.
- **Harm.** The behavior caused harm to another individual or property.

Source of Negligence

The failure of a party to exercise a proper degree of care in a given situation. It can arise from:

- **Imprudent Behavior.** A party fails to behave as a reasonably prudent individual.
- **Commission.** A careless or thoughtless act.
- **Omission.** A failure to perform an act that would be performed by a reasonable person.
- **Legal Decision.** Normally determined by a court or arbitrator.

Acts of Negligence

Positive Voluntary Act. Occurs when a party commits an imprudent act.

Failure to Act. Occurs when a party does not make a reasonable attempt to avoid harm to another party.

Vicarious Act. Occurs when negligence is attributed to one party as a result of the act of a different party.

Question (1)

A teenager purchased a lift ticket:

- She signed a waiver of all rights.
- She acknowledged that skiing is a dangerous sport.
- She said she accepted all risks.

Question (2)

At the top of the mountain, a sign read "***Closed Trail. Dangerous Area. Do not Enter***."

- The sign had been knocked over and was lying the snow.
- The teenager entered the closed area and was seriously injured.
- She filed a lawsuit against the ski area, alleging negligence.
- Did she win?

Elements to Prove Negligence

Unreasonable Behavior. Evidence is presented to demonstrate unreasonable behavior.

Duty and Failure to Act. A party had a legal duty to act or not act and failed to fulfill the duty.

Occurrence of Loss. The plaintiff suffered damage such as injury or financial loss.

Proximate Cause. The plaintiff must show a cause and effect relationship between the act and the loss.

Question (1)

A repairman waited in a hotel entrance for delivery of a replacement part.

- Two hotel employees were smoking, as was the repairman.
- The repairman tossed a lighted cigarette to the ground near an oxygen container left by a departed guest.
- A few minutes later, a fire started under the oxygen container.

Question (2)

In a few seconds, the container exploded causing the three men to run into the street to avoid an expanding fire.

As they ran, one of the hotel employees was hit by a bus and knocked to the ground.

The second employee stopped to call his wife on a cell phone.

Then, he went to help his fellow worker.

Question (3)

- While he was ministering to the injured man, a car struck the uninjured worker and killed him.
- A lawsuit for wrongful death was filed, alleging negligence on the part of the repairman.

Was anyone negligent?

Question

A man and woman were having an argument in a mall. The man entered a store and was making a purchase.

The woman entered the store carrying a gun and shot the man and a store clerk. Later, the clerk sued the store, the man and the woman for negligence. Was anyone negligent?

Question

A man was walking through a parking garage when he was attacked by two large dogs.

- An employee of the garage owner saw the attack but did nothing.
- A pedestrian kept on walking.
- The man was seriously injured.
- He sued the garage owner, the employee, and the pedestrian for negligence.

Did negligence occur?

Defenses to Negligence Claims (1)

A defendant may argue:

Assumption of Risk. That a party has accepted a risk and must accept the consequent loss.

Contributory Negligence. That a party is partly responsible for the loss.

Last Clear Chance. That a party had one final opportunity to avoid an accident caused by negligence but failed to act.

Defenses to Negligence Claims (2)

A defendant may argue:

Statutory Immunity. A law prohibits a negligence lawsuit.

Comparative Negligence. Negligence should be apportioned to two or more parties.

Question (1)

Harry Wallace, a limousine driver, was transporting a client to the airport.

- As requested by the client, Harry was driving 100 MPH(160KPH) in a 55 MPH(80KPH) zone.
- A dog ran in front of the car and caused an accident.
- The dog was killed and the client was injured.

Question (2)

- The dog owner sued the limousine company and Harry, alleging negligence.
- The passenger (client) sued the limousine company, Harry, and dog owner, alleging negligence.
- Harry sued the dog owner for negligence, claiming that the dog should not have been crossing the highway.

Who is likely to win the lawsuits?

Question (1)

Leonard Lemieu, a 68-year old retired airline executive, left a cruise ship in Colombia and took a helicopter ride to the central Andes. Before leaving the vessel, he signed a waiver of all risks.

When the helicopter landed, a threatening group of men walked toward it. Leonard yelled to the pilot to take off but the pilot ignored the request.

Question (2)

When the men got to the helicopter, they asked Leonard for money. He refused the request and argued with the men. The men grabbed Leonard and led him away.

Leonard was taken to a shed where he was beaten and robbed. Then, the men left.

Leonard caught a bus to Bogotá and reported the crime. The police told him that the country prohibited lawsuits in situations of kidnapping.

Question (3)

When Leonard got back to his home in Belgium, he sued the cruise line for negligence.

What defenses can be raised by the cruise line?

Question

A restaurant left rat poison next to a dumpster on the property of an adjacent grocery store.

A neighbor's cat ate the poison. The cat wandered away from the poison and was hit by a car.

The owner of the cat filed a criminal complaint with police against the grocery store and restaurant. He also filed a lawsuit demanding $10,000 for the loss of a companion. Is either complaint valid?

Exceptions to Negligence Liability

Varies by national laws. Common exceptions:

- **Mental Incapacity.** A party that lacks capacity to understand prudent behavior.
- **Children.** Laws provide exceptions for certain ages with respect to prudent behavior.
- **Governments.** Laws may provide immunity to government agencies.

Absolute or Strict Liability

Occurs when an injured party receives damages without anyone being at fault.

- **Hazardous Activities.** When an activity is inherently dangerous, strict liability may be enforced.
- **Statutory Liability.** A law may impose strict liability, as often happens when employers are responsible for employee injuries.

Question

Sam Wong was walking down the street in Montreal when he was attacked by a Bengal tiger. He was severely injured and sued the owner.

In court, the owner testified that he would never have allowed the tiger to be in a position to attack anyone. Further, the owner proved the following:

- He was in Turkey at the time of the attack.
- He left the tiger in the care of a veterinarian and paid for the care.
- He warned the vet that the tiger was dangerous and had to be locked up.

Was the owner negligent?

Presentation

Session 11
Commercial
General Liability
Insurance

General Liability Policy

In the United States, a **commercial general liability (CGL) insurance policy** covers:

- **Damages.** Insures companies from losses from general liability exposures.
- **Duty to Defend.** Pays the costs of defending the company against liability claims and legal fees.

CGL Liability Damages

The CGL policy covers three categories of lawsuits:

- **Bodily Injury.** Individuals harmed by the organization. Includes sickness and disease.
- **Property Damage.** To tangible assets of other parties.
- **Personal or Advertising Injury.** Malicious prosecution, libel, slander, copyright violations.

CGL Insureds

Individual. The owner or operator.

Partners. Any or all of the named partners.

Corporation. The entity itself plus officers, directors, and employees.

Question

A CGL policy covers Joseph Detouro as an individual tax accountant.

- Joseph's wife Maria does not work in the accounting office.
- Anna is a receptionist in the office.
- Anna spills coffee on a client who sues Joseph, Maria, and Anna.

Are these individuals insured persons for purposes of the policy?

CGL Coverages (1)

The CGL policy covers lawsuits from:

- **Premises.** A person's physical presence on property owned or operated by the insured.
- **Operations.** Business activities on or off the premises.
- **Products.** Alleged harm from faulty products produced or sold by the insured.

CGL Coverages (2)

Contractual Liability. Allegations of breach of contract.

Completed Operations. Allegations that work done in past periods is faulty.

Contingent Liability. Allegations from a relationship with the insured.

Question

A realtor owns a building leased to a law firm.

- The law firm is responsible for maintaining the property in a safe condition.
- A client tripped on a loose carpet and fell down the stairs.
- He sued the realtor and law firm.
- Do the realtor's and lawyer's CGL policies cover the exposure?

Question

A maintenance employee is installing wiring on the premises of a customer.

- He falls off a ladder breaking his leg.
- He landed on a woman who required hospitalization for internal bleeding.
- She sued the customer and Cablevision.

Does the building's CGL policy cover damages from injury to the repairman and woman?

Question

Six travel agents are organized in a travel agency.

- They bought chairs for the office.
- A grandmother brought her granddaughter to the office to book a vacation.
- When the grandmother sat down, the chair broke and she was seriously injured.
- The family sued the agency.

Does the agency's CGL policy cover any damages?

CGL Coverage Forms

A CGL policy can be issued using two forms:

- **Occurrence**. A single event that causes a loss. Covers injury or damage that occurs during the policy period even if a claim is not made during the period.
- **Claims-made**. Covers claims made during the policy period regardless of when the injury occurred.

Occurrence Definition

Dealing with occurrence and claims-made forms can be tricky. The definition varies widely.

- **Time Period.** The term can refer to all losses in a fixed period, such as 72 hours.
- **Single Source.** An occurrence of loss can be defined as coming from a single event.
- **Silence.** Sometimes policies are silent on the definition.

World Trade Center

The World Trade Center lessee insured the twin towers for $3.6 billion, half of the replacement cost. On 9/11 no policy had yet been written. Two property forms were under consideration.

- **Form #1.** Occurrence as any loss from a single cause within a specified time period.
- **Form #2**. Occurrence not defined in this form.

Was the loss of the twin towers one or two occurrences?

Claims-made Policy

A problem can arise with the renewal of a claims-made policy.

- Suppose an insured had a bad loss when it had a claims-made policy. If the claim is not filed, it is not covered.
- Insurers may not be willing to cover it when the policy is renewed or replaced.

CGL Claims-made Time Periods

Three periods for claims-made CGL policy.

- **Basic Period**. Start and end time when a policy provides coverage for claims made.
- **Extended Period**. Up to 5 years after the basic period when claims may be filed for losses during the basic period.
- **Supplemental Period**. An unlimited period after the extended period converts claims-made into occurrence coverage.

Question

A visitor to a car dealership was hurt when the ceiling fell on him in September 2012.

- He left and sought treatment at a hospital.
- In April 2013 he filed a lawsuit.
- The dealer had a claims-made policy in 2012.
- It had an occurrence policy in 2013.

Which policy covers the loss?

Question

An equipment company had a CGL policy in 2013 from United Insurance and in 2014 from Northern Insurance. It sold a boiler on November 15, 2013. Six months later the boiler caught fire. The purchaser won damages of $80,000. Which policy covers the damage?

Policy Trigger

An insurance policy **trigger** is an event that activates insurance coverage. Different courts accept:

- **Injury in Fact.** Date when injury occurs.
- **Exposure.** When an injured person is exposed to the cause of the injury.
- **Manifestation.** When symptoms appear or the injury is diagnosed.
- **Injurious Process.** All of the three (**triple trigger**).

Premises Liability

Premises liability exposure varies with the category of individual who enters property:

- **Trespasser.** Without permission.
- **Licensee.** With permission but not for the benefit of the party who controls the property.
- **Invitee.** With permission and for the benefit of the inviter.
- **Child.** Lacks capacity to protect self from danger.

Status of Visitor

The degree of care varies with the status of visitor:

- **Trespasser.** Avoid actions that cause injury.
- **Licensee.** Warn the visitor of danger.
- **Invitee.** Make the premises safe for the visitor.
- **Child.** Separate the visitor from any danger.

Question (1)

A night watchman worked in a factory that had five burglaries in the past year. A clerk accidentally stumbled upon two burglars and was stabbed.

The watchman spent his own money to buy bear traps, which he set by the three back entrances to the factory. The entrances were locked at night.

An apparent burglar broke the lock on a back door, entered the building, and stepped into a trap.

Question (2)

The watchman called the police and emergency medical team. A medical technician accidentally stepped into a second trap.

A woman who was passing by was curious and walked into the factory. She stepped into the third trap. The burglar, medical technician, and passing woman each had serious leg damage, pain, and medical expenses.

All three parties sued the factory and watchman. Who is likely to win?

Question

A hospital rents clinic space in an office building. A man was sitting in the clinic waiting to see a doctor. A sign on the wall said "no pets allowed." A patient sitting next to the man had a raccoon on a leash. The raccoon bit the man on the arm.

The doctor treated the bite, assuring the man that the wound was clean and he would have no problems. Two weeks later, doctors amputated the man's swollen leg.

Question (2)

As he recovered from surgery, the man learned the raccoon had rabies. He underwent an expensive and painful series of shots.

The man sued the hospital and the doctor, alleging negligence for (1) allowing a raccoon in the clinic; and (2) failure to maintain the standards expected in medicine. He sued the hospital for unsafe premises.

Should the man win the suits?

Question

A politician told supporters that he was trying to avoid bankruptcy.

- He and his bank tried to work out the problem.
- A newspaper called the that confirmed the situation.
- The politician subsequently sued the bank. For violating his right to privacy.

Who will win the lawsuit?

Session 12
Professional and Medical Liability

321

Sources of Professional Liability

A profession is a unique form of liability for several reasons:

- **Defined knowledge and skills.** People know what to expect from professionals.
- **Formal training or education.** It qualifies an individual to perform at a high level.
- **Performance Expectation.** A failure to meet the expectation can produce a lawsuit.

Professional Liability Exposure

- **Expectation**. A client or patient engages the services of a professional to pursue a specific goal and agrees to pay for services.
- **Action**. The professional provides the services.
- **Failure**. The services are not provided to the satisfaction of the client.
- **Allegation**. The client sues for damages.

Professional Liability Insurance

Professional liability covers:

- **Medical Professionals.** Doctors, Nurses, Dentists, Hospitals.
- **Errors and Omissions.** Lawyers, Accountants, Financial Planners.
- **Directors and Officers.** Corporate officers and board members.

Medical Malpractice

- Medical malpractice is an act or omission by a health care provider that:
- Deviates from accepted standards of practice in the medical community.
- Causes injury to a patient.
- Is a form of professional negligence.

Medical Malpractice Coverage

Characteristics include:

- **Coverage.** Individuals, groups, and organizations.
- **Liability.** Covers accidental acts as well as deliberate events that are faulty.
- **Per Incident.** Coverage limit.
- **Aggregate.** Coverage limit.
- **Permission to Settle.** Not required.

Errors and Omissions

Characteristics are:

- **Form.** Claims made.
- **Deductible.** High.
- **Damage**. Does not cover tangible property losses, bodily injury, libel, or slander.
- **Exclusions.** Few. Include dishonest, fraudulent, criminal, and malicious acts.

Directors and Officers

Characteristics include:

- **Breach of Fiduciary Duty**. Failure to put the interests of organization above own interests.
- **Negligence**. Failure to make reasonable decisions or actions outside the assigned role or responsibilities.
- **Bad Faith**. Actions outside the scope of the authorized duties or with a conflict of interest.

Professional Liability Examples

The next slides show application in the area of medical malpractice.

Question

A nurse supervisor making her rounds discovered a patient dead in his room.

- A medication overdose was the cause of death.
- The medication was not available in the hospital pharmacy.
- The medical staff denied administering it.

The family of the patient sued the hospital for negligence. Who is likely to win?

Question

A 17-year old woman sought a cosmetic treatment from an oral surgeon.

- She signed a waiver acknowledging the risk.
- Surgery was performed properly but it caused permanent partial paralysis in her face.
- She filed a lawsuit alleging negligence.
- Is the lawsuit valid?

Question

- A patient received medical treatment and incurred no improvement or decline in his condition. Subsequently he learned the doctor:
  - Made the wrong diagnosis.
  - Failed to treat the ailment.
  - Prescribed the wrong drug.
- Which are examples of medical malpractice?

332
332

Question

- In spite of efforts to reduce medical losses, they occur. Do many people die each year while undergoing medical treatment or medication?

333

Data

- Estimates are
- **Cause of Death** **Annual Deaths**

Cause of Death	Annual Deaths
Unnecessary surgery:	2,000
Medication errors:	7,000
Hospital non-medication errors:	20,000
Infections in hospitals:	80,000
Adverse effects of medications	106,000
Total	**215,000**

334

Question

- The health care industry can purchase professional liability insurance. Who are the buyers of medical malpractice insurance?

335

335

Question

- Dentist Robert Woo used anesthesia to make a patient unconscious.
- He inserted fake boar tusks into her mouth and took pictures.
- She sued for damages.
- The medical malpractice insurer refused to defend him in the lawsuit.
- Woo sued the insurer.
- Should he win the lawsuit?

Presentation

Directors and Officers
Liability

Fiduciary Responsibility

This refers to a legal or moral obligation when one party relies on another in some matter

- Board members and officers of businesses and organizations are bound to fulfill a fiduciary responsibility.
- Any failure to fulfill fiduciary obligations is a lapse of ethics.
- For board members and officers it is also a source of legal liability.

Question

What are examples of wrongful acts that could be committed by the board of directors of an investment bank?

Reply

Examples are:

- Failure to buy more modern equipment.
- Ignore reports of neglect with investors.
- Allows excessive errors or omissions when traders follow directives.
- Making misleading statements to the press.
- Refusing to provide information to regulators.

Refusing to evaluate the CEO.

Business Judgment Rule

The business judgment rule:

- If directors acted in good faith, the directors will be deemed innocent of liability for damages.
- Applies to actions of boards of directors.
- Requires board members to act in good faith when making business decisions.
- Shields directors from negligence liability when a board makes a decision that subsequently proves to be faulty.

Three Areas of Director Liability

Shareholder Lawsuits. Class-action lawsuits where owners of common stock allege wrongdoing by the directors.

Third Party Claims. Related or unrelated third parties allege financial damage resulting from board action, inaction, or decisions.

Regulatory Violations. Charges of misbehavior by board members brought by government agencies.

Question

An investor owns 30% of the stock in a company.

- He filed a petition to expand the board.
- The move would force the CEO to retire.
- The board voted down the plan.
- The investor sued the board for a breach of fiduciary responsibility.
- Who should win the case?

Question

The CEO of Hancock Systems proposed to the board the acquisition of a data-management company. The board voted it down because the girlfriend of the CEO operated the company. The board then fired the CEO. The CEO and girlfriend sued. The board claimed it was shielded by the business judgment rule. The plaintiffs alleged that the personal issues caused the board to operate outside the scope of its fiduciary responsibilities. Is the board liable?

Question

A specialty gift distributor had a board composed of 14 members, six of whom owned delivery vans and other shipment services. The CEO proposed acquiring the transport services companies at a low price. If the owners would not sell, they would be removed from the board and cut off as shippers. The board voted 12 to two to reject the acquisition. Shareholders sued alleging the board had allowed a conflict of interest. Is the board liable?

Question

A furniture warehousing company leased two buildings in an industrial park near Detroit. An explosion destroyed a neighboring manufacturing plant. The investigation showed negligence on the part of the company that managed the park. The board voted to abandon the factory and stop payments for the remaining period of the 7-year lease. The park owners filed a lawsuit seeking personal damages from board members. Is it likely that the suit will be successful?

Question (1)

Total Compliance Co. (TCC) sells systems software and applications.

- The company purchased an application from a Malaysian company.
- Larson Systems alleged infringement on its patent by the Malaysian company.
- Larson asked TCC to cease sales.

Question (2)

The board voted to reject the Larson request and authorized continuing sales.

Larson sued for personal damages from board members.

Is the lawsuit likely to be successful?

Criminal Liability

Board members are facing increasing risks of personal criminal liability as a result of company actions.

- Under *mensa re*, a person may not be imprisoned if he did not intend to commit a criminal act.
- This doctrine is being eroded by unconscionable corporate actions that prosecutors believe should have been stopped by the board of directors.

Question

Swanson Industries was cited by the Department of Environment (DofE) for failure to dispose properly of toxic waste. The CEO continued the violations, explaining to the board that the fines were less costly than remedial measures. After two years, the DofE sued Swanson for the full cleanup costs, forcing the company into bankruptcy. The DofE then sued the directors individually. Is it likely that the DofE will win the lawsuit?

Deepening Insolvency

The doctrine of deepening insolvency refers to a situation where a board keeps a company alive after it no longer has realistic prospects to recover from financial loss. The erosion of assets causes creditors to lose money they would have received if the company had been dissolved and the assets sold. Creditors or shareholders may file a lawsuit alleging misrepresentation or gross negligence that caused them harm.

Question (1)

An airline experienced operating losses for 11 straight years.

- In year 3, it sold its food-catering subsidiary.
- In year 5, it sold its cargo services unit.
- In year 7, it sold half of its gates at six airports.
- In year 9, it sold its maintenance hangers and leased them back for 20 years.

Question (2)

The airline used all the funds from the sale of the various units to cover operating deficits.

- In year 11, the airline filed bankruptcy. Shareholders received nothing and then filed a class action suit alleging gross negligence.
- Is it likely that the shareholders will win the lawsuit?

D&O Liability Insurance

Companies, other organizations, officers of a corporation, and members of the board of directors can purchase liability insurance to indemnify them for legal liability losses and legal costs when officers or directors are sued.

Corporate Indemnification (1)

Corporate indemnification refers to arrangements where organizations indemnify (protect against financial loss) directors and officers who make business decisions for the organization.

Corporate Indemnification (2)

Companies can indemnify directors for:

Defense Costs. Expenses of lawyers, discovery proceedings, and other defense costs.

Settlements. Funds paid to settle without the formal decision of a court.

Judgment. Damages paid when a court, arbitrator, or regulatory body awards money to a plaintiff to end a lawsuit.

Indemnification

Mandatory Indemnification. Laws require a company to cover judgments, settlements, defense costs, and other legal obligations that arise from directors and officers performing their official duties for the company

Permissive Indemnification. A company voluntarily agrees to cover defense costs, settlements, or judgments.

D&O Insurance

A D&O policy provides liability coverage:

Official Capacity. Covers allegations of misbehavior taken as an officer or director of an organization.

Wrongful Act. Coverage is triggered by a claim of an improper behavior by the board.

Scope. The policy will provide indemnity for damages, settlements, and legal expenses.

Structure. The policy may contain deductibles, limits, and restrictions.

Primary and Secondary Indemnification

The organization is the primary source of indemnification for officers and directors. This is true even when D&O insurance has been purchased. In most cases, the entity will be able to indemnify directors. The D&O policy reimburses the company and protects its earnings. In some cases, the company may not have sufficient funds to indemnify losses. The D&O insurance becomes a secondary protection.

D&O Insuring Agreement Indemnity

Three indemnities:

- **Coverage A**. Protection where the company will not provide indemnification.
- **Coverage B**. Reimburses the organization after it indemnifies an individual.
- **Coverage C**. Reimburses the organization itself if it is deemed liable for damages. It also covers the legal or settlement costs for the company.
-

Side A-only Coverage

The insured will be reimbursed directly if the company or its insurer fails to provide coverage. To be effective Side A-only should have:

- **Follow Form**. The same coverage as the company's indemnification agreement.
- **Drop Down**. It should become primary insurance when the primary carrier cancels or rescinds coverage.

Defense Costs in the Policy

Two approaches to cover legal costs in D&O policies:

Defense within Limits. Limit reflects both defense costs and damages. This is common with D&O policies.

Defense Outside Limits. Limit applies only to damages. The insurer will pay all legal costs separately. This is common with most general liability policies.

Defense Cost Issues

Full or Limited Indemnification. Does the policy cover full defense costs?

Defense Allocation Provisions. Does the policy specify defense costs limited to a fixed percentage of the policy limit?

Timing. When does the carrier have to advance funds for the payment of defense costs?

Conduct. What happens if the insurer believes the the party was engaged in a crime or fraud?

Defense of Claims

Choices of the party that controls claims.

- **Insured**. With some policies, the insured controls the settling of or defending against claims.
- **Insurer**. With some policies, the insurer controls the handling and settling of claims. The insurer pays legal fees, investigation costs, and other defense costs directly on behalf of the company or individuals.

D&O Exclusions

D&O policies routinely contain exclusions including losses arising from a variety of sources. These include profits or advantages to which an insured is not entitled to gain, legal fines or regulatory penalties, or costs arising when a court has determined that the insured engaged in criminal or fraudulent acts. Other exclusions are damages resulting from service on other boards, claims by one insured against another, and losses arising from the public offering of securities.

D&O Coverage Forms

As with other liability policies, D&O policies may be written using two coverage forms:

Claims Made. This policy applies to claims that are made and reported to the insurer during the period of the policy. Most D&O policies use this form.

Occurrence. This policy applies to claims that arise from alleged wrongful acts (occurrences) that happened during the policy period.

Aggregate Limit of Liability

Most commonly the corporation has the obligation to indemnify directors and officers for defense costs and damages without limit. This is not the case with a D&O policy. It will have an aggregate limit of liability defined as the maximum that will be paid for all claims during the policy period. When losses and damages exceed the limit, the company is liable for indemnification of directors or the side A-only coverage is activated.

Severability

This legal term refers to a provision in a contract with two purposes:

- **Essential Clauses.** For some clauses that are critical to the agreement, voiding the clause voids the contract.
- **Non-essential Clauses**. For less critical clauses, voiding them does not void the remainder of the contract.

Rescission

This legal term is defined as the unmaking of a contract between parties. It is a voiding of the contract that brings the parties, as far as possible, back to the position in which they were before they entered into a contract.

Question

A D&O policy has a provision that voids the contract if any of the directors or officers commits fraud resulting in a lawsuit. What is the issue of severability or rescission in such a situation?

Question

Brandon Industries has been served a lawsuit where defense costs and damages are covered by a D&O policy. The Brandon directors lost $125,000 in salary when they took unpaid leave from their own companies in order to attend the trial. The directors also denied themselves Brandon's customary $200,000 year-end "Holiday gift" for board members. Is the loss of salary and bonus covered under the D&O policy?

Presentation

Lehman Repo Fraud

Balance Sheet

Assets		Debt & Capital	
Cash	300B	Debt	400B
Securities	500B	Capital	450B
Toxic Assets	50B		
Total	**850B**	**Total**	**850B**

Repurchase Agreement

Sell $50B of toxic assets

Buy back one week later.

Fee: $1B.

Balance Sheet at Closing

Assets		**Debt & Capital**	
Cash	350B	Debt	400B
Securities	500B	Capital	450B
Toxic Assets	0		
Total	**850B**	**Total**	**850B**

Balance Sheet after One Week

Assets		**Debt & Capital**	
Cash	299B	Debt	400B
Securities	500B	Capital	449B
Toxic Assets	50B		
Total	**849B**	**Total**	**849B**

Presentation

Session 13
Specialty Lines

Boiler and Machinery Coverage

Two basic coverages:

- **Insured's Property**. The insurance reimburses costs of replacing destroyed property and repairing damaged machinery.
- **Third-party Property**. Insurance reimburses the insured for liability exposures when a loss to covered property damages or destroys the property of other parties.

Question

A company rents space in an office building.

- The area contains a large computer, file server, and auxiliary devices.
- The building owner asked the company to purchase B&M insurance on the equipment.
- The company claims the equipment is protected under a building and premises policy.
- The building owner says no.
- Who is right?

Question

Titan Fabrication has B&M coverage in an industrial park shared with other tenants.

- An explosion in a Titan pneumatic injection machine destroyed a neighboring company's compressor.
- Does the policy cover?
  - Compressor Repair. $ 9,000.
  - Food Spoilage: $ 6,000.
  - Lost Income: $22,000.

Business Interruption

Negative effects:

- **Lost Profits**. A decline in sales or revenues with a resulting loss of profits.
- **Fixed Costs**. Expenses that cannot be reduced in the short term when operations shut down after a loss.
- **Extra Expenses**. Costs to allow an operation to continue with temporary systems while assets and systems are being repaired.
-

Question

A company wants business interruption insurance for the Olympics.

- The number of earning days is 12.
- The expected profit is $600,000 a day.

The insurer offered two policy choices:

- Payment of $450,000 a day.
- Payment of actual calculated loss each day.

Which approach would be better for the company?

Business Interruption Insurance

Considerations are:

Valued Form. Insurer agrees to pay a stated amount for each day that an operation is shut down. No actual loss must be documented.

Actual Loss. An insured must show a calculation of lost income and extra expense. This effort can require extensive documentation.

Inland Marine Insurance

Inland marine insurance indemnifies loss to moving or movable property when it is moving on land.

- "Marine" is historical.
- Inland marine covers railroads and trucks.
- It applies mostly to land shipments and transport.

Floater

A common name for an inland marine policy.

- **Transit Property.** Any asset in the process of moving from one location to another.
- **Bailee Property.** Reimburses the owner of property for damage or loss during transport by another party (bailee).
- **Movable Property.** Assets that can be found at different locations at different times.
- **Transport Property.** Assets used to move other assets.

Breadth of Inland Marine (1)

Accounts Receivable. Sales not collectible.

Bailee Customer's Goods. Insured destroyed goods in transit owned by another party.

Builders' Risk. Loss of materials, fixtures and equipment on a site.

Camera and Photographic Equipment. Used by professional photographers.

Exhibitions. Events and trade shows.

Breadth of Inland Marine (2)

Fine Arts. Paintings, sculptures, and antiques.

Jewelers. Owned stocks and property of others in custody of the jeweler.

Museums. Objects owned and held with the permission of their owners.

Scheduled Property. Property list by name and value.

Trip Transit. Loss or damage on a single shipment of property.

Question

A company has a trip transit property policy.

- It was taken out last year.
- An employee regularly takes to a sales conference a laptop computer, computer plug and play projection unit, and portable screen.
- At the hotel, the equipment was lost in a fire.
- Is the equipment covered by the insurance policy?

Question

A limousine company has full property coverage on all its vehicles.

- A vehicle transported guests to a wedding at a hotel.
- The driver used valet parking while he waited in the hotel.
- The car was damaged when a reckless attendant lost control while parking it.
- Does the company’s insurance cover the loss?

Ocean Marine Insurance.

Hull and Offshore Property. The vessel itself and other structures at sea such as container terminals, ports, oil platforms, and pipelines.

Protection and Indemnity (P&I). Liability losses for claims against the owners or operators of vessels or offshore facilities.

Cargo. When a ship is actually sailing in oceanic waters, not when loading or discharging.

Question

Jonathan Grubbs worked as an engineer on a tugboat.

- The company had a P&I policy to pay the medical bills of injured employees.
- Grubbs' tug was towing two barges in rough seas in Galveston Bay, Texas.
- Grubb's was injured in a storm.
- Did the insurer have to pay his medical expenses?

Question

A ship owner has cargo insurance for the full value of transported goods.

- During a storm, the captain intentionally ordered two trucks to be pushed overboard to lighten the vessel for safety reasons.
- Are the trucks covered by the cargo insurance policy?

Earth Movement Insurance

Natural Causes. Nature can produce movements of earth that are catastrophic to people and property. These sources of loss obviously include earthquake, tsunamis, and landslides.

Man-made Causes. The activities of individuals and organizations can also cause damaging shifts in the earth. Examples include any activity involving machinery at construction sites and cave-ins in mining operations.

Question

An insurance policy insures a port warehouse against earth movement.

- An earthquake does not damage the structure.
- The earthquake does start a fire that destroys the warehouse roof.
- Then, a tidal wave puts out the fire but damages the building's foundation.
- Is the roof damage covered?
- Is the foundation damage covered?

Fine Arts Insurance (1)

Individuals Only. Works not covered if owned by dealers or auction firms.

All-risk Coverage. Exclusions include wear and tear, breakage, war, and nuclear.

Agreed Upon Value. It will not replace with like kind and quality nor reimburse restoring or repairing the item.

Fine Arts Insurance (2)

Scheduled Property. Each item can be specifically listed.

Unscheduled Property. Policy can be written for a collection.

Location. Coverage applies at the insured location and in transit.

Additional Coverage. Purchased separately or added as a endorsement on a property insurance policy.

Question

An insurance policy covers fine art for the insured.

- A truck was carrying three collection pieces.
- They were a Picasso painting, a diamond crown worn by Louis XIV, and a 1910 Mercedes classic car.
- The truck is hijacked and the articles are lost.
- Will the policy replace the items?

Crime Insurance

An organization can purchase insurance to cover losses from wrongdoings by employees, criminals, and others. Such coverage has expanded rapidly as the world and conduct of business become more complex and as technology facilitates new transactions and activities.

Employee Dishonesty

This coverage reimburses losses when dishonest employees misbehave in the workplace.

Named Individual. Reimburses loss caused by a single person identified by name.

Position Coverage. Covers anyone who holds a position identified in the organization.

Blanket Coverage. Covers specified wrongdoing by all employees in a named unit.

Question (1)

Martin Elliott was hired as CFO.

- An employee dishonesty insurance policy was transferred from his previous employer.
- It covered theft, fraud, or embezzlement up to $1 million.

Question (2)

Martin died while the policy was still in effect.

His assistant was named acting CFO.

The assistant forged three wire transfers to an offshore bank and then flew to Brazil.

The company suffered a loss of $1.6 million.

Does the policy cover the loss?

Theft, Disappearance, and Destruction

Theft. Covers stealing the goods or property of an insured.

Burglary. Covers breaking and entering and stealing property.

Disappearance: Covers the vanishing of insured property in an unexplained manner.

Question

An employee was angry with his boss.

- The employee knew the company kept cash in a locked box in a locked desk.
- He returned to the office after hours and stole the box which contained $26,000.
- The company has theft, disappearance, and destruction insurance.
- Does the policy cover the loss?

Robbery and Safe Burglary Insurance

This covers property other than money, securities, and motor vehicles taken by forcible means.

- The coverage includes taking property from the premises of the insured.
- It also includes assets taken from an employee or messenger .
- It includes property taken from a locked safe.

Riot and Civil Commotion Insurance

Riot. This is defined by most state laws as a violent disturbance involving three or more persons.

Civil Commotion. This is a more serious and prolonged disturbance or violent uprising.

Kidnap and Ransom (K&R)

Coverage. Employees who travel on company business or work permanently outside the United States.

Geographic Locations. Operating in high-risk areas around the world.

Perils Covered. Kidnap, extortion, wrongful detention, and hijacking.

Question

A company has kidnap and ransom insurance on "key employees traveling in North America, Europe, and Asia."

- An executive vice president and junior accountant were kidnapped in Indonesia.
- The wife of the accountant said on television, "We are fortunate that the company has ransom insurance. I hope my husband will be home soon."

Does the policy cover the ransom?

Session 14
Facultative and Treaty Reinsurance

Reinsurance Parties

Reinsurance is purchased to spread an insurer's own risk. The parties are:

Primary Insurer. Issues an insurance policy and pays claims that arise from it.

Ceding Insurer. Primary insurer when it transfers (cedes) a portion of the risk to a reinsurer.

Reinsurer. Insurance company that accepts risk under a policy written by a ceding insurer.

Reinsurance Purpose

Increase Capacity. More coverage than allowed based on its financial strength.

Stabilize Profits. Reduce chance of a single large loss.

Higher Limits. Accept risks that exceed its capacity to pay the claim.

Specialized Coverage. Reinsurers have a broad perspective on risk.

Question

One goal of reinsurance is to increase underwriting capacity. How does reinsurance do this?

Question

Another goal of reinsurance is to stabilize profits. How does reinsurance do this?

Question

Another goal of reinsurance is to allow higher limits on individual policies. How does reinsurance do this?

Reinsurance Mechanism

Ceding company and reinsurer enter into a reinsurance agreement:

- Contains the conditions that must arise before the reinsurer would pay a share of the claims.
- Ceding company pays the reinsurer a "reinsurance premium" that is less than the premiums collected by the primary insurer.
- Two companies share the economic consequences of an unexpected loss.

Reinsurance Language

Cession. This the amount of insurance that is transferred, or in the language of reinsurance, it is the amount that is ceded.

Ceding Company. This is the primary insurer that issues the policy and accepts the risk of claims against it.

Reinsurer. This is the party that accepts the cession from the primary carrier.

Retrocession. This is the amount of insurance that the reinsurer cedes to another reinsurer.

Question

Union Insurance, Western Insurance, Northern Insurance, and Asian Insurance are engaged together with a $45 million limit insurance policy. Union writes the policy and sends $25 million to Western Insurance and $10 million to Northern Insurance. Western Insurance sends $15 million to Asian Insurance. Name the primary, ceding, and reinsuring parties to this agreement.

Reinsurance Fronting

Issues a policy to be substantially reinsured.

Restrictive Local Laws. Many countries require the purchase of insurance from locally licensed carriers.

Low Rates. Insurer outside a local market may offer lower premiums.

Better Terms or Service. A reinsurer may be a specialist or be more flexible.

Hard-to-place Risks. For some exposures, only highly-skilled underwriters will write the risk.

Question

A company operates in a country where all property insurance must be purchased locally.

- A local insurer agreed to provide $30 million in coverage
- Reinsurance would cover 80% of any loss.
- The CFO proposed buying only 10% locally and secretly buying the balance outside the country.
- Is this is a good strategy?

Question

With reinsurance, what should be the most important consideration when a primary insurer is selecting a reinsurer?

Categories of Reinsurance

Facultative. In this market, the primary insurer seeks reinsurance on a case by case basis when an application requests a high limit of coverage.

Treaty. The primary insurer writes a policy and then cedes a portion of all policies to a reinsurer under a contract written in advance.

Facultative Reinsurance

Large Single Risk. Coverage for large risks that can be Identified separately.

Unusual Exposure. Primary insurers want another look at factors affecting underwriting.

Individual Underwriting. Reinsurance underwriter really knows the exposure.

Individual Ratemaking. Premium is calculated directly to fit unique aspects of the exposure.

Question

A reinsurer has to take care so it does not accept more risk than it can handle in a facultative reinsurance agreement. How can a reinsurer protect against catastrophic exposure?

Treaty Reinsurance (1)

Broad Coverage. The agreement states a category of risks rather than a single asset.

Exclusions. Identifies assets, perils, time periods, locations, and other exclusions.

Shared Premiums and Losses. Rights and responsibilities of the two parties.

No Advance Approval by Reinsurer. Applies to all primary insurance policies that fit the description of the agreement.

Treaty Reinsurance (2)

Maximum Liability per Treaty. Spells out maximum exposure for the reinsurer for all losses under the agreement.

Minimum Retention by Primary Insurer. Provides for a substantial retention of risk by the primary insurer.

Question

A reinsurer has to take care so it does not accept more risk than it can handle in a treaty reinsurance agreement. How can a reinsurer protect against its own catastrophic exposure?

Question

A primary insurer asked a reinsurer to accept a treaty where the primary insurer accepted five percent of a loss and the reinsurer would cover 95 percent. The reinsurer could then reinsure its portion with another reinsurer. Should the reinsurer agree to the treaty? Why or why not?

Question

Identify each of the following as suitable for facultative or treaty reinsurance.

- $20 million death benefit life insurance policy.
- $100,000 personal liability coverage for 15,000 lawyers.
- Losses in the Philippines resulting from insurgency.
- Liability coverage from meltdown of nuclear power plant.

Pro Rata Treaty

The primary insurer and reinsurer share premiums and losses according to a formula.

- **Quota Share**. Uses a formula. Example: Primary insurer retains 60%. reinsurer accepts 40%.
- **Surplus Share**. Each party's portion is expressed as a multiple of "lines." A **line** is the amount of retention by the primary insurer. This is explained shortly.

Quota Share Treaty

Fixed Percentages. The formula for sharing premiums and losses.

Variable Dollar Commitment. The amount of premiums and payments for losses vary with the size of each policy.

Reinsurer Stated Limit. Most treaties specify a maximum that will be paid by reinsurer.

Ceding Commission. The reinsurer pays a fee called a ceding commission to the primary insurer.

Surplus Share Treaty

Primary Line. The treaty identifies the “line” as the full retention for the primary insurer.

Upper Limit in “Lines.” The reinsurer has an exposure expressed in terms of the number of “lines.” A 4-line reinsurance agreement has a primary insurer retention of one line and has three lines ceded to the reinsurer.

Ceding Commission. A fee paid by the reinsurer to cover primary insurer marketing and administrative costs.

Excess of Loss Insurance

Excess insurance exceeds a specified amount in a primary insurance policy.

- Triggered only when the underlying insurance policy limit has been exceeded.
- An attachment point is the lower limit of excess insurance coverage.
- It may be expressed as a dollar amount or in terms of financial ratio.
- This is often called excess of loss reinsurance.

Characteristics of Excess

Excess per Risk. In this case, the attachment point occurs in an individual policy.

Excess per Occurrence. This insurance attached for each separate event as defined in the policy.

Aggregate Excess. This applies to the total of all losses covered by an agreement. It is also called stop loss insurance.

Stop Loss Characteristics

No Cession to Reinsurer. The excess loss carrier simply agrees to indemnify another carrier if losses meet the attachment point.

No Pro Rata Retention. No sharing takes place. Excess begins at the attachment point..

No Pro Rata Sharing of Premium. The underlying carrier is charged a negotiated premium.

No Ceding Commission. A commission is not needed because the premium is negotiated.

Question

An excess of loss treaty covers all liability losses at an Olympics. The attachment point is $5 million and treaty limit is $15 million. Three injured spectators filed lawsuits producing losses as shown. What is the insurer and reinsurer share of each loss?

Loss #1	$4 million
Loss #2	$6 million
Loss #3	$8 million

Reply

It is excess per risk. The share of loss:

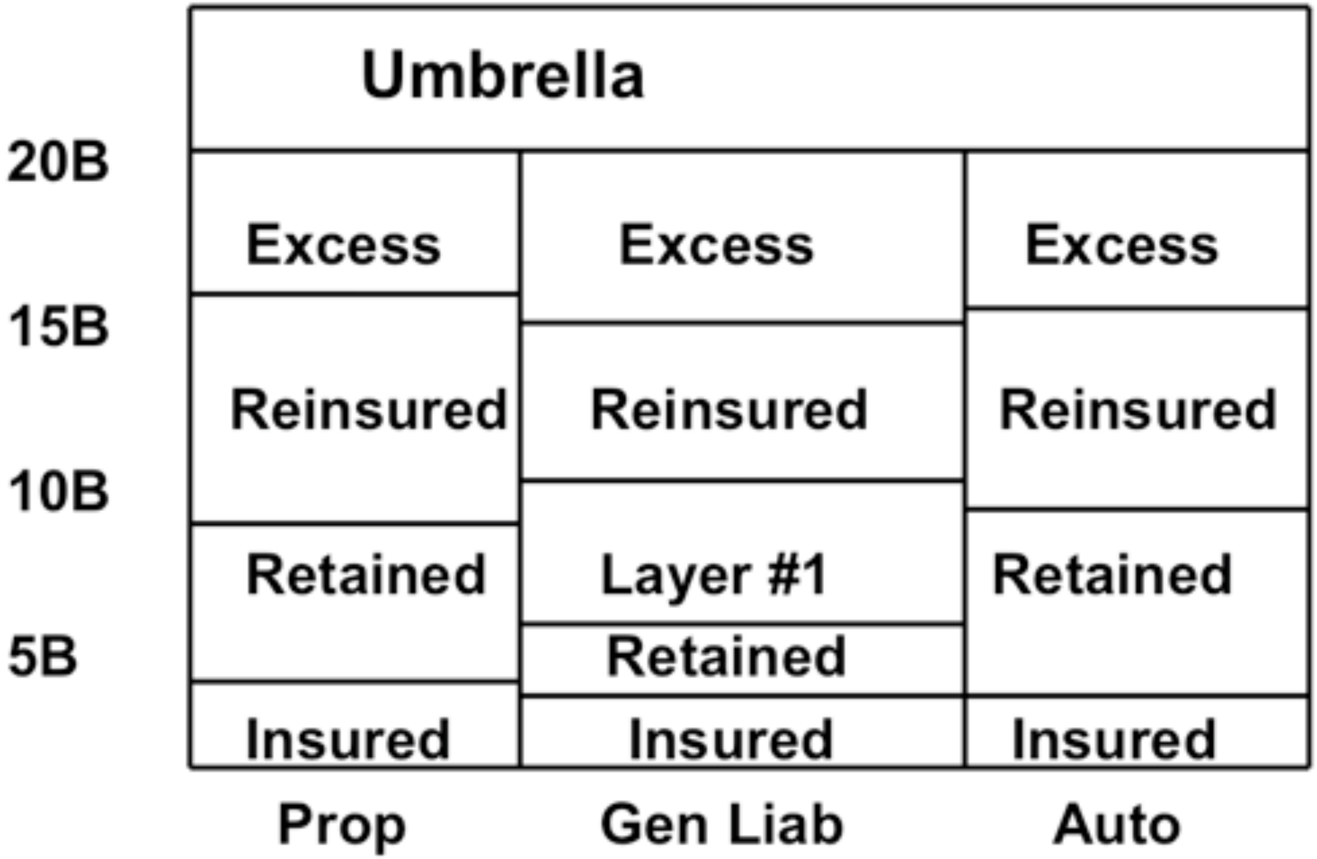
• Total Loss at Event	$18 million
• Attachment Point	$5 million
• Treaty Limit	$15 million
• Insurer Share	$8 million (1)
• Reinsurer Share	$10 million

(1) $5 million retention plus $3 million above limit.

Umbrella Insurance

Umbrella insurance is the highest layer of coverage. We noted that commercial umbrella insurance usually does not have an upper limit. It does not contain exclusions that found in lower layers. It can drop down to fill gaps in coverage in lower layers.

Insurer Layering



Presentation

Insurance Securitization

Role of the Capital Markets

Financial Market	Amount of Capital
Global insurance companies	$600 billion
U.S. property values	$30 trillion
Global capital markets	$50 trillion
Derivative markets	$550 trillion

Solution

Bring in the capital markets. (2008)

- U.S. Property Values $30 trillion
- Global capital markets $50 trillion
- How to do it?
  - **Create Derivatives.** A security whose value derives from another asset.
  - **Sell Derivatives.** Capital markets can purchase securities and share in the profits and risks.

Catastrophe Bond Explained

Insurer fears a $300 million loss if a hurricane damages covered property.

- **Insurer.** Creates 2-year Cat bond paying 15% interest. Sells it to investment banker. Invests cash received in secure assets.
- **Investors.** Purchases slices. Collect interest during 2 years principal at maturity.
- **Contingency.** Hurricane causes $175 million. Investors get back $125 million.

Actual Loss on Cat Bond

For a hurricane catastrophe bond, a mild season can offer a return on investment of 20 to 30 percent. In the 2005 season, the Olympus Reinsurance cat bond lost its entire $650 million in capital as a result of a heavy hurricane season.

Insurance Securitization

Transfers underwriting risks to capital markets

- **Tradable Security.** Create a security and sell it in smaller tranches to investors.
- **Contingency.** Investors agree to waive principal repayment if a contingent loss occurs.
- **Interest Rate.** Pay above market rates of interest to holders of the security.
- **Principal Repayment.** Return it to investors, either periodically or at maturity.

Insurance Securitization Terms

Terms to describe insurance securitization:

- **Alternative Risk Transfer.** A broad term that includes traditional insurance and insurance securitization components.
- **Catastrophe Bond.** Issued to transfer massive loss from smaller insurance markets ($billions) to larger capital markets ($trillions).
- **Reinsurance Sidecar.** An agreement similar to a catastrophe bond in a reinsurance structure.

Future of Insurance Securitization

- **Derivatives.** They will continue to be used. Investors will seek profits while protecting insurers against their own catastrophic loss.
- **Insurance.** A derivative can actually be a form of insurance. It can provide money to pay insurable losses if they occur.
- **Trouble.** An insurer is not likely to get into trouble with insurance securities if they are designed properly and issued.

Presentation

Session 15

Homeowners and Automobile

Question

In addition to the named insured, are any of the following also an insured under a homeowners policy?

- Spouse of the person named.
- Relatives of the person named.
- Children in the care of the person named.
- Other residents of the property.

Question

Homeowners policies identify the residence premises. What is the meaning of the term?

HO-3 Homeowners Policy

HO-3 is the most common homeowners policy in the U.S. Characteristics:

- **Package Policy.** It covers property and liability exposures.
- **All Risk.** It does not spell out the specific risks that are covered. This is also called an "open perils" or "all risks" policy.
- **Exclusions.** Some risks are not covered.
- **Limits of Liability.** Some risks are covered up to specific limits.

Residence Premises Coverage

Two HO-3 coverages for the residence premises are:

- **Coverage A. Dwelling**. A house or similar structure used for human habitation, generally having walls and a roof to shelter its enclosed space from precipitation, wind, heat, and cold.
- **Coverage B. Other Structures**. Buildings on the residence premises such as a garage or shed.

Question

Do you think coverages A or B cover the following?

- Backyard swimming pool.
- Screened cage around the swimming pool.
- Attached garage.
- Unattached workshop.
- Shutters on the dwelling.
- Mailbox.
- Land or landscaping (bushes, trees).
- Fences.

Question

A homeowner has an HO-3 policy that covers property with a house and a barn. The homeowner rents the barn to a neighbor who charges others to board horses. Four neighbors are paying for boarding at a time when a fire destroys the barn and horses. Is the loss covered under the HO-3 policy?

Question

An individual has an HO-3 policy with a $200,000 limit of coverage. A windstorm causes $40,000 of damage to the home and $30,000 damage to an unattached garage and apartment. The HO-3 policy places a limit on how much will be reimbursed for a single loss. In this case, how much do you think is reasonable as a reimbursement for the loss?

Personal Property and Loss of Use

HO-3 covers two other losses linked to the residence premises.

- **Coverage C. Personal Property**. Damage to items such as clothing and furniture.
- **Coverage D**. **Loss of Use.** Additional living expenses when a covered loss forces an individual or family to move temporarily from their home temporarily as a result of a covered loss.

Question

Do you think the HO-3 policy places a limit on the coverage for personal property or loss of use? If yes, what do you think is a reasonable limit for each?

Question

A fire damaged a covered premise with a $200,000 policy limit. The insured had serious problems with the contractor who did the reconstruction work on the house. He paid $65,000 to live in a Ritz-Carlton hotel and eat out in fancy restaurants while waiting for the house to be repaired. He also lost $3,000 in rental income from a tenant in the attic. Are these losses likely to be covered by HO-3?

Question

Do you think HO-3 covers the following?

- Personal property off the premises.
- Clothing and furniture.
- Cash and securities.
- Watercraft and trailers.
- Jewelry.
- Silverware.
- Firearms.

Question

Do you think HO-3 covers business property stored:

- On the premises.
- Off the premises.

HO-3 Liability Coverage

HO-3 is a **package policy** which means that it covers both property and liability losses. Two coverages are:

- **Coverage E. Personal Liability.** Provides liability coverage if a claim is made or suit is brought against an insured because of bodily injury or property damage.
- **Coverage F. Medical Payments.** Pays medical expenses for bodily injury of others.

Question

Which of the following do you think should be covered under HO-3 Coverage E Personal Liability?

- **On the Premises.** Lawsuit judgments for negligence by any insured.
- **Off the Premises.** Lawsuit judgments for negligence by any insured.
- **Defense Costs.** Legal fees to defend a lawsuit.

Question

HO-3 Coverage E Personal Liability has a limit of $100,000 per occurrence, which may be increased for an additional premium. Do you think the coverage should include?

- Expenses incurred providing first aid to injured parties.
- Damage to property of person who files lawsuit.

Question

Under its liability coverage provisions, is HO-3 likely to cover lawyers fees when the insured is sued by a third party if the insured is at fault for the loss.

Question

Coverage F Medical Payments offers **medical payment** coverage that reimburses a policyholder for physical harm to individuals. Is it likely to cover:

- **Guest on Property.** When a visitor is accidentally injured on the premises.
- **Injury Off the Premises.** When someone is injured by the insured or a family member.
- **Family Member.** When a family member is injured on the property.

Additional Coverages

The coverage under a basic insurance policy can be modified or customized two ways:

- **Endorsement.** This is a written provision that modifies an insurance policy. It is also called a **rider.**
- **Supplemental Policy.** This is a second policy that expands the coverage under an insurance policy.

Scheduled Personal Property

This is an endorsement to HO-3 to cover direct loss of valuable items. Scheduled property can be insured for any amount the insured desires up the value of an item.

Question

What are some examples of scheduled property items?

Question

Are earthquake and flood covered in a homeowners policy?

Question

What is the best way to buy homeowners insurance?

Other U.S. Insurance

In addition to HO-3, U.S. insurers sell:

- **HO-1.** Covers specific named items.
- **HO-2.** Named perils for dwelling, other structures, and personal property.
- **HO-4.** Contents of dwelling only.
- **HO-5.** All risk for dwelling et al, with named exclusions.
- **HO-6.** Condominium and coops.
- **HO-8.** Designed for older homes.

Question

A burglar broke into an apartment rented by a young couple and stole a big-screen television, diamond ring, video camera, and $2,000 in cash hidden in a desk drawer. The couple sued the landlord but lost the case. Could they have purchased insurance to cover the loss?

Question

An individual buys a condominium in a large building. The homeowner's association purchased a blanket insurance for the entire building. Does it cover each individual condominium?

Question

An individual has an expensive peacock that was stuffed by a taxidermist. It sits in the living room of her home. It was damaged by a small child who painted it a dark blue. Is the damage covered by her HO-3 policy?

Question

A named perils policy covers weight of objects that cause the collapse to a dwelling. During a freak arctic storm, 28 inches of snow was dumped on a covered roof. The property owner takes no steps to remove the snow. Four days later, the roof collapsed. Is the loss covered?

Question

A policy covers fire, lightning, windstorm, hail, explosion, riot, civil commotion, aircraft, vehicles, smoke, vandalism, malicious mischief, theft, falling objects, weight of ice, snow, or sleet, some equipment failures that cause damage, and volcanic eruption. The house has a large southern exposure with four glass sliding doors, 2 French doors, and 4 plate glass windows. Is this a good policy for this house? Why or why not?

Question

A policy covers all perils except losses from freezing in unheated homes, theft during construction, mold, fungus, or rot, rust, discharge or seepage, pollutants, settling, shrinking or bulging, insects, rodents, or pets. A hurricane damaged furniture in the living room, a garden tractor on the lawn, a computer on the floor in the basement, and a storage shed in the yard. Mud and tree branches covered most of the property. Are these losses likely to be covered?

Liability Coverages

Homeowners policies can cover:

- **Personal Liability.** ($300,000 limit?) Pays:
  - **Damages**. When others allege bodily injury or property damage.
  - **Legal Fees**. Above limit of the policy.
- **Medical Payments.** Pays:
  - **At Insured Location.** Whether caused by insured or not.
  - **Elsewhere.** Injury caused by insured.
  - **Animal.** Injury caused by animal owned or in care of insured.

Liability Exclusions

Homeowners policies do not cover:

- **Business Pursuits.** Except an occasional activity such as a garage sale or Tupperware party.
- **Motor Vehicles.** Separate policy needed.
- **Watercraft and Aircraft.** Separate policy needed.
- **Nuclear Activity or War.**

Question

An insured's dog chased a deer across the yard and through a sliding glass door. Inside, the deer destroyed a TV and damaged equipment in an office used for designing software for clients. The deer raced onto a neighbor's property where it stepped on a small child. The dog was cut by the glass and bled on the couch. The owner had losses from broken glass, ruined couch, TV, software equipment and vet expenses for the dog. He was sued by the parent of the child. Are any of these losses covered by homeowners insurance?

Amount of the Loss

A policy will spell out the amount of the loss, either:

- **Replacement Cost.** The amount needed to construct a new and similar house on the site of the destroyed house.
- **Actual Cash Value.** Replacement cost minus depreciation on the damaged portion.

The recommended approach is replacement cost. We will not cover actual cash value.

Underinsurance

Underinsurance occurs when the policy limit is below 100% of replacement cost. Effects are:

- **Total Loss.** Failure to provide enough money to replace the dwelling.
- **Partial Loss.** Most losses are partial. An important caveat is that an insured must maintain a policy limit of at least 80% of the replacement cost. If this is done, the insurer will pay 100% of partial losses up to the limit of the policy.

Partial Loss Below 80 Percent

With a replacement cost policy and a policy limit **below 80%** of replacement cost, a partial loss is paid using the formula:

- ***Have/Should x Loss.*** A formula that multiplies the policy limit divided by 80% of the policy limit times the replacement cost.

Partial Loss Formula

Use the following formula for partial losses

Have/Should $\$$_______/$\$$_________ = _____%

Reimbursement $\$$_________ x _____% = $\$$_____

Question

A dwelling has a replacement cost of $500,000. It is insured by a replacement cost policy with a limit of $300,000 and a $10,000 deductible. A fire causes $50,000 in damage to part of the house. The have/should formula at 80% applies. How much will be reimbursed by the policy?

Have/Should $________/$_______ = ____%

Reimbursement $_______ x ____% = $____

Answer

Have/Should	$300,000/400,000	=	75%
Reimbursement	$50,000x75%	=	$37,500
Less Deductible			-10,000
Net Reimbursement			$27,500

Pet Insurance Rider

Coverage Highlights

- Annual Exam
- Accidents and Illnesses.
- MRI, CAT Scans, and X-Rays
- Surgeries Cancer Treatments
- Prescription, medication, hospitalization, vaccinations, heartworm protection
- Flea Control Spay & Neuter

Pet Cancer Rider

Extends the cancer protection for cats and dogs.

- Studies show that dogs and cats may be the family members most likely to get cancer.
- Use any licensed veterinarian even when you are out of town.

Automobile Insurance

Compulsory Insurance

In compulsory insurance states, motorists must carry minimum amounts of liability insurance before a vehicle can be licensed or registered. Problems that arise include:

- **Uninsured Motorists.** Many still exist.
- **Loss Experience.** Does not improve.

No Fault

In no fault states, injured parties collect from their own insurer without having to prove fault. In many states, lawsuits are allowed if the injury exceeds a minimum threshold:

- **Monetary Threshold.** Bodily injury claim must meet a certain amount ($2000?)
- **Verbal Threshold.** Bodily injury claim must be serious, involving death, dismemberment or permanent physical loss.

Question

Lawsuits with auto insurance distribute funds as follows:

- Medical Bills. ______
- Pain and Suffering. ______
- Fraudulent and Excessive Claims. ______
- Attorneys Fees. ______
- Selling Fees. ______
- Overhead and Other. ______

Estimate the percentage in each category.

Answer

○ Medical Bills.	15%
○ Pain and Suffering.	17%
○ Fraudulent and Excessive Claims.	13%
○ Attorneys Fees.	28%
○ Selling Fees.	15%
○ Overhead and Other.	12%
○ Total	100%

Categories of Auto Loss

Major categories of loss to autos are:

- **Injuries or Death to Insureds.** Individuals who own or operate a vehicle.
- **Third Party Injuries or Death.** Injuries to others.
- **Damage to the Auto.** A loss on the vehicle itself.
- **Damage to Other Property.** Loss of value of property that encounters the vehicle.

PAP Covered Auto

In the PAP, a covered auto may be:

- **Named Vehicle in the Policy.** This may be an owned automobile, van, or pickup (all under a weight limit) or it may be a vehicle leased for over 6 months.
- **Newly Acquired Vehicle.** Owned or leased during the policy period.
- **Trailer Owned by the Insured.** Designed to be towed by an auto.
- **Temporary Substitute Vehicle.** Borrowed because of short-term need.

PAP Newly Acquired Vehicle

For a newly acquired vehicle under the PAP, the following generally applies:

- **Additional Vehicle.** Must notify insurer within 14 days to be covered from day one.
- **Replacement Vehicle.** Coverage is automatic for liability coverages. For damage to the auto itself, the insured has 4 days to notify the insurer. Some caveats apply,

Question

An insured purchases a vehicle on April 1. Without removing it from the dealership or notifying his insurance company, the insured leaves on a three-week cruise. On April 26, he picks up the vehicle and has an accident on the way home. Is the vehicle covered by his insurance policy?

PAP Insuring Agreement

The insurer agrees to pay bodily injury or property damages for which an insured is legally responsible because of an auto accident. The PAP can express the policy limit two ways:

- **Single Limit.** The policy will reimburse losses up to a total limit for bodily injury and property damage liability.
- **Split Limit.** The policy reimburses bodily injury and property damage liability separately.

PAP Legal Costs

The PAP handles legal costs as follows:

- **Outside Limits.** The insurer will defend against the claim and pay legal costs at the insured's expense.
- **Judgments or Settlements End Defense Obligation.** When the insurer has made payments equal to the policy limit, the insurer has no further obligation to pay legal or defense costs.

Insured Person

The PAP identifies an insured person as:

- **Named Insured and Resident Family Members.** Includes children and spouse who was resident in past 90 days.
- **Others Using Covered Auto.** With permission of the named insured.
- **Responsible Organization.** Responsible for acts of covered person while using a covered auto.

Question

A boyfriend is on vacation. His girlfriend's car breaks down so she borrows his covered car and has an accident. Her insurance has lapsed so she has no coverage under her own policy. Is she an insured person under his PAP policy?

Exclusions

The PAP has a long list of exclusions, including:

- **Intentional Injury or Damage.** Loss must be fortuitous.
- **Personal Property in Auto.** Coverage does not extend to items in the auto.
- **Business Uses.** Other coverage is needed.

Question

A man drives off from a tavern and has an accident. The police test shows his alcohol level exceeds the state allowable level. He is given a ticket for driving under the influence. Is he covered under his PAP?

Question

A man changed lanes abruptly without signaling causing a woman in another car to hit the brakes.

- She speeded up and bumped him, causing both them to lose control.
- Both are insured persons under their own PAP policies.
- Are both parties covered by their own policies?

Question

A woman takes her car to an auto shop to be repaired. After fixing the vehicle, a mechanic tests it on the road and has an accident. The car is damaged and an injured party sues the owner. Is the accident covered by the PAP?

Question

A family goes on an exchange program to Europe and leaves the family car with a friend who is told to drive it regularly. The friend does not list the vehicle on his PAP. Is it covered anyway?

Question

An insured person borrows a motorcycle from a friend. He rode to a farm where he drove a snowmobile across a mountain. While on the snowmobile, he broke his leg. He got back to the farm and started for home on the cycle. He was in an accident because his broken leg did not allow him to stop in time. In the second accident, he broke his arm. Are the medical expenses covered by the PAP?

Uninsured Motorist

Uninsured motorist coverage pays for bodily injury and maybe property damage where legal responsibility lies with:

- **Uninsured Motorist.** Irresponsible individual who does not have auto insurance.
- **Motorist with Insolvency Insurer.** Insurer unable to pay.
- **Hit and Run Driver.** Responsible party not known.

Damage to Own Auto

The PAP provides coverage for damage to an insured person's vehicle:

- **Collision.** A loss resulting from the upset of a covered auto or non-owned auto or its impact with another vehicle or object.
- **Comprehensive.** Theft of the vehicle or parts of the vehicle or damage from non-collision causes.

Question

Identify each of the following as collision or comprehensive losses.

- Sliding into a tree on an icy road.
- Car catches on fire while driving down the road.
- The car hits a deer crossing the road at night.
- Finding a dent in the fender of a car you parked an hour ago.

Question

Automobile Statistics. How many automobiles are:

- On U.S. Highways ____
- Insured in the U.S. ____
- Uninsured on U.S. Highways ____

Question

Which of the following states have the most uninsured drivers? The least?

- Mississippi ______
- Maine ______
- California ______
- Massachusetts ______
- Arizona ______
- New York ______

Answer

Percent of uninsured drivers:

Mississippi	26%
Maine	4%
California	25%
Massachusetts	6%
Arizona	22%
New York	7%

Question

What percent of automobile insurance premiums are used for each of the following?

- Medical expenses for injuries. ____%
- Damage to automobiles. ____%
- Insurer administrative costs. ____%
- Lawyers fees. ____%
- Claims costs. ____%
- Insurance company profits. ____%

100%

Answer

Percent of automobile insurance premiums:

○ Medical expenses for injuries.	17%
○ Damage to automobiles.	23%
○ Insurer administrative costs.	24%
○ Lawyers fees.	10%
○ Claims costs.	16%
○ Insurance company profits.	10%
	100%

Question

What percentage of automobile accidents involved death or disability in each year? What was the average economic loss resulting from an accident?

Year	% Serious Injury	$ Loss
1977	___%	$____
1987	___%	$____
1997	___%	$____
2002	___%	$____

Answer

Automobile accidents involving death or disability.
Average economic loss from an accident.

Year	% Serious Injury	$ Loss
1977	60%	$1200
1987	52%	$3000
1997	32%	$5000
2002	30%	$5800

Question

For each of the following states, estimate the annual average cost for automobile insurance for one car. Match each state with its ranking among 50 states in terms of the cost of automobile insurance.

- **States:** California, Iowa, New Jersey, New York, North Dakota.
- **Rank (1=highest cost).** 1, 2, 20, 48, 50.

Answer

Ranking among 50 states in terms of the cost of automobile insurance:

State	Average Cost	Rank
California	$ 825	20
Iowa	$ 580	49
New Jersey	$1200	1
New York	$1160	2
North Dakota.	$ 536	50
Average for U.S.	$ 820	

Question

For each of the following cities, which is the most costly in terms of auto insurance? The least costly?

- Detroit
- Philadelphia
- Newark
- New York City
- Los Angeles

Green Bay
Raleigh
Chattanooga
Roanoke

Answer

Cost of insurance for one automobile – top five and bottom four cities:

Average for the U.S.

Detroit.	$5200	Green Bay	$950
Philadelphia	$4100	Raleigh	$950
Newark	$3500	Chattanooga	$910
New York	$3100	Roanoke	$750
Los Angeles	$3200		

Presentation

Session 16
Modern Risk Management

Framework for Risk Management

A **SWOT** Analysis:

- Strengths.
- Weaknesses.
- Opportunities.
- Threats.

Framework for Risk Management

A **TWOS** Analysis:

- Threats
- Weaknesses.
- Opportunities.
- Strengths.

Threats

National Association of Insurance Buyers

Global Association of Risk Professionals

Institute of Internal Auditors

Casualty Actuarial Society

Threats

NAIB. Risk managers primarily buy insurance.

Threats

NAIB. Buyers of insurance.

GARP. Financial risk management is the only risk management.

Threats

NAIB. Buyers of insurance.

GARP. Only financial risk

IIA. Risk management is violation of policies caught on audits.

Threats

NAIB. Buyers of insurance.

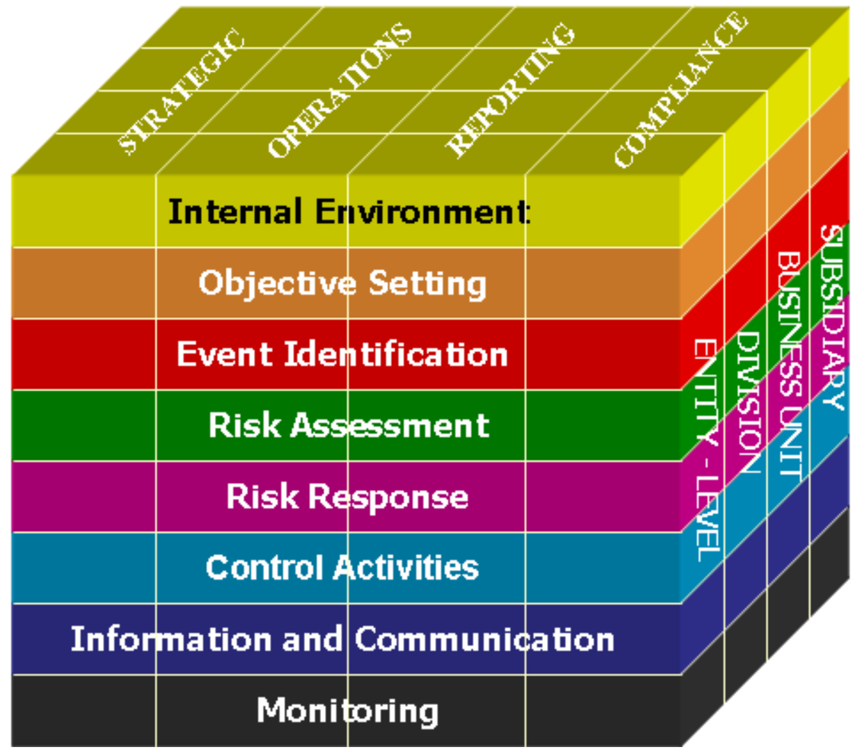
GARP. Only financial risk

IIA. Violations.

CAS. Its all in the numbers.

Weaknesses

Internal Environment	• What is the internal philosophy and culture?
Objective Setting	• What are we trying to accomplish?
Event Identification	• What could stop us from accomplishing it?
Risk Assessment	• How bad are these events? • Will they really happen?
Risk Answer	• What are our options to stop those things from happening?
Control Activities	• How do we make sure they don't happen?
Information and Communication	• How [and from/with whom] will we obtain information and communicate?
Monitoring	• How will we know that we've achieved what we wanted to accomplish?



Source: Committee of Sponsoring Organizations of the Treadway Commission www.coso.org. Used with permission.

COSO ERM Framework

Internal Environment	•What is the internal philosophy and culture?
Objective Setting	•What are we trying to accomplish?
Event Identification	•What could stop us from accomplishing it?
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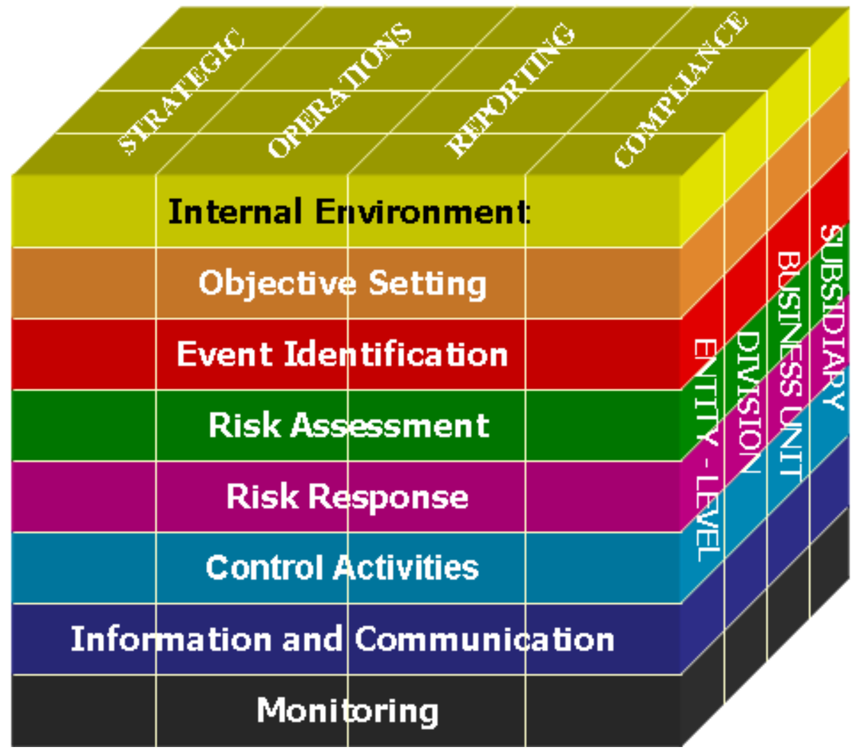

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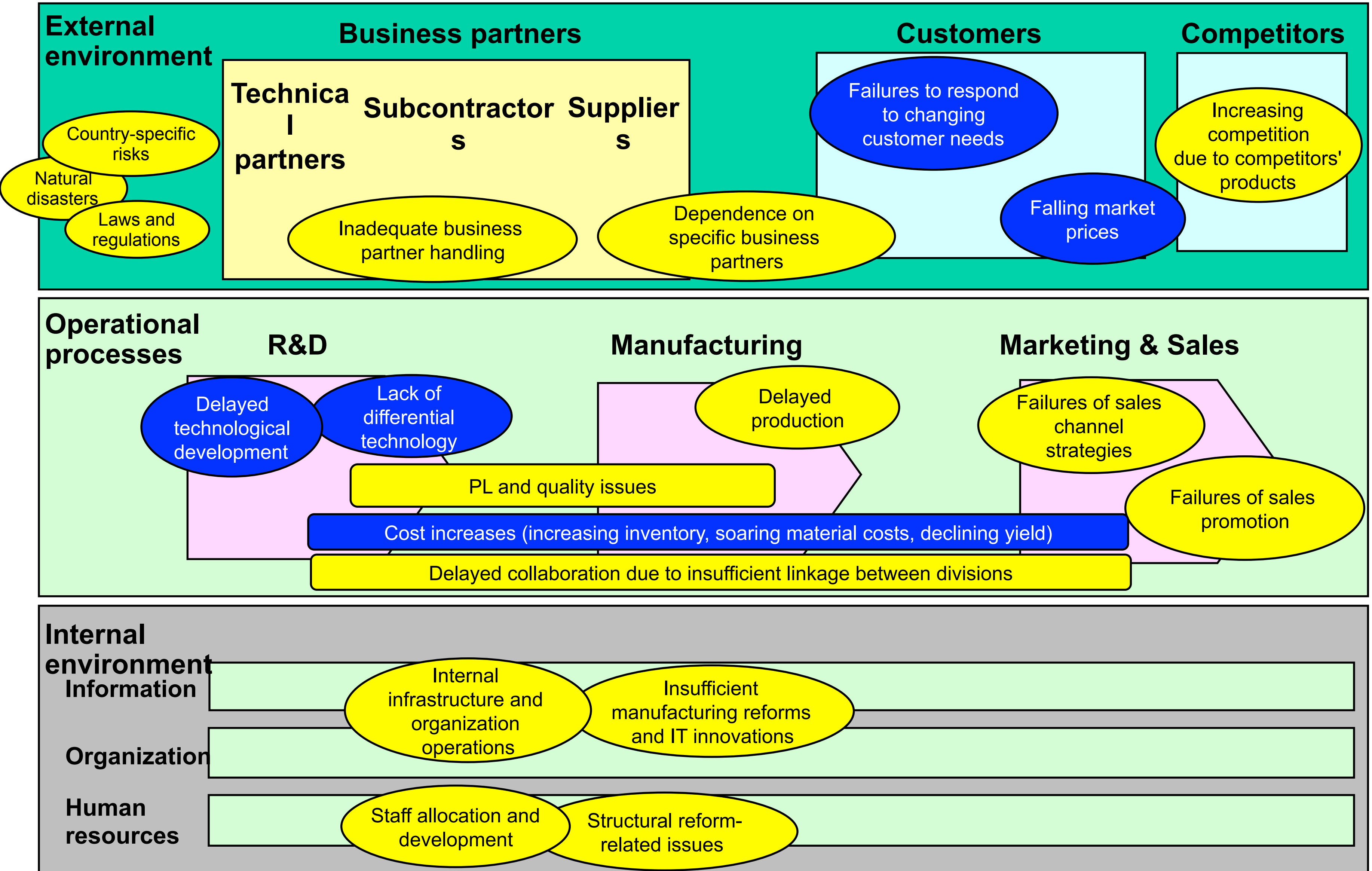
COSO Implementation

Multinational Corporation ERM program:

- **800 Business Risks.** Consolidated into 20 categories:
- **2100 Common Risks** Group-wide exposures.

Results of Business Risk Consolidation

- Business risks in the external environment, operational processes, and internal environment -



Business Structure

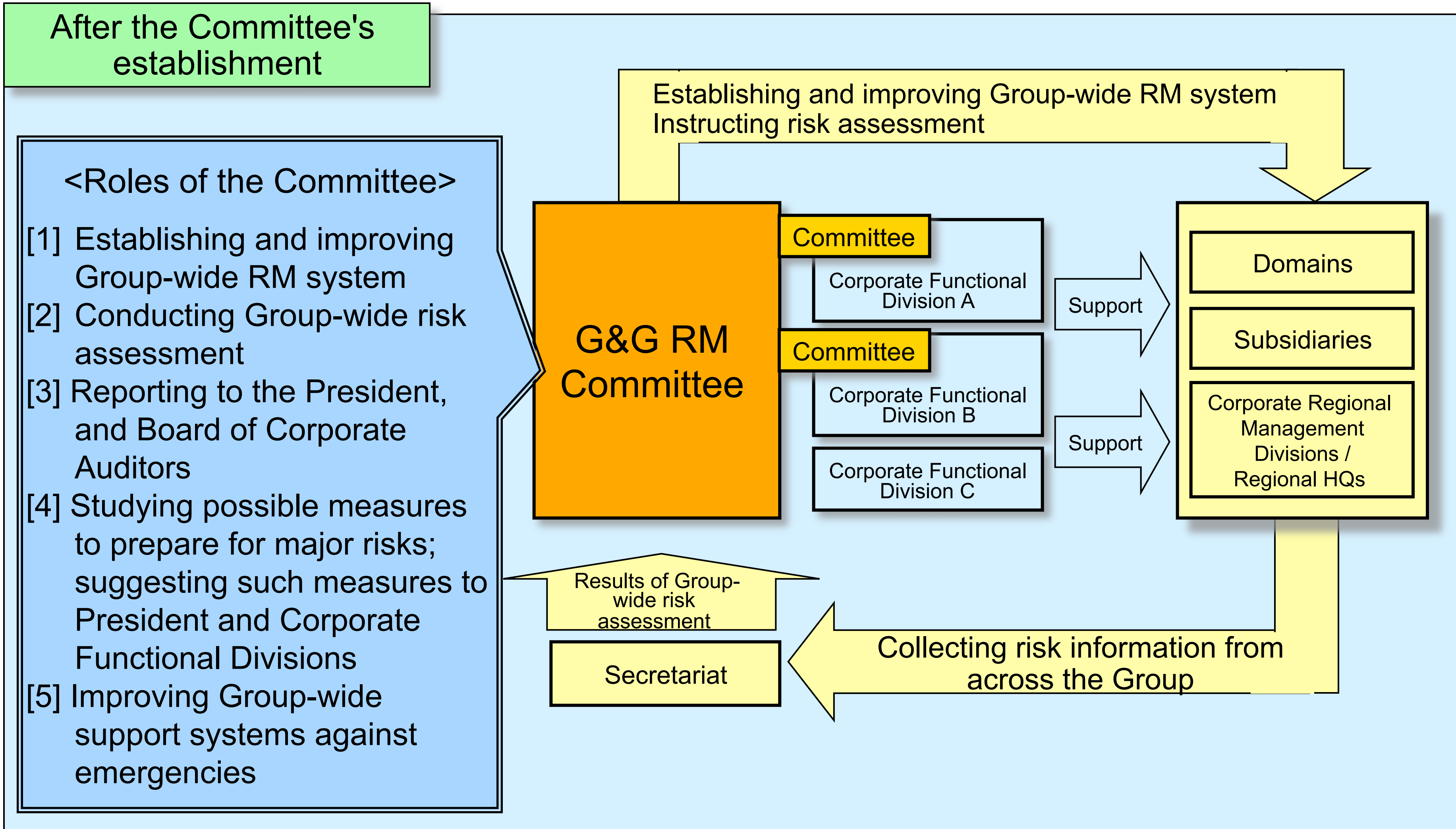
Global and Group Head Office

- Head Office
- CISC
- Panasonic Design Company
- R&D divisions
- Sales division
- Overseas divisions

Segment	Business domain	Business Domain Companies and Group Companies
AVC Networks	AVC Fixed-line communications Mobile communications Automotive electronics Systems	Panasonic AVC Networks Company Panasonic Communications Co., Ltd.* Panasonic Mobile Communications Co., Ltd.* Panasonic Automotive Systems Company Panasonic System Solutions Company Panasonic Shikoku Electronics Co., Ltd.*
Home Appliances	Home appliances, household equipment, healthcare systems Lighting Environmental systems	Matsushita Home Appliances Company, Matsushita Refrigeration Company* Healthcare Business Company Lighting Company Matsushita Ecology Systems Co., Ltd.*
Components and Devices	Semiconductors Display devices Batteries Electronic components Motors	Semiconductor Company Matsushita Battery Industrial Co., Ltd.* Panasonic Electronic Devices Co., Ltd.* Motor Company Others
Solutions	FA, Corporate *e*Net Business Division	Panasonic Factory Solutions Co., Ltd.*, and others
MEW and PanaHome		Matsushita Electric Works, Ltd.*, PanaHome Corporation*
JVC		Victor Company of Japan, Ltd.*

Group-wide Risk Management System for General Control

(2) Establish a G&G Risk Management Committee to address the current problems



Clarify Sections Responsible for Each Risk

1. Disasters and accidents

Earthquakes, typhoons, tsunamis, floods, and other natural disasters	General Affairs Group, Overseas Security management Office
Fires, explosions, airplane crashes, terrorist attacks, and other major destructive or violent events	General Affairs Group, Corporate Personnel Group, Overseas Security Management Office

2. Politics, economy, and society

Wars, civil wars, conflicts, etc.	General Affairs Group, Overseas Security Management Office
Corporate threats, abduction, and violent civil unrest	General Affairs Group, Overseas Security Management Office

3. Operations

(1) Quality, CS, and intellectual property

PL and recall issues, other quality problems	Corporate Quality Administration Division
Failure in complaint-handling	Corporate CS Division
Intellectual property right infringements	Corporate Intellectual Property Division

(2) Sales and procurement

Violation of antitrust (competition laws)	Corporate Legal Affairs Division
Bribery	Corporate Legal Affairs Division
Violation of Subcontractors Act	Corporate Procurement Division
Soaring raw material prices and unavailability	Corporate Procurement Division

(3) Information

Trade secret leakage	Corporate Information Security Division
Private data leakage and violation of privacy	Corporate Information Security Division
Information security incidents related to products and services	Corporate Information Security Division
Insider trading	General Affairs Group

(4) Information systems

Shutdown or malfunction of information systems and communication networks	General Affairs Group, Corporate Information Security Division
Unauthorized use of information systems	General Affairs Group, Corporate Information Security Division
Inadequate security measures related to information systems	General Affairs Group, Corporate Information Security Division

(5) Environment

Environmental pollution	Corporate Environmental Affairs Group
Waste treatment	Corporate Environmental Affairs Group
Environmental regulations	Corporate Environmental Affairs Group

(6) International relations

Violation of security export control	Corporate Legal Affairs Division
Trade issues	Corporate Legal Affairs Division

(7) Finance

Bad loans and business partner bankruptcy	Corporate Accounting Group
Tax and accounting system changes	Corporate Accounting Group
Exchange rate fluctuations	Corporate Finance & IR Group
Interest fluctuations	Corporate Finance & IR Group
Stock price fluctuations	Corporate Finance & IR Group
Impairment of long-term assets and deferred tax assets	Corporate Accounting Group

(8) Labor issues

Human rights issues, including sexual harassment	Industrial Relations Group, Corporate Personnel Group, Overseas Security Management Office
Employment	Corporate Personnel Group, Industrial Relations Group
Industrial accidents	Industrial Relations Group
Health issues such as infectious diseases	Industrial Relations Group, Overseas Security Management Office

Spreadsheet Risk Listing (1)

Administration risk.
Business support risk.
Capital budgeting risk.
Capital structure risk.
Communications risk.
Compliance risk.

Credit risk.
Design risk.
Distribution risk.
Efficiency risk.
Financial reporting risk
Finance risk.

Spreadsheet Risk Listing (2)

Information systems risk

Key initiative risk.

Marketing risk.

Needs risk.

Performance risk.

Portfolio risk.

Pricing risk.

Process risk.

Production risk.

Records management risk.

Supply risk.

Technology risk.

Valuation risk.

Volume risk.

Let’s bring risk opportunity to the CFO

We need modern risk management:

- Non-legacy technology.
- Big data.
- Communication links.
- Relationships among risk factors.
- Mobile devices.

Try some details

- **Operational Risk**. Reduce it.
- **Strategic Risk.** Better business decisions.
- **More Profit.** Pursue opportunities more quickly.
- **Lower Costs**. Tax benefits, lower cost of insurance and claims administration.

Strength

Behavior: Talk Finance

Ask the CFO: Should we use a captive to fund workers compensation?

Maybe, if you can tell me . . .

What happens in a hard market?

What happens in a soft market?

Who covers catastrophic risks?

What specific coverages make sense?

What happens if the tax position changes?

How do we work with financial markets?

Give me a moment . . .

- We are investing capital.
- A captive decision is more of a financial rather than insurance decision.

Here's where we need financial tools.

We need Financial Tools that . . .

- Tell a compelling story.
- Are relevant.
- Provide a foundation for further discussion.

Decision Point

Let’s look at some numbers.

Four Questions

1. What is the cost of retention/insurance?
2. What would be the cost of a captive?
3. What is the captive net present value?
4. What is the total cost of risk?

1. Cost of Retention/Insurance

	Yr. 0	Yr. 1	Yr. 2	Yr. 3	Yr. 4
Losses/Adjusting		-3500	-3500	-3500	-3500
Retention Admin		-800	-800	-800	-800
Excess Premiums		-500	-500	-500	-500
Cash Flows		-4800	-4800	-4800	-4800
Present Values* 8%		-4594	-4237	-3905	-3599
Present Value	**-16336**				
* mid-year factors		0.57	1.62	2.68	3.74

2. Cost of a Captive? (Claims 5%)

	Yr. 0	Yr. 1	Yr. 2	Yr. 3	Yr. 4
Invested Capital	-1200				1200
Captive Premiums		-4850	-4850	-4850	-4850
Admin with Captive		-400	-400	-400	-400
Tax Savings 6%		291	291	291	291
Reduced Claims 5%		243	243	243	243
Parent Deductible		-300	-300	-300	-300
Cash Flows	-1200	-5017	-5017	-5017	-3817
Present Values 8%	-1200	-4801	-4428	-4082	-2862
Present Value	**-17373**				

3. Captive Net Present Value

	Yr. 0	Yr. 1	Yr. 2	Yr. 3	Yr. 4
Invested Capital	-1200				1200
Captive Premiums		4850	4850	4850	4850
Losses/Adjusting		-3500	-3500	-3500	-3500
Parent Deductible		300	300	300	300
Captive Admin		-600	-600	-600	-600
Excess Premiums		-500	-500	-500	-500
Cash Flows	-1200	550	550	550	1750
Present Values 8%	-1200	526	486	447	1312
Net Present Value	**1572**				
Internal Rate of Rtn	56%				

4. Total Cost of Risk?

	Claims 5%
Cost of Retention	-16336
Cost of Captive	-17373
NPV of Captive	1572
Net Cost of Captive	-15801
Difference	535

4. Total Cost of Risk?

	Claims 5%	Claims 15%
Cost of Retention	**-16336**	**-16336**
Cost of Captive	-17373	-15723
NPV of Captive	1572	1572
Net Cost of Captive	**-15801**	**-14151**
Difference	**535**	**2185**

Now we are Ready to Discuss . . .

What happens in a hard market?

What happens in a soft market?

Who covers catastrophic risks?

What specific coverages make sense?

What happens if the tax position changes?

How do we work with financial markets?

Other Questions

We can also discuss

Is the cost forecast realistic?

Who absorbs larger than expected losses?

Everything else.

We can examine . . .

Would a captive help us make better decisions on **the risk we retain**?

Can a captive provide us **valuable benefits**?

Would a captive **be right** for us?

The Message?

Does it make a Difference Whether we speak the Language of the Chief Financial Officer?

Conclusion

Better decisions on risk.

Is it

Risk Management?

Finance?

Both?