

INSURANCE AS A CONTRACT

An insurance policy is a contract between the insurer and the insured. Through insurance policies, insureds transfer the possible costs of losses to insurers. In return for the premiums paid by insureds, insurers promise to pay for the losses covered by the insurance policy. As noted, this promise reduces the uncertainty or insecurity that insureds have about paying for losses that may occur. The coverage provided by insurance policies enables individuals, families, businesses, and organizations to protect their assets and minimize the adverse financial effects of losses.

The four basic types of insurance—property, liability, life, and health—are generally divided into two broad categories, as follows:

1. Property/liability insurance
2. Life/health insurance

Property insurance provides coverage for property and net income loss exposures. It protects an insured's assets by paying to repair or replace property that is damaged, lost, or destroyed, or by replacing the net income lost and the extra expenses incurred as a result of a property loss. Liability insurance covers liability loss exposures. It provides for payment on behalf of the insured for injury to others or damage to others' property for which the insured is legally responsible.

Life insurance and health insurance cover the financial consequences of personal and personnel loss exposures. Life insurance replaces the income-earning potential lost through death and also helps to pay expenses related to an insured's death. Health insurance protects individuals and families from financial losses caused by sickness and accidents. Disability insurance is a form of health insurance that replaces an insured's income if the insured is unable to work because of illness or injury.

Property Insurance

Property insurance covers the costs of accidental losses to an insured's property. The insured could be a family insuring its house and personal property or a business insuring its building, inventory, and equipment. When the insured experiences a loss, such as fire damage to a house, the insured deals directly with the insurer to settle the loss and receive payment.

Many types of insurance are classified as property insurance, such as the following:

- Fire and allied lines insurance
- Business income insurance
- Crime insurance
- Ocean marine insurance
- Inland marine insurance
- Auto physical damage insurance

Fire and allied lines insurance generally covers direct damage to or loss of insured property, such as buildings and personal property, at a fixed location or locations described in the policy. The term “allied lines” refers to insurance against causes of loss usually written with (allied to) fire insurance, such as windstorm, hail, smoke, explosion, vandalism, and others. Examples of fire and allied lines insurance policies are a dwelling policy and a commercial property policy.

Business income insurance, traditionally called **business interruption insurance**, covers the loss of net income or additional expenses incurred by a business as the result of a covered loss to its property. For example, when a business has a serious fire, it may have to close until repairs to the building are made and personal property is replaced. A resulting loss of net income occurs over time. Business income insurance pays the insured for the loss of income or additional expenses that the insured incurs because of the loss during the time needed to restore the business to its pre-loss condition.

Crime insurance covers money, securities, merchandise, and other property from various causes of loss such as burglary, robbery, theft, and employee dishonesty. Coverage for crime losses that a business may incur is usually provided by separate policies that insure specific types of property against specific crime losses. Crime losses that a person or family may suffer are usually insured under a homeowners policy.

Ocean marine insurance, one of the oldest forms of insurance, covers ships and their cargo against such causes of loss as fire, lightning, and “perils of the seas,” which include high winds, rough waters, running aground, and collision with other ships or objects.

Inland marine insurance covers miscellaneous types of property, such as movable property, goods in domestic transit, and property used in transportation and communication. It was originally developed to provide coverage for losses to cargo transported over land but now covers many different types of property in addition to goods in transit.

Auto physical damage insurance covers loss of or damage to specified vehicles from collision, fire, theft, or other causes. It is usually part of a policy that also provides auto liability coverage, such as a personal auto policy or a business auto policy.

Liability Insurance

Because an insurance policy is a contract between the insured and the insurer, these two are usually the only parties involved in a property loss. Liability insurance, however, is sometimes called third-party insurance because three parties are involved in a liability loss: the insured, the insurer, and the party who is injured or whose property is damaged by the insured. (The third party is usually called the claimant.) The insurer pays the claimant *on behalf of the insured* if the insured is legally liable for the injury or damage. An insured’s

Fire and allied lines insurance

Insurance that covers direct damage to or loss of insured property.

Business income insurance, or business interruption insurance

Insurance that covers the loss of net income or additional expenses incurred by a business as the result of a covered loss to its property.

Crime insurance

Insurance that covers money, securities, merchandise, and other property from various causes of loss such as burglary, robbery, theft, and employee dishonesty.

Ocean marine insurance

Insurance that covers ships and their cargo against such causes of loss as fire, lightning, and “perils of the seas.”

Inland marine insurance

Insurance that covers miscellaneous types of property, such as movable property, goods in domestic transit, and property used in transportation and communication.

Auto physical damage insurance

Insurance that covers loss of or damage to specified vehicles from collision, fire, theft, or other causes.

legal liability for injury or damage is often the result of a negligent act, but there are other sources of liability as well. Examples of liability insurance include the following:

- Auto liability insurance
- Commercial general liability insurance
- Personal liability insurance
- Professional liability insurance

Auto liability insurance

Insurance that covers an insured's legal liability arising out of the ownership, maintenance, or use of an automobile.

Auto liability insurance covers an insured's legal liability arising out of the ownership, maintenance, or use of an automobile. The legal costs of defending the insured against lawsuits are also covered when such defense is necessary. The personal auto policy and the business auto policy are the most widely used auto insurance policies. These policies can include coverage for both auto liability and auto physical damage losses.

Commercial general liability insurance

Insurance that covers liability loss exposures arising from a business organization's premises and operations, its products, or its completed work.

Commercial general liability insurance covers liability loss exposures arising from a business organization's premises and operations, its products, or its completed work. The following examples of liability claims against an appliance store illustrate the various ways that a business can be liable for the bodily injury or property damage suffered by others:

- *Premises.* A customer whose finger was caught in a revolving door incurred medical expenses for treatment in a hospital emergency room.
- *Business operations.* Employees broke a water pipe while installing a dishwasher in an apartment, causing substantial water damage to property in the apartment below.
- *Products.* A customer's face was cut when an electric mixer sold to the customer malfunctioned and shattered a glass mixing bowl.
- *Completed operations.* A short circuit developed in an electric stove incorrectly installed by employees and caused a fire that damaged the customer's kitchen.

Personal liability insurance

Insurance that provides liability coverage to individuals and families for bodily injury and property damage arising from the insured's personal premises or activities.

Personal liability insurance provides liability coverage to individuals and families for bodily injury and property damage arising from the insured's personal premises or activities. As mentioned previously, in most instances, the liability arises from the insured's negligence. For example, a visitor to the insured's home may slip and fall on the insured's icy driveway, or the insured may hit a golf ball that accidentally strikes a pedestrian in the head. This type of coverage is included in all homeowners policies.

Professional liability insurance

Insurance that provides liability coverage to professionals for errors and omissions arising out of their professional duties.

Professional liability insurance provides liability coverage to professionals for errors and omissions arising out of their professional duties. Medical malpractice insurance, which covers doctors and other healthcare providers, is probably the best known type of professional liability insurance, but similar coverage is available to other types of professionals, including insurance producers, attorneys, architects, and engineers.