Basic Principles of Insurance

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Homework #3

1. What are the principles of insurance? Define each of them in detail.

Ans: there are **six principles of insurance** as follows:

I. ***Utmost Good Faith.*** A contract of insurance must be made based on utmost good faith (a contract of uberrimae fidei). It is important that the insured disclose all relevant facts to the insurance company. Any facts that would increase his premium amount, or would cause any prudent insurer to reconsider the policy must be disclosed. If it is later discovered that some such fact was hidden by the insured, the insurer will be within his rights to void the insurance policy.

II. ***Insurable Interest.*** This means that the insurer must have some pecuniary interest in the subject matter of the insurance. This means that the insurer need not necessarily be the owner of the insured property but he must have some vested interest in it. If the property is damaged the insurer must suffer from some financial losses.

III. ***Indemnity.*** Insurances like fire and marine insurance are contracts of indemnity. Here the insurer undertakes the responsibility of compensating the insured against any possible damage or loss that he may or may not suffer. Life insurance is not a contract of indemnity.

IV. ***Subrogation.*** This principle says that once the compensation has been paid, the right of ownership of the property will shift from the insured to the insurer. So the insured will not be able to make a profit from the damaged property or sell it.

V. ***Contribution.*** This principle applies if there are more than one insurers. In such a case, the insurer can ask the other insurers to contribute their share of the compensation. If the insured claims full insurance from one insurer he loses his right to claim any amount from the other insurers.

VI. ***Proximate Cause.*** This principle states that the property is insured only against the incidents that are mentioned in the policy. In case the loss is due to more than one such peril, the one that is most effective in causing the damage is the cause to be considered.

2. Define and distinguish the 6 types of risk classified by insurance and give one example of each risk classification.
   Ans: the **six types of risk** classified by insurance are as follows:
   I. ***Pure Risk.*** Pure risk refers to the situation where it is certain that the outcome will lead to loss of the person only or maximum it could lead to the condition of the break-even to the person, but it can never cause profit to the person. ***An example*** of pure risk includes the possibility of damage to the house due to natural calamity. In case any natural calamity occurs, it will damage the house of the person and its household items, or it will not affect the person's home and household items. Still, this natural calamity will not give any profit or gain to the person. So, this will fall under the pure risk, and these risks are insurable.
   II. ***Speculative Risk.*** Speculative risk refers to the situation where the direction of the outcome is not specific, i.e., it could lead to a condition of loss, profit, or break-even. These risks are generally not insurable. ***An example*** of speculative risk includes the purchase of the shares of a company by a person. Now, the prices of the shares can go in any direction, and a person can make either loss, profit, or no loss, no profit at the time of the sale of those shares. So, this will fall under the Speculative risk.
   III. ***Financial Risk.*** refers to the danger in which the outcome of the event is measurable in terms of the money, i.e., any loss that could occur due to the risk can be measured by the concerned person in monetary value. ***An example*** of the financial risk includes a loss to the goods in the warehouse of the company due to the fire. These risks are insurable and are generally the main subjects of the insurance.
   IV. ***Non-Financial Risk.*** Non-Financial risk refers to the risk in which the outcome of the event is not measurable in terms of the money, i.e., any loss that could occur due to the risk cannot be measured by the concerned person in the monetary value. ***An example*** of the non-financial risk includes the risk of poor selection of the brand while purchasing mobile phones. These risks are uninsurable since they cannot be measured.
   V. ***Particular Risk.*** Particular risk refers to the risk which arises mainly because of the actions or the interventions of the individual or the group of some individuals. So, the origin of the particular risk by individual-level and impact of the same is felt at a localized level. ***An example*** of a specific chance includes an accident on the bus. These risks are insurable and are generally the main subjects of the insurance.
   VI. ***Fundamental Risk.*** Fundamental risk refers to the risk which arises due to the causes which are not under the control of any person. So, it can be said that the fundamental risk is impersonal in its origin and the consequences. The impact of these risks is essentially on the group, i.e., it affects the large population. ***For instance***, the fundamental risk includes risks on the group by events such as natural calamity, economic slowdown, etc. These risks are insurable.

3. Briefly describe what are the risk handling methods with an example.
   Ans: the risk handling methods are as follows:
   I. ***Avoidance.*** We can completely take the risk out of the equation by opting to never get involved in the first place. You effectively never play the game so you cannot lose. To see Avoidance in ***an example***, look no further than someone's commute to work. By taking the train into the city, you avoid any chance of getting into an auto accident thus avoiding any liability or physical damage possibility.
   II. ***Control.*** We can minimize our exposure to risk as we limit the opportunity for losses to occur. We use this method for handling situations that we have the power over before the loss event happens. To reduce hazards is to get rid of the possibilities of unwanted occurrences. ***An example*** of control would be installing an obvious security system at your place of business to dissuade intruders from committing the crime in the first place. Here, the business owner is utilizing the technique of control.
   III. ***Retention.*** Retention can simply be described as not buying insurance. This is a situation where the individual takes on all the risk on their own. In any situation where they would be liable for an event that they caused, they respond by paying out of pocket. If a loss never happens, the individual ends up saving money by never purchasing insurance in the first place. Retention is never advisable by any means! The best ***example*** for this is when someone buys an older car for very cheap and opts out of buying the collision coverage. The coverage would end up costing the amount they paid for the car. It would make more sense at that point to just scrap the whole thing and buy a new car. Also not having a claim would make your driving record look cleaner. Of course, you would still want to purchase liability as you could be found liable for damages to a third party.
   IV. ***Transfer (buy insurance).*** You can transfer your risk to an insurance carrier. It is based on the principle of indemnity (to make whole). Insurance will see to it that you will be made whole after a loss provided you have the correct coverage. ***For instance***, If you accidentally hit someone with your car, the insurance will pay first. If someone slips and falls on your property, the insurance will pay first. If your power goes out and disrupts your business operations, insurance will pay first. Hence, the losses of the few are made paid by the premiums of the many.
   V. ***Non-insurance Transfer.*** The transfer of risk to someone other than an insurance carrier. This usually happens within contracts between companies and individuals in the fine print of certain services. ***For example***, an online clothing company rents expensive clothes through the internet. The clothes get shipped to the customers place of residence and can choose to buy them or return them afterwards. The customer has signed up for this service and in the contract they signed was a form promising to return the clothes in the same condition they came in. If the customer fails to do so, they will be responsible and be charged for the clothes. The clothing company has used a non-insurance transfer to protect their property.

Homework #4

1. Define who the insurance agent is and who the insurance broker is. What are the differences between this Agent and Brokers? (Please do more research from the textbook or Google)
   Ans: define the insurance agent & insurance broker:
   - ***Insurance Agent.*** is a natural person or legal entity representing an insurer to introduce insurance sales, prepare insurance contracts, collect premiums, and prepare for indemnification, based on a clearly specified framework of the agreement between the insurer and the insured. The insurance agent receives commission from the insurer it represents.
   - ***Insurance Broker.*** is a legal entity working for the benefits of the insured, providing consultation service and information relating to types of insurance, terms and conditions, and premium of the insurance contract; negotiating and preparing insurance contract between the applicant and the insurer; and selling insurance contract by receiving a brokerage commission in a legal manner from the insurer.

   The differences between these two are:

Type	Insurance Agent	Insurance Broker
Representation	Up to three principals (insurers) – normally representing the insurer.	Any number of insurers – normally representing the insured.
Appointment	Agency Agreement with the insurer	Letter of Appointment by the insured
Remuneration	Commission.	Brokerage or Fee.
Professional Indemnity Insurance Requirement	None.	Yes, minimum limit $500,000 apropos to the Law on Insurance, the Sub-Decree on Insurance dated 22 October 2001, Article 86.
Minimum Paid- up Share Capital	KHR 20M	KHR 200M
Solvency Requirements	$10,000	$50,000

2. Define agents, principals and third parties. How an agency is created?
   Ans: An **agent** is an appointed person who has the authority or power to act, in accordance with the Agency Agreement, on behalf of another person, known as the **principal**, to whom the agent represents. The task of the agent is to bring about a contractual relationship between his principal and a third person, referred to as a **third party**. Simply put, **Agents** are essentially intermediaries or "middle-men"; **Principal** is the insurance company; and **Third Party** is the client.

   An agency could be created by:
   - ***Direct (express) Appointment.*** The standard form of creating an agency is by direct appointment. When a person, in writing or speech appoints another person as his agent, an agency is created between the two.
   - ***Implication.*** When an agent is not directly appointed but his appointment can be inferred from the circumstances, an agency by implication is created.
   - ***Necessity.*** In a situation of necessity, one person can act on behalf of another to save the person from any loss or damage, without expressly being appointed as an agent. This creates an agency out of necessity.
   - ***Estoppel.*** An agency can also be created by estoppel. In a situation where one person behaves in such a manner in front of a third person, as to make someone believe he is an authorized agent on behalf of someone, an agency by estoppel is created.
   - ***Ratification.*** When an act of a person, who acted as another person's agent (on his behalf) without his knowledge is later ratified by that person, this creates an agency by ratification between the two.

3. What is waiver and what is estoppel? Give each an example.
   Ans. Define waiver and estoppel:
   - ***Waiver.*** is a voluntary relinquishment or abandonment (express or implied) of a legal right or advantage. The person who is found to have waived a right must do it knowingly, with knowledge of the existing right and the intention of forgoing the right. ***For instance***, If someone is the claimant in, say, a car accident, an insurance company would have the claimant sign a waiver as part of their settlement offer. This means that although the insurance company is paying a settlement to the claimant, the claimant can no longer pursue legal action against the insurance company.
   - ***Estoppel.*** is a representation of fact made by one person to another person that is reasonably relied on by that person, to such an extent, that it will be inequitable to allow the first person to deny the truth of the representation. ***For example***, If you send in a late payment for your insurance premium, the insurance company cannot cancel your insurance if it has established a pattern of accepting late payments from other insured persons. This is because you were under the impression that a late payment would not lead to a policy cancellation, based on the insurance company's behavior of accepting late payments from others without consequence.

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