

## Chapter 6 – Study Guide

### I. **Introduction:**

1. What are the two major contexts used to define insurance?

### II. **The Nature of Insurance:**

2. Explain the role of insurance as an economic institution.
3. Important quote: “Thus, through the insurance mechanism, insureds transfer various risks to the group and exchange a potentially large, uncertain loss for a relatively smaller certain payment (the premium).”
4. Why are gambling and insurance exactly opposite one another from an economic standpoint?
5. What is an insurance policy?
6. Discuss the following quotes:
  - a. “Implicit in insurance transfers is the assumption that the insurer will indeed be able to pay whatever losses may occur.”
  - b. “when using insurance as a risk management technique, it is important to consider the financial condition of the insurer and the probability that it will be able to pay for all insure losses that may occur.”
7. When is it usually best to use insurance as a risk management technique?
8. Should an individual or firm assume that insurance is the best technique to manage risk?

### III. **Principle of Indemnity:**

9. In what type of insurance is the principle of indemnity most relevant?
10. What is the principle of indemnity?
11. What is the main reason for the principle of indemnity?
12. How does the principle of indemnity potentially lower moral hazard?
13. How does the principle of indemnity apply to individuals that suffer a loss covered under more than one insurance contract?
14. Does the principle of indemnity apply to life insurance?

### IV. **Principle of Insurable Interest:**

15. Explain the term insurable interest.
16. Why is there a requirement of insurable interest in insurance contracts?

#### A. **What Constitutes Insurable Interest:**

17. How can insurable interest be established?
18. Do general creditors have an insurable interest?
19. How does insurable interest work in the case of life insurance?

#### B. **When the Insurable Interest Must Exist:**

20. When must an individual have an insurable interest in the case of property and liability insurance?
21. When must an individual have an insurable interest in the case of life insurance?
22. How do the courts view life insurance contracts?
23. What is the general rule concerning life insurance and insurable interest?

### V. **Principle of Subrogation:**

24. What principle gives rise to the principle of subrogation?
25. Explain the principle of subrogation.
26. Provide an example of subrogation.

## Chapter 6 – Study Guide

### A. Reasons or Subrogation:

27. What is “one of the important reasons for subrogation”?
28. Provide an example of how subrogation alleviates this potential problem.
29. List and discuss the three reasons for subrogation.

### B. Exceptions to the Principle of Subrogation:

30. Where does subrogation not normally apply?
31. What happens in the case that the insured acts in a way that either destroys or reduces the insurer’s right of subrogation?
32. What happens in the case where an insurer successfully subrogates a claim against a responsible third party in the case where an insured has sustained losses in excess of the policy limits?

## VI. Principle of Utmost Good Faith:

33. In general terms, explain utmost good faith.

### A. Representations:

34. What is a representation?
35. Explain what happens when there is a misrepresentation in an insurance contract?
36. Explain the term material?
37. What happens in the case where the insured made an innocent misrepresentation- in other words there was no intent to deceive on the part of the insured?
38. Does the insurer need to be able to show that the misrepresentation was related to the cause of loss?

### B. Warranties:

39. What is a warranty?
40. How does a warranty compare to a representation?
41. What is the distinction between an express and implied warranty?
42. What is the distinction between a promissory warranty and an affirmative warranty?

### C. Concealments:

43. What is a concealment?
44. What are the tests of concealment?
45. What is the test of materiality as it applies to concealment?
46. What are the two rules determining the standard of care required of the applicant?
47. Important quote: “the intentional withholding of material facts with the intent to deceive constitutes fraud.”

### A. Mistakes:

48. What can be done in the case where a mistake was made in a written contract?
49. Text example of the courts reforming a contract due to a mistake.

## VII. Requisites of Insurable Risks:

50. What term is used to describe characteristics of risk that make it feasible for insurers to offer insurance?
51. Is it necessary for all of the requisites of insurable risk to be met before an insurer can offer commercial insurance?

## Chapter 6 – Study Guide

### A. Large Number of Similar Objects:

52. How does the law of large numbers apply to the requisites of insurable risk?
53. What happens in the case where only a few objects are insured by the insurer?
54. What impact does the law of large numbers have on the risk associated with life insurance?
55. Why must the insured objects be “enough alike”?

### B. Accidental and Unintentional Loss:

56. What is the main point of insurance?
57. Why does insurance not cover intentional losses?
58. What is adverse selection?
59. What is asymmetric information?
60. How does an insurer prevent against adverse selection and asymmetric information?

### C. Determinable and Measurable Loss:

61. Why may it be difficult for an insurer to determine and measure a loss?

### D. Loss not Subject to Catastrophic Hazard:

62. Explain the requisite of insurable risk that losses not be subject to catastrophic hazard?
63. What are some examples where this requisite may be violated?
64. How do most insurers handle this requisite?
65. What is reinsurance and how can it assist an insurer in terms of the requisites for an insurable risk?

### E. Large Loss:

66. Explain the requisite of large loss?
67. What is the large loss principle?

### F. Probability of Loss Must Not be Too High:

68. Explain the relationship between the probability of a loss and insurable risk.

## VIII. Requirements of an Insurance Contract:

69. What is a contract?

### A. Requirements of All Valid Contracts:

70. What are the four requirements that are common to all valid contracts?
71. Who makes the offer in an insurance contract?
72. When does an insurance contract go into effect?
73. What is a conditional receipt?
74. Discuss the textbook case of Todd and his application for life insurance.
75. What would have occurred had the insurer “rated” the policy differently due to health conditions revealed in the physical?
76. What happens in the event that an individual applies for insurance but does not remit the payment with the application?
77. What is consideration?
78. What is the consideration of the insured?
79. What is the consideration of the insurer?

## Chapter 6 – Study Guide

### **IX. Distinguishing Characteristics of Insurance Contracts:**

#### **A. Aleatory Contract:**

- 80. What is an aleatory contract?
- 81. Explain why insurance is an aleatory contract?

#### **B. Conditional Contract:**

- 82. Why is insurance considered a conditional contract?
- 83. What are some conditions normally imposed upon the insured?

#### **C. Contract of Adhesion:**

- 84. What is a contract of adhesion?
- 85. How will courts normally interpret a contract if it is considered a contract of adhesion?
- 86. What is the doctrine of reasonable expectations?

#### **D. Unilateral Contract:**

- 87. Why is insurance considered a unilateral contract?

### **X. Role of Agents and Brokers:**

- 88. Explain the role of an agent and principal.
- 89. What are the two types of agents?
- 90. How does agency apply to an insurance agent?
- 91. How does agency apply to an insurance broker?

#### **A. Authority of Agents and Brokers:**

- 92. What are the two sources of authority for agents and brokers in the insurance distribution channel?
- 93. What is an agency agreement?
- 94. What is ratification?
- 95. What is the concept of waiver?
- 96. What is the concept of estoppel?
- 97. What is an example of estoppel?

### **XI. Principles of Social Insurance:**

- 98. What is social insurance?
- 99. What are some of the key distinctions between private insurance and social insurance programs?

### **XII. Social and Economic Values and Costs of Insurance:**

- 100. What are the social and economic values of insurance?
- 101. What are the social costs of insurance?