National INSURANCE DAY CELEBRATIONS

IASL Insurance Association of Sri Lanka

Fundamentals of Insurance

When lots of people pay premiums but only a few file claims each year, coverage is there for everyone when they need it. Now, let's talk about some additional insurance basics: the different types of risk and why it makes sense to eliminate or minimize them even if you have insurance, who can buy insurance and how to get it, and the importance of reviewing your insurance contract.

Risks

Risks can broadly be sorted into four categories.

Preventable risks are possibilities of something bad happening that you have the power to stop. If you don't run red lights, you can prevent yourself from causing some types of car accidents.

Minimizable risks are bad things that you can greatly reduce the chances of. You can greatly reduce the chances of someone stealing your car by not parking it on the street with the keys on the front seat and the doors unlocked. You can greatly reduce your chances of getting lung cancer by not smoking cigarettes.

Avoidable risks are dangers you can stay away from. Your house can't fall off a cliff in a mudslide if you don't buy a house on a cliff.

Unforeseeable risks are ones you have no power to minimize or prevent. A sinkhole could open up in your backyard and severely damage your house. If you don't live in an area that is predisposed to sinkholes, you would have no reason to think you were at risk of one. Taking risks costs you money and limiting risks can save you money. Here's an example of how this works.

Type of risk: garage fire

The effect: You have to file a homeowner's insurance claim.

The costs: When you file an insurance claim, you have to pay your deductible, and your premiums are likely to go up the next time you renew your policy.

Mitigating risk: Don't store the gas can you use to fill your lawn mower next to the your water heater, whose pilot light could ignite the gasoline vapors and start a fire or cause an explosion. Buy a gas container with a flame arrestor and a lid that prevents spills.

Risk Financing and Transference

If you can't eliminate a particular risk from your life, then you should try to prevent, minimize or avoid it while purchasing insurance to protect against the unforeseeable aspects of that risk.

For example, if you don't have access to good public transportation where you live and you can't walk or bike everywhere, you'll have to drive a vehicle to get to work, run errands and have a social life. That puts you at risk of causing a car accident or being involved in a car accident caused by someone else.

You can lessen the risks of driving by obeying the speed limit, driving defensively, wearing a seatbelt, not using your phone while you drive and paying extra attention in challenging driving conditions like traffic jams and downpours, but no matter how careful you are, you could still be involved in an accident.

You can't foresee that a cyclist will suddenly fall off his bike, causing you to swerve into the other lane and hit someone. Insurance helps protect you against such risks. It allows you to transfer the majority of the financial risk of a loss to an insurance company in exchange for paying a premium and sharing a portion of any loss through a deductible.

Required Insurance vs. Optional Insurance

Some types of insurance are required. Mortgage lenders require borrowers to carry homeowners insurance. They also require homeowners to carry flood insurance if they live in a high-risk flood zone.

Other types of insurance are optional. No one will make you buy life insurance, disability insurance, personal liability umbrella insurance or long-term care insurance. You don't even have to buy comprehensive coverage on your car if you don't mind paying to replace it yourself if it's stolen (that's called self-insuring). But you might want to have some types of optional insurance anyway to protect yourself, your family and your finances.

Sometimes insurance is unavailable for the risk you want to insure because the risk is so high or the potential loss is so large that insurers can't afford to cover it. For example, most insurance policies don't cover damage caused by acts of war. Sometimes insurance is unavailable to particular individuals because of their unique risk.

If you're terminally ill, you will not be able to get life insurance. If you're filed too many homeowners insurance claims, haven't taken care of regular maintenance on your house, have bad credit or live in a particularly high crime area, you might have a hard time finding an insurer that will offer you coverage.

Insurable Interest

To buy any type of insurance policy, you must have an insurable interest in the risk being insured against. This means that you would suffer a financial loss or legal liability if you didn't have insurance against that event.

For example, you can't buy automobile insurance for your neighbor's car because you don't stand to lose anything if she gets into an accident; if that accident happens to be with you, your own insurance would cover it.

And you can't buy homeowners insurance on your parents' home because you hope to one day inherit it. Your parents would have to purchase and own the policy – though you could reimburse them for the premiums.

How to Buy Insurance

You can buy insurance directly from an agent who works for a specific insurance company or from an insurance broker who is authorized to sell policies for many different insurance companies.

You can also buy insurance directly through an insurance company's website or through a website that offers policies from numerous insurance companies and allows you to compare prices.

The two types of insurance agents are captive agents, who work for a single company, and independent agents, who sell policies from many different companies and are compensated by each of those companies for every policy they sell.

A benefit of working with a captive agent is that they should be well versed in that company's offerings. A benefit of working with an independent agent is that they can shop around with different insurers to find you the best value on a policy. One type of agent is not necessarily better than the other for consumers as long as you understand what you stand to gain or lose from working with each type.

Underwriting

When you apply for a policy, an insurance underwriter will evaluate your underwriting risk before deciding whether to issue a policy to you and at what cost.

If the insurance underwriter denies your application, find out why and see if they would be willing to approve you if you remedied the problem. If not, you can keep trying other insurers until you get a yes.

To save time or to get insurance when you're especially high risk, an independent agent who specializes in people in your situation can be a tremendous help.

Your Insurance Contract

Your insurance contract defines the terms of the agreement between you and your insurance company. It lays out your responsibilities as well as the insurance company's responsibilities. It explains what losses the insurance company will cover and under what conditions, as well as what losses are excluded.

When you purchase an insurance policy, you will receive a copy of your insurance contract. You should read this contract from cover to cover right away. It might seem intimidating at first, but once you start to read it, you might find that you understand more than you think.

For the parts that you don't understand, you should do research online or talk to your insurance agent. You want to make sure that your policy protects you against everything you think it does and that you're getting what you think you're paying for.

Insurance contracts are usually standard forms; everyone who buys a policy gets the same contract. Don't expect to negotiate with your insurance company to get them to cover something that isn't covered by the standard form.