DEFINITIONS
Risk is the uncertainty of loss. Buying insurance transfers risk. There are two types of risk:
- Pure risk (insurable)
- Speculative risk (not insurable)
The following are risk management methods (STARR):
- Sharing
- Transfer
- Avoidance
- Reduction
- Retention

A peril is a direct cause of loss. A hazard increases the chance that loss will occur. There are three types of hazards:
- Physical
- Moral
- Moral

CHARACTERISTICS OF INSURABLE RISKS
The characteristics of insurable risks that make the rate of loss fairly predictable are large numbers of homogenous units, measurable loss, uncertain loss, economic hardship, and the loss must not be catastrophic.

ADVERSE SELECTION: the tendency of poor risks to purchase insurance

DOMICILE

- Domestic company: insurer incorporated under the laws of a home state
- Foreign company: insurer incorporated under the laws of another state, district, or territory
- Alien company: insurer incorporated under the laws of another country

AUTHORIZATION

- Admitted (authorized) insurer: licensed to transact insurance business in the state
- Nonadmitted (unauthorized) insurer: not licensed to transact insurance business in the state

ELEMENTS OF A LEGAL CONTRACT
There are four elements of a contract (CLOAC):
- Consideration
- Legal purpose
- Offer
- Acceptance
- Competent parties

CHARACTERISTICS OF INSURANCE CONTRACTS

- In a contract of adhesion, the insurer drafts the contract and it is not negotiable. The owner must adhere to the terms to benefit from the contract. Any ambiguity found in the wording will result in the courts finding in favor of the owner or insured.

ALETORY: there is an unequal exchange of values (consideration)

UNILATERAL CONTRACT: only one party is legally bound to perform its part of the agreement

INDEMNITY: restores an insured to the approximate condition existing before loss

WARRANTIES: guarantee material facts in the application

REPRESENTATION: statement made by the applicant that is true to the best of the applicant's knowledge

MISREPRESENTATION: statement that is false and voids a contract if it is material to the risk(s) insured

FRAUD: intentional act designed to deceive

MORALITY/MORBIDITY TABLES: used to predict future losses from death/illness

LIFE/HEALTH INSURANCE UNDERWRITING

Underwriters classify, select, and rate risks.

THE APPLICATION
The application must be signed by the insured, the applicant or owner, and the producer or agent. The policyowner, insured, and beneficiary could be three different persons in a life insurance contract.

Part I of a life insurance application collects personal and general information about the applicant.

Part II of a life insurance application collects the applicant's medical history information.

Part III of a life insurance application is the Producer or Agents Report. This section contains the producer's information of the financial status, habits, and character of the proposed insured.

CONDITIONAL RECEIPT: issued when premium is paid with the application and makes coverage effective as of the date of application or any required medical exam, whichever is later, as long as the policy is issued as applied for.

SOURCES OF INFORMATION
Medical Information Bureau (MIB): a nonprofit organization formed by insurance companies; used in underwriting to help detect fraud

Consumer reports and investigatory reports: credit reports and information collected through interviews about the insured. Both require the insured's knowledge and consent.

RISK CLASSIFICATION

There are four classifications of risk:
- Preferred
- Standard
- Substandard
- Declined

DISCRIMINATION: charging a different rate for individuals of the same class and risk based on place of residence, race, creed, or national origin

STATEMENT OF GOOD HEALTH: required at the time of policy delivery if the initial premium has not yet been paid

FAIR CREDIT REPORTING ACT: protects an individual's right to privacy and access to a credit report

FIDUCIARY: a person in a position of financial trust

BASICS OF LIFE INSURANCE

INSURABLE INTEREST: the person will suffer the financial consequences of death, illness, accident, or injury

THIRD-PARTY OWNERSHIP: when the owner and insured are two different parties

LIFE INSURANCE creates an immediate estate. The following are two approaches to take when evaluating life insurance needs:

- HUMAN LIFE VALUE APPROACH: takes into consideration the loss of future earnings if the insured dies
- NEEDS ANALYSIS APPROACH: takes into consideration the financial needs of the survivor(s)

KEY PERSON INSURANCE: is a type of insurance that protects the employer in the event a valuable employee dies. Premiums paid for key person insurance by an employer are not tax deductible.

Life insurance can also be used to fund a buy-sell agreement that provides the necessary cash for an individual to buy out a deceased individual's interest in a business so the business can continue without interruption.

PREMIUMS

The following are components of premiums:
- MORTALITY/MORBIDITY
- INTEREST
- EXPENSES

Premium mode varies. The following are different frequencies of premium payment:
- ANNUAL
- SEMIANNUAL
- QUARTERLY
- MONTHLY

The most expensive premium mode is monthly; the least expensive is annually.