KISH P & I LOSS PREVENTION CIRCULAR KPI-LP-119-2013

(Seven Principles of Insurance in Common Concept)

We all have at least one type of insurance, more often than not many more, you need one to have & drive a car, start a business, build a house or take a trip, in fact Insurances are so ubiquitous & omnipresent that it would be hard to imagine a world without one.

Like so many things we take for granted insurance is rarely understood. This notice will look at 7 principles that govern how insurance works worldwide and how you can make the most of them.

What is insurance?
Insurance provides compensation or cover for individuals or companies that undergo some accident or situation that causes physical, emotional or financial damage. Most of us understand that. But how does that work? How can companies provide this service?

►The Seven Principles:

One: Law Of Large Numbers
You need a lot of people to buy insurance or as they say it in the business, you need a large number of homogeneous units. Insurance experts are just hopeless romantics.
Large numbers are necessary in order for insurance companies to be able to calculate risk and work out the cost of providing insurance.
The bread and butter of insurance companies are statistics. Statistics is the tool that tells insurance providers what the chances are something will happen. If you have a large number of clients you can use the “law of large numbers” which states that if you have a large enough number of exposure units you can expect them to behave as the population in general does.
This principle is used when doing polls in elections. If you ask a large enough number of people how they will vote you can expect it to be representative of a whole country. This “law” allows an insurance company to use statistics and apply them to their clients. If for example the average driver spends $300 a year on repairs an insurance company can work out how expensive the insurance premiums should be.

Two: A Specified Loss
Insurance companies must have a specific coverage that clearly sets out what is being covered and what compensation will be paid out. This is one of the hardest things for customers to understand. We like to think that if we are covered by an insurance say a Health Insurance or Auto Insurance we are covered for any eventuality. Of course “any eventuality” is not a specified loss. Insurance coverage needs to be specific for insurance companies to calculate the cost of providing cover. That is why although insurance companies seem heartless when they will not cover a specific medical procedure it is often a case of needing to draw a line of what is covered and what is not.

Three: Accidents Must Be Accidents
This means that the accident must fortuitous or occur by chance. If the beneficiary causes the accident to happen, like burn down their own business, then the whole principles that insurance is built on will break down, making the business unviable.

Four: There Must Be Something Valuable To Insure
The potential loss to the client must be valuable or important enough to justify the high running costs of providing the service.

Five: The Cost Of The Insurance Premiums Must Be Reasonable
If the cost of the insurance cover is so large it is similar to the value of what is being insured the reason for the insurance no longer exists.

Six: There Must Be A Way To Calculate The Loss
This means that insurance companies must be able to estimate the chances of an insurance claim and calculate the cost of covering the claim.

Seven: Limited Risk Of Catastrophically Large Losses
This is another of the most polemic basis for insurance. Insurance companies limit their coverage to when there is a catastrophe (for instance; act of God) that causes many policyholders to claim their insurance. This is often necessary for the insurance company to be able to provide the service. If companies were to insure for catastrophic disasters the cost of insurance might be too high.

These characteristics are not universal & there are exceptions however they provide a benchmark by which to measure insurances and guide us in making insurance choices.