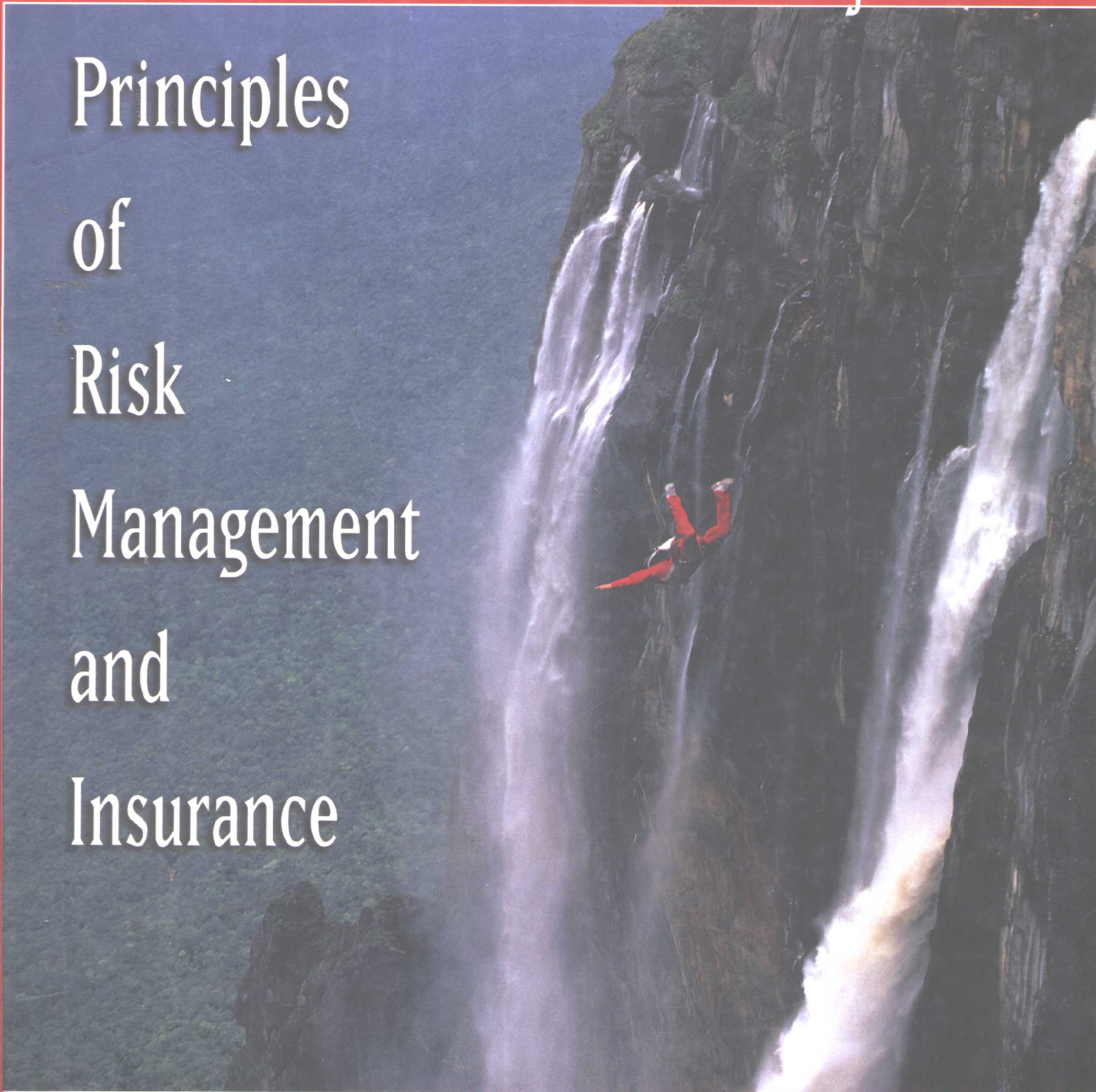


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Principles  
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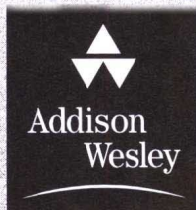


# Principles of Risk Management and Insurance



*Seventh Edition*

George E. Rejda



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# Preface

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In the three years since the sixth edition of *Principles of Risk Management and Insurance* was published, newspapers across the nation carried disturbing headlines that shocked and saddened Americans. Congress impeached President William J. Clinton for perjury and obstruction of justice; two teenage shooters entered Columbine High School in Littleton, Colorado, killing 12 classmates, one teacher, and then themselves; earthquakes in Turkey killed more than 1000 people; and Hurricane Floyd devastated parts of the Carolinas and other seaboard states, causing billions of dollars of property damage and enormous personal hardship. Speculators and day traders went on a frantic feeding frenzy, rocketing the prices of several Internet stocks to atmospheric levels; the nation feared a Y2K computer meltdown going into the new millennium; Microsoft Corporation faced a federal anti-trust suit because of an alleged software monopoly; and, on the bright side, Mark McGwire of the St. Louis Cardinals belted 70 home runs for a new major league record.

The U.S. Senate went on to acquit President Clinton in his impeachment trial; the media continues to grapple with why school children turn into rogue killers; earthquakes, hurricanes, tornadoes, and floods continue their awesome destruction; Y2K brought few problems; and Mark McGwire still hits home runs. To say that a lot has happened since the publication of the sixth edition might be an understatement.

Likewise, the insurance industry has experienced rapid changes in the last three years. Significant changes include a growing use of the Internet by insurance consumers; convergence of financial services; mergers and acquisitions; and demutualization of several large insurers. New federal legislation now allows banks, insurers, and investment companies to compete in each other's markets with fewer obstacles. In addition, insurers continue to settle class action suits by disgruntled policyowners regarding deceptive sales practices; commercial lines have been

deregulated in many states; and new forms of risk management are emerging, such as enterprise risk management. The problem of paying catastrophic losses from natural disasters continues to challenge the industry. Finally, the Insurance Services Office (ISO) introduced a new homeowners policy and new personal auto policy (PAP).

The seventh edition of *Principles of Risk Management and Insurance* reflects these changes and others. Like earlier editions, the text is designed for a beginning undergraduate course in risk management and insurance with no prerequisites. Thoroughly revised and updated, the seventh edition provides complete and current coverage of the major areas in risk management and insurance. Coverage includes basic concepts of risk and insurance, risk management, legal principles, property and liability insurance, life and health insurance, employee benefits, social insurance, and functional and financial operations of insurers. The seventh edition also emphasizes the changing nature of insurance regulation and current public policy issues, especially those affecting consumers.

As with previous editions, the seventh edition emphasizes the insurance consumer and blends basic risk management and insurance principles with consumer considerations. Further, it addresses personal risk management and financial planning, so that students can apply basic concepts immediately to their own lives.

---

## MAJOR CHANGES IN THE SEVENTH EDITION

1. **Increased emphasis on the Internet.** In recognition of the importance of the Internet as a powerful learning tool and source of insurance information to consumers, each chapter contains a number of Web sites that students can access. The seventh edition has an Internet site ([www.awlonline](http://www.awlonline))

.com/rejda) that will be updated periodically as new developments in insurance occur. The site also provides Internet Exercises corresponding to each chapter that instructors can assign. In addition, after studying each chapter, students can take a self-administered test online and get instant feedback on how well they have mastered the material.

2. **New “Insight” boxes.** Instructors and students have enthusiastically endorsed the “Insight” boxes in each chapter in previous editions. “Insights” are effective learning tools that provide real-world applications of principles. Most “Insights” have been replaced with compelling new ones, such as the following examples:

- “More Bad News for Widows”
- “Parts Case May Hike Premiums, Auto Insurers Say Generic Parts Have Helped to Keep Costs Down”
- “Genetic Testing Threatens to Alter Fundamentally the Whole Notion of Insurance”
- “Report Says Mistakes in Medicine Too Frequent”
- “New Life Study Reveals Crisis of Underinsurance”
- “Look for Term Insurance Rates to Rise in the Future”
- “For-Profit HMOs Score Lower on Care”
- “Rising Numbers of Doctors Cut Links to HMOs”
- “Ten Common Causes of Errors in Pension Calculations”
- “Are Professional Football and Baseball Players Eligible for Workers Compensation?”
- “Boundaries Blurring for Financial Services”

3. **Clarity in writing.** Insurance as a subject can intimidate students if set forth in a disjointed or abstract way. Since readability is crucial, I persist in presenting concepts clearly and directly, for the most user friendly of texts.

4. **Technical accuracy.** As in past editions, numerous insurance specialists and experts have reviewed the text for technical accuracy, especially in areas where changes have occurred rapidly or dramatically. The seventh edition offers the most technically accurate and up-to-date information available.

## CONTENT CHANGES

Thoroughly updated, the seventh edition provides an in-depth analysis of current issues, which readers expect from *Principles of Risk Management and Insurance*. Timely content changes include the following:

1. **Heightened coverage of risk management.** In response to instructors’ requests for more emphasis on risk management, the seventh edition contains a new stand-alone chapter on advanced topics in risk management (Chapter 4). Topics discussed include enterprise risk management, financial risk management, loss forecasting, financial analysis in decision making, and the application of new technology to risk management programs. In addition, Chapter 3 now includes a discussion of personal risk management for instructors who prefer this approach.
2. **New homeowners policy.** Chapters 8 and 9 discuss the major provisions in the new homeowners policies drafted by the ISO.
3. **New personal auto policy (PAP).** Chapter 10 discusses the basic provisions of the 1998 PAP drafted by the ISO. The chapter contains an appendix that summarizes the basic coverages in the new PAP, for the benefit of students.
4. **Consolidation of life insurance planning.** Discussion of life insurance planning and the needs approach has been streamlined and condensed into one chapter (16) to enable instructors to discuss the needs approach quickly and easily.
5. **Life insurance premiums quotes.** Chapters 16–19 contain a number of Internet sites that will enable students to obtain life insurance quotes conveniently (for example, see Exhibit 19.5 on page 404).
6. **Elimination of estate planning chapter.** Because few instructors teach estate planning in the introductory course, coverage of estate planning, which appeared in a separate chapter in earlier editions, has been substantially reduced and integrated with the material on the taxation of life insurance (Chapter 19).

7. **New chapter on annuities and individual retirement accounts (IRAs).** Because of their importance, annuities and IRAs are now discussed in a new chapter (20) dealing with retirement plans. The chapter contains a number of interesting Internet sites that provide additional material on annuities and IRAs.
8. **Managed care plans.** The important area of managed care plans has been updated to discuss physicians' widespread dissatisfaction with managed care plans and proposals for patients' bill of rights.
9. **Social Security and Medicare financial problems.** Chapter 24 outlines the various proposals for dealing with the financial problems plaguing Social Security and Medicare.
10. **Convergence of financial services.** Chapter 25 examines the important and timely topic of the convergence of financial services in the insurance industry. Chapter 25 also discusses demutualization of large insurers and the formation of mutual holding companies as a response to the trend toward "one-stop shopping."
11. **Life insurance distribution systems.** Material dealing with life insurance distribution systems has been substantially revised. Chapter 25 discusses the major life insurance distribution systems that life insurers are now using.
12. **Timely issues in insurance regulation.** Chapter 28 examines a number of timely issues in insurance regulation, including the new Financial Modernization Act of 1999, the convergence of financial services, the increase in mergers and acquisitions, the growth of the Internet, the insolvency of insurers, the quality of insurance regulation, and the deregulation of commercial lines.

## SUPPLEMENTS

The seventh edition contains a number of new supplementary materials—specifically an Instructor's Resource CD-ROM and a Companion Web site—to help busy instructors save time and teach more effectively. The following items are available to qualified domestic adopters but in some cases may not be available to international adopters:

**Companion Web Site** As noted earlier, the seventh edition provides an Internet site (available at [www.awlonline.com/rejda](http://www.awlonline.com/rejda)) that will be updated periodically. The site offers self-administered quizzes and Internet exercises corresponding to each chapter. The Companion Web site system provides an online syllabus builder that allows instructors to create a calendar of assignments for each class and to track student activity with an electronic gradebook.

### **Instructor's Manual with Transparency Masters**

Designed to reduce start-up costs and class preparation time for busy instructors, this comprehensive manual contains teaching notes; lecture outlines; answers to all in-text review, application, and case questions; and transparency masters that illustrate key points.

**Test Bank** Prepared by Michael J. McNamara, Washington State University, this new test bank enables instructors to construct objective exams quickly and easily. The test bank contains new mini-case objective questions to test students' critical thinking skills and analytical abilities.

**Study Guide** Prepared by Michael J. McNamara, Washington State University, this study tool is an improvement over traditional study guides. The guide contains exercises that enable students to apply basic concepts to their own personal risk management program. Each chapter contains objective questions similar to test bank questions, worksheets (where appropriate) for solving end-of-chapter cases, and answers to all questions at the end of each chapter for quick reference and self testing.

**Instructor's Resource CD-ROM** Fully compatible with the Windows NT, 95, and higher platforms and Macintosh computers, this CD-ROM provides a number of resources. First, PowerPoint lecture slides of all figures and tables from the book enhance classroom presentations. Instructors with Microsoft PowerPoint 97, 98, or higher can customize the slides by adding their personal lecture notes. Second, for added convenience, the CD-ROM contains Microsoft Word files for the entire contents of the instructor's manual. Finally, the CD-ROM includes computerized test bank files. The easy-to-use software (TestGen-EQ with QuizMaster-EQ for Windows and Macintosh) is a valuable test preparation tool that allows professors to view, edit, and add questions.



## ACKNOWLEDGMENTS

A market-leading textbook is never written alone. I owe an enormous intellectual debt to many people for their gracious assistance. Numerous educators and insurance experts have taken time out of their busy schedules to review part or all of the seventh edition, to provide supplementary materials, or to make valuable comments. They include the following:

Vickie L. Bajtelsmit, Colorado State University  
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 Joseph M. Belth, professor emeritus, Indiana University  
 James O. Brown, Delta State University  
 William L. Ferguson, University of Southwestern Louisiana  
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 Kenn B. Tacchino, Widener University  
 Brenda P. Wells, University of North Texas  
 Eric A. Wiening, American Institute for Chartered Property Casualty Underwriters  
 Millicent W. Workman, Mueller Industries, Inc.  
 Emily Norman Zietz, Middle Tennessee State University

Special thanks are due to Michael J. McNamara of Washington State University. Professor McNamara wrote the new chapter (4) on advanced topics in risk management and the study guide. He also developed a new test bank and reviewed each chapter for clarity and accuracy. As a result, the seventh edition is a substantially improved product.

I also wish to acknowledge the technical assistance of Rebecca Ferris, who served as the development editor for the seventh edition. Her keen editorial insights and numerous suggestions have been invaluable.

Finally, the fundamental objective of the seventh edition remains the same as earlier editions—I have attempted to write an intellectually stimulating and visually attractive textbook from which students can learn and professors can teach.

*George E. Rejda, PhD, CLU*  
*V.J. Skutt Distinguished Professor of Insurance*  
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