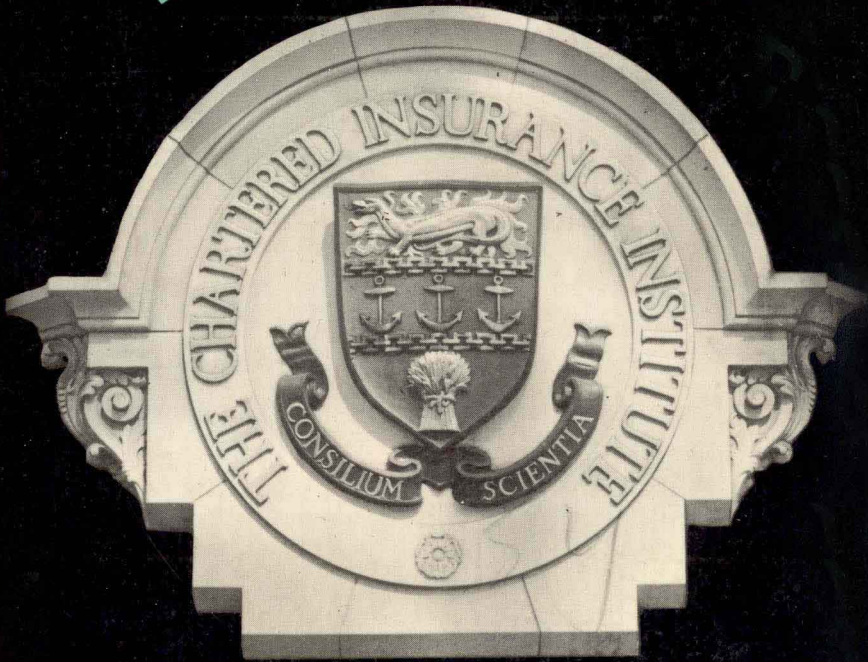


Fifth Edition

# ELEMENTS OF INSURANCE



WA Dinsdale & DC McMurdie

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# **Elements of Insurance**

*Fifth Edition*

**W. A. Dinsdale, Phd, FCII and**

**D. C. McMurdie, LLB, FCII Barrister**

**Pitman**

**PITMAN BOOKS LIMITED**  
128 Long Acre, London WC2E 9AN

*Associated Companies*

Pitman Publishing Pty Ltd, Melbourne  
Pitman Publishing New Zealand Ltd, Wellington  
Copp Clark Pitman, Toronto

© Rita M. Dinsdale and D. C. McMurdie 1971, 1973, 1980  
Fifth edition published in Great Britain 1980, reprinted 1982, 1983

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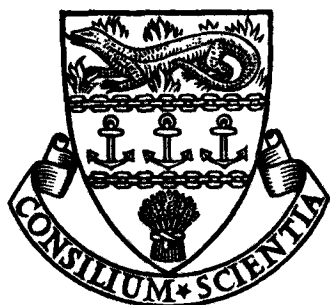
Text set in 10/11 Times

Printed and bound in Great Britain  
at The Pitman Press, Bath

ISBN 0 273 01414 5

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# **The Chartered Insurance Institute**



This handbook is issued under the authority of The Chartered Insurance Institute and is designed specially for the use of students.

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## **Preface to Fifth Edition**

The business of insurance is operating today in a world of intensifying complexity. The factors which contribute to this are many, including new supervisory and control legislation, scientific and technological developments and the new hazards which they bring, extensive law reform with its impact on underwriting, new marketing techniques and economic pressures, not the least of which is the problem of inflation. Added to these are the problems of designing a coherent insurance policy within the framework of the EEC. Although this book is merely an introduction to insurance, a new edition is necessary in order to keep abreast of these changes.

This edition has been written without the invaluable help of my co-author and late colleague, Dr W. A. Dinsdale, who died in 1970. In order to take account of the many changes over the last eight years it has been necessary to revise considerably some of the chapters which we wrote together. However, his influence on the book is still most marked and I trust that his comprehensive knowledge of insurance and lucidity of style will not be entirely lost for some years to come.

Because of the complexity of insurance, it is essential to acquire a general basic knowledge of the business as a whole, and this should certainly be the first step to be taken by new entrants with an insurance career ahead of them. In this way a sense of perspective is obtained, and sound foundations laid for future specialized studies. This is the reason why 'elements of insurance' has been an examination subject since 1954, and this book has been designed to cover the syllabus for this subject in the CII Qualifying Examination and also in the examination for the option module 'elements of insurance' in the Business Education Council National Certificate in Business Studies.

General before specialized studies are desirable. Every insurance student should begin by a study of the risks in life and business with the application of insurance to risk. This necessitates an acquaintance with the development, scope and function of insurance (and re-insurance), the insurance market, the legal principles of insurance—utmost good faith, insurable interest and indemnity—and

insurance practice, such as the structure of proposal and policy forms, cover notes, endorsements and renewal procedure. The associations of Insurers and of persons engaged in insurance, the organization of the Companies and of Lloyd's, the ancillary services rendered by Insurers and State regulation of the business also fall within the general introduction to insurance studies. These and other features, including a chapter on claims procedure, are dealt with in this book.

Insurance is so wide in scope that later some degree of specialization is usually necessary. After an initial period of general training, people employed in insurance companies may specialize in one of the many branches of business or even on a narrower basis in one of the principal classes of insurance.

Insurance brokers, however, may not specialize in the same way, although there are often specialists in the larger firms and there are specialist brokers in the Life and Pensions field. One of the dangers of specializing is the development of a narrow outlook, but this is less likely if at the outset a general background is obtained.

In addition to supplying the needs of the examination student, the book is planned for the student at the College of Insurance who follows an introductory course and needs a text book to supplement the oral instruction received. It should be of equal value to new entrants who follow internal office training courses. Then, too, teachers in Business Studies or Economics at institutions of higher education are advised to include in their instruction something about insurance in the same way as they deal with banking, shipping and other services to the community. This book gives the necessary information and can be used by both teachers and students of Business Studies.

In the preparation of previous editions suggestions have been received from various friends and acknowledged with gratitude.

*London*  
1979

D.C.McM.

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## **Preface to First Edition**

Insurance covers a very wide field of activity. Its many sections are highly specialized and no man can hope to be master of the whole. Indeed, a considerable period of training in theory with practical experience is necessary in order to obtain a sound knowledge of any one of the main branches of the business—marine, fire, life, or accident insurance. Specialization, however, proceeds farther than this, so that, for example, profits insurance, public liability indemnities, or fidelity guarantee may well be for the specialist the study of a lifetime.

At the same time, there are certain fundamental principles which are common to all classes of insurance, for example, utmost good faith and insurable interest, while in matters of general practice, such as office organization and procedure, reinsurance, and accounting, the underlying method is the same, although there are often differences in detail between the various departments. It is the purpose of this book to deal with the general features of the subject, so that the student may be able to obtain a broad view of insurance as a whole.

There is much truth in the suggestion that one of the dangers of specialization is the development of a narrow outlook. It follows that a general knowledge of insurance, apart from a specialized acquaintance with the features peculiar to one branch, cannot fail to be of value to the student.

It was originally intended to prepare this book jointly with my colleague, Mr H. A. L. Cockerell, B.A., F.C.I.I., but pressure of work made this impossible. I have, however, had the benefit of his advice throughout.

This book is designed primarily for the use of those preparing for The Chartered Insurance Institute Associateship Examination: General Branch, but it can be read with advantage by any insurance man who desires to refresh his knowledge of the fundamental features of the business in which he is engaged.

Valuable help has been received from the suggestions made by various friends, to whom sincere thanks are due, and, in particular.

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to Mr S. K. Dunford, F.C.I.I., for his technical criticism of the script, and to Mr G. W. Southgate, B.A., who has checked the proofs.

*London*  
*July, 1948*

W.A.D.



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# 1 General Approach to Insurance

Insurance is a device for the handling of some of the risks—or chances of loss—to which man is subject. Risks can be classified in various ways. For example, there are business risks and personal risks. Business risks include possible loss of goods by fire or theft or loss by reason of periods of bad trade. Every individual faces risks, so that like the trader his goods may be destroyed while his dependants may suffer loss of income through his death. Another classification is into dynamic or speculative risks, which are uninsurable, and static or pure risks, which are insurable because they are susceptible to the principles on which insurance is based.<sup>1</sup>

Dynamic risks may result in either a profit or a loss, which may be either large or small. There are many risks in the marketing of goods as, for example, changes in fashion making valuable stock unsaleable, variations in trading profit on account of cycles of national prosperity and depression, and labour disputes, which may mean loss of orders on a large scale, both at home and overseas. The marketing of a new product is always risky; it may make a wide appeal or be a complete failure. Political risks, such as the consequences of an outbreak of war or loss of overseas trade by the imposition of currency restrictions, likewise cannot be foreseen. There is no way of measuring these risks and they are therefore uninsurable by commercial Insurers.

Static risks, on the other hand, can result only in loss, such as shipwreck, physical loss of or damage to goods by fire, theft or, say, riot (called perils), the incurring of legal liability to pay damages by negligently causing bodily injury to, or damage to the property of, others, and death, which comes to all sooner or later. These risks are insurable, because they are measurable statistically. For instance, mortality tables extending over a long period and covering hundreds of thousands of lives make it possible to calculate the average number

<sup>1</sup> Some writers have used the term uncertainty as a synonym of an uninsurable or dynamic risk, and the word risk for an insurable risk, but today risk and uncertainty are usually regarded as identical.



of people who will die in any given year. This is the basis of life assurance. It is thus possible by this law of large numbers or the law of averages to calculate what are the chances of an event or events happening and the amount that will be required to provide the common fund or pool to which the many contribute, and out of which those who suffer losses are compensated.

The risks which can be insured have increased in number and extent owing to the growing complexity of the present-day economic system, and insurance therefore occupies an important place in the modern world. It would be impossible to do without insurance. Moreover, because insurance has over the years been able to offer better service through growing financial strength of Insurers, more reliable statistics, and research within the business itself, it is today impregnable.

### Methods of Handling Risk

Because the economic risks faced by businesses and individuals are inevitable concomitants of life, some means of dealing with them have had to be devised. There are the following main possibilities:

#### Risks may be avoided

Some people may balance the pleasure to be derived from some risky course of action against the degree of risk involved. Thus, for the sake of the short-term gains of cigarette-smoking some people accept a much higher risk of early death. If a man feels that the risk is too great for the pleasure involved, he can stop smoking or not start it. Similarly, it is possible to avoid involvement in an aeroplane accident by not engaging in air travel. Carried to its logical conclusion, however, avoidance of risk would make life very tame and unbearable, if not impossible. Moreover, some risks are inherent in life itself and cannot be avoided. Men are mortal and all must die. The only uncertainty is the date of death, but the fact of death cannot be avoided.

Usually, avoidance is only a satisfactory method of counteracting risk when a choice is available. If a man buys a house he runs the risk of it being destroyed by fire. A house with a thatched roof is a greater fire risk than one with a tiled roof. Most people will avoid the greater risk attaching to the thatch and accept the smaller risk