



Subject: Non-Life Insurance PPP

Chapter: 3: Product, Underwriting &
Claim settlement 2
Corporate Product Lines –
Liability Insurance

Category: Notes

Liability Insurance

Liability insurance cover provides indemnity to the insured in respect of financial consequences arising out of liability under the civil law. The liability arises either due to the operation of

- Law of torts
- Specific statutory enactments

It provides the insured party with protection against claims resulting from injuries and damage to people or property. Liability insurance policies cover both legal costs and any payouts for which the insured party would be responsible if found legally liable. Intentional damage and contractual liabilities are generally not covered in these types of policies.

In legal terms, the word liability refers to fault. The person who is at fault is liable to another because of his or her actions or failure to act. One example is in the case of a crime. The liability of the offending party may include providing restitution for damage to property or paying medical bills in the case of physical injury.

Automobile accident, an example of liability in the legal realm is an automobile accident. The person who caused the accident, through action or omission, is liable to the injured party. Liability insurance exists for just such a purpose. It covers the expenses of the injured party, including damage to the vehicle or other property as well as a certain amount of medical expenses, and may reimburse the injured party for attorney's fees if civil action is required.

In accounting terms, liability describes an obligation. It refers to money owed to complete a transaction, debt that has yet to be paid, or products or services that have been paid for but have not yet been rendered. There are two general classifications to sum up these types of liability: long term and short term.

- Long-term liability describes debt paid out over more than one year, while
- Short-term liability refers to debt paid within a year or less.

Some other examples of liability include: Money that is yet to be paid out, such as benefits from a life insurance policy or a settlement, either one of which represents a liability for the insurance provider.

An employee's pension, as well as any other savings or retirement fund, is also considered a liability for a company. For the consumer, liabilities may include a home mortgage, second mortgage, line of credit, lien of any kind or car payment. Of course, for the entity to which these monies are owed, each item generally represents an asset.

Overall, liability simply describes some form of obligation or responsibility. It represents an outstanding debt, products or services that have yet to be provided, or acknowledgment of responsibility and payment provided for damage caused through actions or negligence.

Types of liability insurance

There are different types of liability insurance, including general liability, which works in much the same way as auto liability insurance, but covers businesses. General liability protects a company from third party claims. Aside from general liability, there is also D & O liability, employer liability, and professional liability insurance.

1) Commercial general liability (CGL) policy:

A CGL policy protects the businesses against the claims arising out of bodily injury and property damage arising out of:

- Premises
- Operations
- Products
- Completed operations

It also covers the losses caused due to advertising and personal injury.

Case Study:

A customer visits a construction company to look for the sample flats of its newly constructed residential project. During the visit, the customer trips on the loose flooring and suffers a leg injury. The commercial general liability policy taken by the construction company covers the loss caused due to the medical expenses of the bodily injury of the customer.

2) Directors and Officers liability insurance:

It is a type of liability insurance which covers the directors and officers against the claims made by

- Employees
- Suppliers
- Competitors
- Regulators
- Customers
- Shareholders
- Other stakeholders

Case Study:

The dismissal of the four employees of the firm was based on cost-cutting measures, but the female employee filed a suit claiming that a particular director had always discriminated her on the grounds of her gender.

However, upon investigation, it was cleared that she was dismissed based on the cost-cutting measure of the firm. Thus, the directors and officers liability insurance taken by the firm protected its director against the claims.

3) Professional indemnity insurance:

A Professional Indemnity Insurance is a type of liability insurance that covers the businesses or individuals who provide advice or a professional service to clients. It covers the compensation claims when the business is sued by its clients for making a mistake.

Case Study:

An investment firm was approached by a client for giving an investment advice. Upon implementation of the advice, the client suffered huge financial losses.

The professional indemnity insurance policy covered the investment firm for the losses suffered by the client and helped it to settle the claim.

4) Cyber risk insurance:

A cyber insurance policy is designed to help an organization or business to cover against the liability and property losses arising due to any electronic activity that the business engages in. This policy helps to offset the risk involved with recovery, after a cyber-related security breach.

Case Study:

A dismissed employee of the IT company stole the names, addresses, social security numbers from the customer files. She gave this information to a fraudulent person who in turn used it to obtain credit cards. The affected customers filed a complaint against the IT company for their breach of identity. However, the cyber risk insurance policy obtained by the IT firm helped to settle the claims of the customers.

5) Commercial crime insurance:

A Commercial Crime Insurance policy offers to protect the businesses against the losses due to third-party fraud or employee fidelity. It protects the business against:

- Employee dishonesty
- Theft of money
- Burglary
- Robbery
- Forgery
- Computer fraud

Case Study:

An employee of a cable manufacturing company stole bundles of cables from the inventory which was later discovered at a salvage yard. The inventory was found in a damaged state.

The commercial crime insurance policy protected the business against the loss caused due to robbery.

6) Carrier legal liability insurance:

Carrier legal liability insurance covers the insured for the physical loss or damage to goods or merchandise directly caused by fire or/and accident to the vehicle while such goods or merchandise are in transit. It covers for the losses of the goods or merchandise when they are in the custody of the insured.

Case Study:

A transportation company was in the business of transporting assignments of other companies to their destined locations. During one such transit, the goods of a small business owner were damaged due to the accident. However, the carrier legal liability insurance secured by the transportation company helped it to cover the financial loss caused to the business owner.

7) Product liability insurance:

A product liability insurance covers the business against the claims arising with respect to its products and services. The claims may arise due to personal injury or property damage caused due to the products or services of the business.

Case Study:

A paint manufacturer imported the cardboard material required to produce color charts for different paints. However, the finished product of cardboard supplied by the vendor was of a sub-standard quality which caused the final coat of paint to appear a shade lighter. As a result, the paint manufacturer suffered losses and sued the vendor for the same. The product liability insurance policy of the vendor helped him cover the losses.

8) Trade credit insurance:

This insurance helps the business owners to protect their accounts receivable from loss due to credit risks such as protracted default, insolvency or bankruptcy.

Case Study:

A steel company sells a large shipment of raw product to its major client company, who in turn makes other steel products and sells it in the market. In the case where the client company is unable to pay back to the steel manufacturer, due to loss of business, the trade credit insurance policy will cover the steel manufacturers for the portion of the debt.

Underwriting

The general underwriting factors available in all liability insurance are:

The **insured's name** is one of the important factors which appear on the application forms of insurance. The names of the members of the applicant's household or business are also critical in order to assess the entire risk to which the short-term insurer will be exposed. The applicant may present a low risk level, while the members of his/her household or business may expose the short-term insurer to unacceptable high risks. The **age of the applicant and the members of his/her household or business** is also important, as young as well as old people may bear a higher risk. The physical address of the insured's household or business is important as it provides an indication of the **geographical location** of the premises and the risks associated

with the neighbourhood. Unsafe vicinities may have a higher risk level and may therefore have to pay a higher premium if the risk is eventually covered by the short-term insurer.

The character, reputation and lifestyle of the applicant, applying for liability insurance, and the members of his/her household or business provide an indication whether they are exposed to more than normal risk due to the level of their dangerous or harmful lifestyles. The **claims history** of the applicant and the members of his/her household or business, is very important as it provides the details concerning the number of claims and the extent of the claims from various insurers in the past.

The **implementation of safety precautions** by the applicant and the members of his/her household or business, which may be of a physical, financial or procedural nature to avoid liability exposures, is an important underwriting factor to consider by the insurer.

It is of prime importance to take any refusals of coverage by any insurer to the applicant or the members of his/her household or business in the past into account. The focus should be on the reasons why the insurer was reluctant to provide indemnity to the particular exposures. An applicant should also disclose previous **criminal convictions** of him/her or the members of his/her household or business to the short-term insurer even if the conviction occurred long ago.

The amount of coverage which the applicant requires, the liability coverage which the applicant and the members of his/her household or business already obtained from other short-term insurers, as well as aggregate indemnity limit of liability coverage which the applicant and the members of his/her household or business will eventually have, should point at the extent of the liability exposures of the applicant and the members of his/her household or business.

The nature and particulars of the liability exposures for which the applicant and the members of his/her household or business want coverage are also an important underwriting factor in the underwriting process of liability insurance.

Over and above the general underwriting factors present in all types of liability insurance, there are also underwriting factors which are linked to particular types of liability insurance. The following sections focus on the underwriting factors which affect product, public, employer's, professional, personal and householder's liability insurance.

The underwriting factors of product and public liability insurance

The number of branches of the applicant, the number of employees at each branch, the annual turnover of the enterprise, the various types of products manufactured and/or sold, as well as the liability coverage provided to the applicant up to a stipulated indemnity limit, are amongst the most important underwriting factors when underwriting product and public liability insurance. When the number of branches and/or the number of employees of an enterprise increase, it may point to an increase in the product and public

liabilities. The extent of the annual turnover may indicate two aspects, viz. a positive correlation between the extent of the turnover and the associated risk concerning product and public liabilities, as well as the ability of the enterprise to afford the insurance premium and to settle any excess in the event of a claim. As the types of products manufactured and/or sold by the applicant may differ regarding their level of liability risks and the possibility of defective products, the short-term insurer should obtain detailed information concerning the nature thereof. The level of the premium should be adjusted according to the level of risk related to the various types of products on the premises of the applicant. The legal aspect of product liabilities should play an important role in this type of liability insurance as tort doctrines may negatively impact on the underwriting risk. Due to the high risk of product and public liabilities which may have a long-tailed nature, short term insurers prefer to limit the possible claims amount up to a stipulated indemnity limit. The short term insurer thus estimates the possible extent of the maximum claims amount in advance and can set the premium level of the applicant accordingly. It should also be borne in mind that the application of public policies and decisions by authorities may stimulate or counteract the effective functioning of the insurance market concerning public liability insurance

The underwriting factors of employer's liability insurance

Employer's liability insurance covers the risks of an accident or injury to the employees when they are in the employer's service. Employment practices and labour laws have an important impact on the application of employer's liability insurance. The following underwriting factors should play a vital role in employer's liability insurance as the factors are indicating the level and extent of associated risk, namely the number of employees, their average annual wage level and the nature of the manufacturing and/or sales operations of the enterprise. The amount of premium charged by the short-term insurer should increase when the impact of these underwriting factors increases, especially when an escalation of dangerous activities occur.

The underwriting factors of professional liability insurance

Professional people are accustomed to disclose information to relevant parties. When a short-term insurer underwrites professional liability insurance, the professional person should also disclose information to the insurer to enable the underwriter to assess the level and extent of the associated risk. Special attention should amongst others be paid to the professional knowledge and experience of the staff, whether they are registered at a professional association, the level of fees which they are able to charge, their claims history, as well as their internal controls and procedures to lower their professional risk.

The underwriting factors of personal liability insurance

Although personal liability insurance usually covers the insured and the members of his/her household when they are not at their residence, short-term insurers may sometimes offer personal umbrella liability insurance which may provide a more extensive coverage; The Insurance Institute of South Africa, n.d.:9/8). Bodily injury and disease to the third party and damage to the property of the third party may be caused by the private activities of the insured and the members of his/her household. These private activities may, for example, be caused by the use of sport equipment, roller blades and bicycles or by domestic animals. It is logic that the larger the number of insured's covered by a specific insurance policy and the higher the risk level of their activities are, the higher the premium will be.

The underwriting factors of householder's liability insurance

Householder's liability insurance covers liability to third parties for bodily injury, disease and damage to their property caused by events on or in connection with the premises of the insured. Householder's liability insurance should not be confused with house-owner's property coverage which covers the property of the insured as such. The short-term insurer should take the information regarding the activities on or in connection with the property of the insured into account when underwriting householder's liabilities.