

# Six Reasons The Loss Is Excluded

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Insurance was created as a mechanism to protect insureds against the financial consequences of an unforeseen, potentially catastrophic individual loss. The number of covered perils has expanded and contracted over time to match the changes in exposure's severity, frequency and ultimate costs; but the original concept of protecting the insured's financial condition has not changed. However, insureds are not protected against every possible source of financial loss.

Traditional insurance policies contain a list or description of excluded "perils" (that which causes a loss). This is true whether a property or liability form; and regardless whether the insured is a commercial or personal lines client. Exclusions always exist, and there is a reason for each one.

## Exclusion Categories

To understand the six reasons for each exclusion first requires knowledge of the three broad categories of exclusions. The three categories of exclusions are: 1) excluded "perils;" 2) excluded "hazards;" and 3) excluded "property." A "peril," as defined previously, is the actual cause of the damage resulting in financial loss (i.e.

fire); a "hazard" is anything that increases the likelihood that a financial loss or "peril" will occur (i.e. frayed wires (the hazard) may cause a fire (the peril)). "Property" can be tangible or intangible.

Excluded perils and excluded hazards are not equal in their ultimate effect on the insured. "Excluded perils" can generally (but not always) be remedied either by an exception to the exclusion, an endorsement or the purchase of a separate policy. Conversely, "excluded hazards" are almost always absolute with little possibility of plugging the hole created by the exclusion or broadening any coverage that may be given by an exception to the exclusion.

In ISO's "Cause of Loss - Special Form" (CP 10 30), for instance, "Earth Movement" is an excluded peril but "War and Military Action" is an excluded hazard. Insureds can purchase earthquake coverage; but even difference in condition (DIC) forms exclude war, leaving the insured no reasonable recourse. Earth movement is the peril, the cause of the loss; whereas war or military action simply increases the chance that something is going to happen - the war itself doesn't cause a loss, it's just a hazard that increases the chance of a loss.

Some exclusions walk the line between "excluded peril" and "excluded hazard." The "Ordinance or Law" exclusion is an example. Ordinance or law is a "peril" because the enforcement of building codes actually does cause a financial loss; but it's also a hazard because the condition of being "out of code" increases the amount of loss and the possibility that a peril will occur.

"Excluded property" is somewhat self-explanatory. Under the commercial property form, for example, there is no coverage for money; and under the general liability form there is no coverage for the property of others in the insured's care, custody or control (with some exceptions).

Both are "property"-related exclusions.

Why is it Excluded?

From the three broad exclusionary categories flow the six reasons for exclusions. Nearly all policy exclusions arise from one of the following:

1. The peril, hazard or property is better covered elsewhere; 2. The loss or damage is catastrophic in nature; 3. The loss or damage is not accidental or unforeseen; 4. The insurance carrier is willing to provide coverage; they just want more information and more premium; 5. The insurance carrier wants to control the amount of coverage granted; or 6. The loss results from a "speculative" or business risk.

1. The Peril, Hazard or Property Can be Better Covered Some exclusions exist because there is a more appropriate coverage form available to provide the needed protection. Money loss is excluded in the commercial property form because this exposure is better covered under a crime policy; likewise, the use of an auto is excluded under the commercial general liability policy because the auto policy is the more appropriate place for coverage.

Property and liability forms both contain exclusions existing simply because the particular form was not created for that specific exposure.

It is incumbent upon the agent to cover those exposures with the appropriate policy.

The final reason for the use of separate policies is the threat of adverse selection

<[http://www.mynewmarkets.com/article\\_view.php?id=91435](http://www.mynewmarkets.com/article_view.php?id=91435)> (see definition). Some perils and hazards are such that only those in danger of suffering such loss are willing to pay for the coverage. If only a small number of insureds buy the coverage, the insurer would not have the ample funds to pay the potential losses; which would require higher premiums - resulting in fewer insureds (thus begins the adverse selection spiral). Some of these excluded losses also fall under the catastrophic loss exclusion.

2. The Loss or Damage is Catastrophic in Nature Insurance was not designed to respond to community disasters, only to individual "disasters." Certain perils and hazards have the potential to result in wide-spread damage the industry is not structured to handle; nor is the consuming public willing to pay the additional premium to finance coverage for catastrophic losses in their policies.

Two "adverse selection" exclusions, as discussed in the previous section, within the commercial property form also fall under the "catastrophic" loss category. Flood and earthquake damage can be insured by purchasing other coverage, but damage by these perils is considered catastrophic so coverage is not provided in the property form.

3. The Loss or Damage is not Accidental or Unforeseen by the Insured An "insurable loss" is one that is accidental, unforeseen, definite in time and place and is measurable. Intentional acts of the insured are excluded in nearly every insurance policy, property or liability. Also falling outside the definition of "insurable loss" are losses that are likely to or will happen, damage specifically controllable by the insured and known events.

- Exclusions for losses that are likely or will happen: Wear and tear to property is going to happen, as does general deterioration; the insurance company is not going to insure something guaranteed to happen (the policy would then be a warranty rather than insurance).

- The insured can control the loss: This eliminates coverage for intentional acts; damage over long periods of time; and failure to care for the property (not maintaining heat to keep water pipes from freezing). An example from the CGL is the violation of SPAM laws.

- Exclusion for known or previously occurring events: This eliminates coverage for losses that the insured knew about prior to the policy period or began prior to coverage being enacted.

4. Insurance Carrier Wants More Information and Premium Endorsements are available to remove or narrow the breadth of some policy exclusions, allowing the insured to customize coverage to fit its needs. Insurance policies are, to some extent, written with the "average" insured in mind; not doing this would increase premiums for all insureds - even when some have no need for the additional coverage. Other-than-average insureds with special exposures or needs have the option to endorse away various exclusions.

Additionally, before granting extended coverage insurance carriers often want more information about the insured plus some additional premium.

This allows some level of policy customization for unique insureds while maintaining an appropriate premium for the risk but without discriminating unfairly against insureds which do not need the same breadth of coverage.

5. Insurance Carrier Wants to Control the Amount of Coverage Granted The commercial property policy specifically excludes loss caused by collapse; but then it gives back some coverage for loss caused by collapse under the "Additional Coverage" section. Excluding coverage only to give it back under another section (or even in the same section) seems to perpetuate the public's perception that insurance is confusing. But this method is not as counterintuitive as it first appears.

Excluding coverage and giving some of it back allows the insurance carrier to dictate the exact amount of coverage they are willing to offer. They control the breadth of coverage. Compare that with trying to give the coverage outright then limit it with exclusions; there is no way that all possible situations could be imagined leading to confusion and likely court involvement.

Taking coverage away and giving it back in pre-determined amounts makes far more sense and reduces the potential for confusion. This tactic is used in property and liability coverage forms.

6. Speculative or Business Risk Exclusions "Pure risk

<[http://www.mynewmarkets.com/article\\_view.php?id=92443](http://www.mynewmarkets.com/article_view.php?id=92443)> " has only two possibilities, something bad happens or nothing happens. There is no possibility for gain; the insured enjoys a "zero-sum year" or suffers financial loss. Pure risk, also known as absolute risk, is insurable. Its counterpart is "speculative risk."

"Speculative risk

<[http://www.mynewmarkets.com/article\\_view.php?id=92443](http://www.mynewmarkets.com/article_view.php?id=92443)> " (or "business risk") involves the chance of loss, of no change or gain. Insurance is not designed to protect the insured from a bad investment or bad business decision.

Examples of speculative risk exclusions include the CGL's product recall exclusion (which can be covered by endorsement) and the commercial property policy's special cause of loss exclusions "voluntary parting" and "delay, loss of use or loss of market."

Conditional Conclusion

The insurance contract is a conditional contract; excluded perils, excluded hazards and excluded property are part of the conditions. When viewed in the light of reason, policy exclusions are not unreasonable - even if the insured thinks they are.

Without many of the exclusions contained in property and liability policies, premiums would be prohibitively high and fewer viable carriers would be available to accept the risk.

Compare this list of six reasons to any property or liability policy when explaining coverage and exclusions to the insured. The list can also be used to uncover the insured's exposures that require other coverage forms or customizing endorsements.