



# THE ROYAL BANK OF CANADA

## MONTHLY LETTER

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### *The Protection of General Insurance*

EVERYONE who owns property is under the risk of losing it by fire, theft, storm or other malign acts of men or of nature. Only beach-combers and vagabonds are free of concern about such things. Even they, by the very act of living, have certain legal obligation to reimburse others for damage they cause.

General insurance is our protection against catastrophe. It is the shock absorber of industry and the individual. The farmer with his crop ripening in his fields rests easy because it is insured against hail; the furrier with thousands of dollars' worth of furs in his loft knows that his insurance protects him against financial ruin by fire or theft; the home owner who carries adequate insurance need not fear financial disaster by fire, burglary, or public liability.

So widely are the advantages of general property insurance accepted that, as was shown by a consumer education study of the National Education Association in 1946, more families in the United States have the protection of property insurance than of life insurance.

We recognize pretty generally a wide variety of risks against which it would be advantageous to have protection, but there is still a surprisingly large number of chances we take. There are four principal motivations in our disregard of insurance protection: the "it won't happen to me" feeling; ignorance of the fact that we are exposed to risk; unawareness of the fact that the protection we need is readily available; and procrastination.

More might be done to remedy this state of affairs by the insurance companies. They could tell through organs of public information and education what catastrophes may be averted or remedied. They should do this in non-technical language, and they should simplify their contracts in length, manner of expression and arrangement. Some of the quaint wording in marine insurance policies has been preserved of necessity, because it has been subjected to repeated interpretation by courts of law, and its meaning is now

considered definite. But insurance agents should be qualified and eager to tell the applicant in his own language precisely what protection is offered.

We cannot hedge against every possibility of loss, but we can analyze our situation, estimate the risks, calculate the cost of covering each risk by insurance, and then choose what ones to cover. Prudent persons will want to insure against any occurrence that would wipe them out financially or cause them a major set-back. After making sure of this primary protection, insurance against minor misfortunes can be taken as purely a matter of choice.

The sort of insurance this *Monthly Letter* is about is called, roughly, fire and casualty insurance. It includes all kinds of insurance except ocean marine and life.

#### *The "why" of insurance*

Insurance lifts a great load from the minds of the people who are protected by it. It removes the dread that some accident will throw a heavy or fatal financial load on their shoulders. It encourages those who embark upon pioneer ventures by giving them, as it were, elbow-room in their investment operations.

The principle behind insurance protection is that what are uncertainties to the individual can be made certainties for the group. Take fire insurance as an example. It cannot be known whether a particular property will be burned down, but there is reasonable certainty, based upon statistical experience, that about the same proportion of all similar property exposed to fire will be burned in a year.

By the collection of data on the frequency and magnitude of losses in the past we can construct a measure of the frequency with which such losses will occur in the future. Thus, we apply the principles of probability to economic risks. We base our insurance needs on statistical measures of risk instead of on casual or inspired estimates and guesses.

The *Insurance* volume of the Alexander Hamilton Modern Business Texts points the lesson of foresight neatly: "A catastrophe or calamity is an accomplished fact with consequences that may be measured or defined. A risk, however, is not a catastrophe; it has no objective existence, but is subjective, and denotes the uncertainty where or when or upon whom the catastrophe may fall. This element of uncertainty explains the essential nature of risk."

Every reasonable person will try to control the risks so as to avoid the catastrophes by limiting losses, but in addition he will carry insurance so as to protect himself or his business against losses he cannot control. Successful business operation, big or small, requires judgment about the risks to be accepted and those to be protected against. Tranquil living, in business or personal life, depends to a bigger extent than we realize upon making the correct decision about what risks we shall bear and what risks we shall transfer to specialists in risk bearing.

The cost of insurance sometimes deters those who have not grasped the insurance principle. The insurance company is a formal organization through which, for a relatively small price to each, the thousands of policy-holders may be assured that the small number who suffer loss will be fully indemnified.

A few people are tempted to over-insure, thus indulging in a waste of money. A fire policy should be large enough to cover ordinary additions to inventory or, if on home furnishings, the to-be-expected additions to furniture and wardrobe, so that the insurance cover need not be changed every time we buy something. But there is no point in carrying insurance that is out of line with the actual value of the property covered. An inventory will help us to avoid the danger of under-insurance and the waste of over-insurance.

### *Rates and contracts*

We cannot insure property unless we have an insurable interest in it, that is, unless we have some control over it, and would suffer financial loss if the property were destroyed or damaged. When we have an interest in something material, like buildings, machinery, furniture and merchandise, and can calculate the amount of possible loss, we can protect our interest by payment of a premium to a suitable insurance company.

The rate charged us will depend upon several factors. If we seek fire insurance, the company will take into account the location and construction of our building, the safety devices we provide, the relative hazard of the building's contents, and the fire protection available. The community may, by substantially increasing its fire defences, bring down fire insurance costs.

To make insurance reliable and effective, the rates charged must fulfil certain general needs: they must be adequate, reasonable and non-discriminative.

The insurance carrier must build up a fund from which losses are paid, making provision in ordinary years for years of heavy losses. It must keep its premiums within the bounds of reasonable cost; if it does not apply actuarial skill and keen foresight it may price its protection out of the market. It must, in its rating system, measure the proper contribution to be made by its clients according to the risk of the business they offer, so that those who insure with it pay equitably according to the possible burden they may impose through loss. In every event, however, its maximum rate must be governed by the rates of competing insurers.

Statistics and judgment are the important tools of the general insurance carrier. By using them skilfully the insurance company can approach even a big operation with confidence. Take the *Insurance* textbook example as an illustration of the working of the insurance principle and rate-setting.

In one of our many new suburban developments where there are a thousand home owners, each with a house valued at \$10,000, all equally exposed to fire loss and having the same community and individual protection, statistical records may tell the insurance carrier that one house in a hundred will probably be burned in a year, or ten houses in the group. This means that \$100,000 worth of property will be burned during the year.

If it costs \$10,000 to perform the necessary work of collection, administration, handling and distribution, and to provide profit compensation, then the total amount to be collected from the entire group of insured property owners will be \$110,000, or from each owner \$110. Since fire insurance premiums are usually quoted at so much per \$100 of liability assumed, the rate in our supposed case will be approximately \$1.10.

Now, check this against the "general needs" previously mentioned: if less than \$1.10 per \$100 insurance is collected, the fund will be inadequate; if more is collected it will be unreasonable, and if half the owners are charged \$1.20 while the others pay only \$1.00 the fund will be adequate but the rates are discriminative.

### *Many kinds of insurance*

The oldest type of insurance for business and commerce is "ocean marine" insurance. It applies to ships and their cargoes, covering such risks as collision, stranding, sinking, fire, and other "perils of the sea".

Nearly every form of personal or commercial risk that can be put on a mathematical basis can now be insured against. Within the past fifty years man-made hazards have been added to those brought about by natural causes: falling aircraft, motor vehicles, operation of atomic power installations, and so forth. The property owner can be protected from financial loss due to accidents to visitors. The business man may insure

against dishonesty of his employees, defalcations of people to whom he has extended credit, and losses due to raised or forged cheques. Promoters of outdoor events may insure against loss due to rain. The automobile insurance policy protects the owner against fire, theft, collision damage, liability for bodily injury or death, and liability for damage to the property of others.

What insurance to carry, and the amount of insurance and the value of the premium measured against other wants and needs: these are individual matters to be calculated against the possible effects of not being insured.

### *Fire insurance*

Because most of us own at least a small amount of personal or business property, the loss of which would be a hardship, the demand for fire protection is nearly universal. People don't usually wait to be sold fire insurance; they seek it.

Organized fire insurance began after the great fire of London in 1666, and by 1720 there were private companies specializing in the business. Today, nearly every article that enters into commerce has, at many stages of its progress from natural resource to final use, been covered by fire insurance policies. According to a report of the Superintendent of Insurance, fire insurance claims in Canada totalled \$1,414,336,399 from 1869 to 1954 inclusive. In 1955, fire insurance claims were in excess of \$77,750,000. The total value of property at risk under fire insurance in a year is about \$45,500,000,000.

The first step toward setting up a fire insurance programme, commercial or on a home, is to appraise the value of your property. A home inventory should list all goods — furniture, household equipment, clothing, books, musical instruments, tools, and all other personal property of those living in your house.

A good inventory is of more uses than one. It expedites insurance settlement. It serves as a check on articles you might not remember after the occurrence of a fire. If no fire occurs, your inventory will be useful in checking the service given you by a piece of equipment, and in appraising your goods in case you wish to sell them.

The simplest listing is sufficient: article, date of purchase, price paid. If you wish to do so, you may detail the goods room-by-room. A copy, brought up to date periodically, should be kept in a safe place, such as a safety deposit box, with other valuable papers like insurance policies.

The increase in dollar cost of buildings and contents should not be forgotten in deciding the amount of insurance needed. The history of losses during the past ten years has shown that many households that were

adequately protected when the policies were first written are not today carrying sufficient insurance to offset the increased prices.

Fire insurance policies on dwellings are usually written for three years, at a slight reduction in cost compared with an annual rate. The amount named in the policy is the maximum the carrier can be called upon to pay. When a loss occurs the company pays the actual cash or market value of the property destroyed, subject to the maximum amount named in the policy.

### *Casualty insurance*

Casualty insurance is a recent development as compared with marine and fire insurance. It started with the growth of railways in England, where the first "casualty" company was formed in 1849. Its name indicates its field: "The Railway Passengers Assurance Company", providing accident insurance to those exposing themselves to the danger of travelling by steam-engine.

Accident and sickness insurance companies, not including Blue Cross, Blue Shield, and other such plans, paid \$87,313,735 to policy-holders in 1955 in recompense for their expenses or loss of wages due to accident or sickness.

Most automobile owners recognize the need to provide insurance against the injuries and damage that may be caused by their cars, in addition to the self-protective insurance against theft, fire and collision damage. In fact, under some circumstances some provinces require proof of insurance before an owner may regain his license to operate his car after he has been involved in an accident.

The view of some people is that automobile insurance should be made compulsory by law, so as to protect the innocent against the carelessness or worse of people who are financially incapable of making good the damage they cause.

Automobile claims frequently run into large sums. Many people think of "damage" as being the scratches or breakages caused by collision with another car, but it can be much more. If your driving is responsible for the overturning of a truck laden with expensive goods that are destroyed, the resulting legal judgment might embarrass you. If your car were to skid when driving in to a service station, strike a pump and set fire to the escaping gasoline, it does not require much imagination to picture the station and cars and adjoining property falling prey to the flames. The damage for which your car could be held responsible might exceed your ability to pay, even allowing for stunted living over many years.

These are the sorts of thing that justify insurance: the crippling, disastrous accidents that occur every so often.

Obviously, the insurance against damage your car may cause to persons or property is the most important. Damage to your car itself is limited to its value, but the cost of claims to which you may be subjected because of accidents is almost unlimited. Judgments entered against you might easily wipe out not only your car but other property you own, and your earnings might be attached.

A typical policy on a modern sedan would afford protection against liability for bodily injury or death up to \$5,000 for one person and \$10,000 in one accident; \$1,000 liability for damage to the property of others; fire, theft, collision (\$100 deductible), and miscellaneous damage.

The cost varies according to the classification of the owner, the use to which the car is put, the value of the vehicle, and the area in which the car is mostly operated. It can range from \$70 to \$325 in Montreal, while in rural Manitoba the identical protection would call for a price spread of from \$24 to \$119. The difference in cost in various areas is determined by the actual losses incurred, and this information is known from complete statistical records of these areas which must be maintained according to law.

Claims under automobile insurance in 1955 totalled \$99,229,507 in all Canada.

### *Legal liability*

Not only automobile owners, but all who own property or are responsible for it, must meet the hazard of claims for damages. It is a well-established principle in British law that a person is held liable for the consequences of his acts and omissions if through failure to exercise reasonable care another person suffers accident or damage to his person or property. He is also liable for similar hurt caused by his employees or members of his family.

This is a state of affairs that should be closely attended to by home owners and business people. Any person who is injured on your premises is free to bring action against you. He may be a guest, a customer, a meter reader, a delivery man, or a messenger. The claim may be big or small, resulting from a big or little fault. If you don't clear the snow off your house steps, and somebody slips and falls, you may get a claim for injuries. If your dog or cat causes injury, you may have to pay the bill. If one of your children runs into another with his bicycle, you may be held financially responsible. If a tool breaks away from you or flies out of your hand; if the tree you are trimming strikes a passer-by; if an icicle falls from your roof on a caller: judgment may be given against you in a suit for damages.

Even small demands may be troublesome and expensive, while damages given in serious accidents can be enormous. The obligations assumed by the liability

insurance company usually include the furnishing to the insured of certain services, the payment of certain costs, and the payment for damages assessed upon the insured because of negligence.

### *Theft, burglary, etc.*

There are many types of theft, burglary, robbery, larceny and mysterious disappearance insurance, covering property at home or abroad. An increasing number of "personal property floater" policies is being sold.

The first requirement for an intelligent theft insurance programme is to determine the amount of coverage required. Then you must decide whether you need insurance for your belongings only in your home, or, if you travel, in hotels and on vehicles. Certain goods, such as expensive cameras, projectors and equipment; musical instruments; jewellery, watches, furs, and so on, may be specially covered under policies issued by casualty, fire and general insurance companies.

### *Learning about insurance*

What has been written here is merely indicative of what is offered in the way of general insurance coverage; it is only a hint as to how an individual should go about estimating his insurance needs. It is the function of the insurance agent or broker to give skilled assistance in determining the type of contract and the estimates of values the individual requires.

There are more than 300 competing companies in the fire and casualty insurance business in Canada, registered with the Federal Government, and several hundred incorporated in the provinces. All of them operate subject to government supervision, and all are required to maintain reserves calculated to be sufficient to protect their policy-holders. The fire and casualty business has more than \$300 million in compulsory reserves with the Federal Government.

The prevention of loss is closely associated with insurance. The life insurance companies are energetic in promoting health measures and movements. Fire insurance companies co-operate with fire departments and safety associations in urging the removal of fire hazards and the inspection of factory, home, school and public hall fire protection. Many communities enforce building laws that tend to prevent conflagrations. The steam-boiler insurance companies have succeeded admirably in their effort to prevent by inspection service every boiler explosion that could possibly be prevented.

Education by the insurance companies, by community organizations, by public and high schools, and by newspaper and magazine editors, can do much in two areas of the unhappy tendency of human beings to get into disastrous trouble. We may learn to prevent what we can prevent by thoughtfulness and carefulness, and we may learn about insurance, so as to protect ourselves against the perils that are beyond our control.