Guide to Home Ownership Insurance

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HOMEOWNER'S INSURANCE GUIDE
TABLE OF CONTENTS

Chapter 1 –Guide to The Basics of Homeowner's Insurance **1**
The History of Insurance 1
Defining Homeowner's Insurance
2
Basic Aspects of Homeowner's Insurance 2
Considering The Structure 5
Considering Building Codes 5
The Basics of Insuring Personal Property 6
The Basics of Home Inventory 7

Chapter 2 -- Guide to The Value of A Home **9**
Determining The Value of a Home 9
Types of Value 9
Appreciation Value 9
Liquidation Value 10
Fair Value 10
Appraisal Value 11
Comparative Market Analysis (CMA) - Property Valuation 11
Fair Market Value 12
Replacement Cost 12
Guaranteed Or Extended Replacement Cost Coverage 12
Assessing The Value of The Property 13

Chapter 3 – Guide to Home Appraisal **15**
Defining Appraisal 15
Guide to The Basics of Appraisal 15
Guide to Reasons For Appraisals 16
Refinancing 16
Mortgage Lending 16
Other Ad Valorum Tax Consequences 17
Property Tax Issues 17
To Determine Value 18
To Provide Information to Lender 18
Insurance 18

Guide to The Appraiser's Job 18
Guide to Types of Appraisals 19
A Refinance Appraisal 20
County Appraisal 20
Independent Appraisal 20
Full Appraisal 20
Exterior-Only Appraisal 21
Guide to Appraisal Methods 21
The Cost Approach 21
The Sales Comparison Approach 22
The Income Approach 22
Guide to Tax Assessments 23
Guide to Regulations For Appraisals and Appraisers 23

Chapter 4 – Guide to Elements of Homeowner's Insurance 25
Key Elements Of The Homeowner's Insurance Policy 25
Insurance Contract 25
Parts of The Insurance Contract 27
Legal Aspects of The Insurance Contract 27
The Insurance Binder 28
Homeowner's Insurance Policy Cost 29
Trigger Theories in Homeowners Insurance 29
The Trigger Analysis 31
State Applied Trigger Methods 31
The Courts and The Trigger Issue 31
The Cost of Homeowners Insurance 32
Limitations and Exclusions 32
Discounts For Homeowner's Insurance 33
Deductible and Risk 34
A Good Credit Record 34
Guide to Insurance Disclosures 34
Homeowner's Liability 34
Individuals Covered Under Liability Insurance 35
Renters Insurance 35

Chapter 5 – Guide to Homeowner's Insurance Policies 37
Dwelling vs. Property 37
Levels of Coverage 37

HO Coverages 38
HO-1 -- Limited Coverage Policy 38
HO-2 -- Broad Form 38
HO-3 -- Special Form 39
HO4 – Renter 39
HO-5 – Comprehensive Form 39
H0-6 -- Condo/Co-op 39
HO-8 -- Older Home 40

Chapter 6 – Guide to The Standard Homeowners Insurance Policy 41
HO-4 – Special Form 41
Section 1 — Property Coverage 41
Declarations 41
Insuring Agreement 41
Definitions 42
Coverage A; Coverage B 42
Coverage C - Personal Property Coverage 42
Coverage D – Loss of Use Coverage 43
Section 1 Additional Coverages 43
Perils Insured Against 43
Section 1 Exclusions 44
Section 1 Conditions 44
Section 2 Liability Coverage 44
Coverage E: Personal Liability 45
Coverage F: Medical Payments to Others 45
Section 2 Exclusions 48
Section 2 Additional Coverages 48
Sections 1 and 2 Conditions 49

Chapter 7 – Guide to Provisions, Exclusions and Endorsements 50
Guide to The Provisions 50
Cancellation and Non-renewal Provision
50
Guaranteed Replacement Provision 50
Special Deductibles Provision 51
The Policy Premium Provision 51
Guide to Exclusions 51
Guide to Endorsements and Riders 52

Inflation Guard Endorsement 52
Special Loss Settlement Endorsement 53
Home Office Coverage Endorsement 54
Additional Living Expenses Endorsement 55
Scheduled Personal Property Endorsement 55
Buy Replacement Cost Insurance 55
Personal Property Replacement Cost Endorsement 56
Earthquake Insurance Endorsement 57
Theft Endorsement 57
Increased Blanket Endorsement 57
Personal Injury Endorsement 57
Building Code Coverage Endorsement 57
Riders 58
Jewelry 58
Electronic Equipment 58
Art and Antiques 59
Guide to Floaters 59
Personal Articles Floater 59

Chapter 8 – Guide to Catastrophic Insurance Coverages 61
Guide to Catastrophic Events and Losses 61
The Impact of Catastrophic Losses 61
The Risk From Catastrophic Events 62
Guide to The Insurability of Catastrophe Risk 63
The Limits to Insurability 63
Guide to Disaster Insurance 63
Named Perils Policy vs. All-Risk Policy 64
Guide to Mitigation 65
Loss Mitigation Measures 66
Earthquake 66
Hurricane 67
Tornado 68
Wildfire 69
Guide to Reinsurance 70
The Reinsured and The Reinsurer 71
Reinsurance Plans and Types 72
Stabilizing Profits 73

Underwriting
74
Reinsurance For Catastrophic Events 74
Reinsurance Angle 74
The Mechanics of Reinsurance 75
Limiting Liability 76
Cause and Probability Factors 77

Chapter 9 – Guide to Flood Insurance 78
Guide to the Dynamics of Floods 78
Guide to Flood Zones 78
Low to Moderate Risk Areas 79
High Risk Areas 79
High Risk - Coastal Areas 81
Undetermined Risk Areas 81
One Hundred Year Flood 82
The Mandatory Flood Insurance Purchase Requirement 83
National Flood Insurance Program 84
Forms 87
Dwelling Forms 87
General Property Form 88
ResidentialCondominium Building Association Policy 89
Provisions of Flood Insurance Policies 89
Preferred Risk Policy 91
Eligibility Requirements 92

Chapter 10 ~~ Toxic Mold Syndrome and Insurance Coverage 94
Guide to the Toxic Mold And Insurance Crisis 94
Characteristics of House Mold 95
Physical Signs of a Mold Problem *96*
Mold Inspection and Testing 97
Standards and Guidelines for Testing 98
Environmental Control and Mold Growth
100
The Remediation Process 101
The Levels of Mold Remediation 102
Liability From Toxic Mold 105
Toxic Mold Insurance Regulation 106

The United States Toxic Mold Safety and Protection Act 107

Chapter 11 – Guide to Umbrella or Excess Liability 109
Defining The Umbrella Insurance Policy 109
The Umbrella Insurance Policy As Liability Coverage 109
Guide to The Cost of Umbrella Insurance 110
Guide to Coverages of Umbrella Insurance 111
Bodily Injury Liability 111
Property Damage Liability 112
Owners of Rental Units 112
Guide to Provisions of the Umbrella 112
Affect of Limits On Homeowner's Insurance 113
Provision of High Deductible 113
Actual Function of The Umbrella Insurance Policy 113
Guide to the Benefits of Umbrella Insurance 114

Chapter 12 – Mortgage and Title Insurance 115
Mortgage Insurance 115
FHA Mortgage Insurance Program 115
Private Mortgage Insurance 116
Title Insurance 117

Chapter 13 --Guide to Underwriting Homeowners Insurance Policy 119
Underwriter Responsibilities 119
Dwelling Environment and Risk Evaluation 120
Premise Location 121
Dwelling Construction 121
Building Ordinance 122
Personal Property Risk and Valuation 122
Property Appearance 122
Underwriting Guidelines 123
Underwriting and Cancellation 125
Issues For Underwriting Homeowners' Insurance 125
Underwriting and Discounts 127

Chapter 14 – Guide to Specialty Endorsements 128
Personal Property Loss Endorsement 129

Scheduled Personal Property Endorsement
HO 04 60; HO 04 61 129
Loss Assessment Coverage 130
Types of Theft Loss Endorsement 130
Theft Coverage Protection Endorsement 130
Identity Fraud Expense Coverage – HO 04 55 130
Residence Rental Theft HO 04 80 131
Motorized Vehicle Loss Endorsement 131
Watercraft And Recreational Vehicle Endorsement 131
Owned Snowmobile -- HO 24 64 131
Home Business Related Endorsements 131
Special Computer Coverage HO 04 14 131
Home Day Care Coverage Endorsement -- HO 04 97 132
Home Business Insurance Coverage HO 07 01 133
Weather or Natural Disaster Related Endorsements 135
Increase Wind & Hail Deductibles
135
Sinkhole Collapse HO 04 99 135
Earthquake HO 04 54 135
Structure Related Endorsements 136
Extended Replacement Cost on Dwelling 136
Secondary Residence Premises Endorsement 136
Special Loss Settlement HO 04 56 136

Chapter 15 – Guide to Federal Legislation 137
National Flood Insurance Reform Act of 1994 137
Flood Insurance Reform and Modernization Act of 2007 138
Flood Disaster Protection Act of 1973 138
Homeowners Protection Act of 1998 139
Homeowners Insurance Protection Act of 2009 140
Understanding Insurance Regulation 141
Insurance Regulation and Legislation 142
The Sherman Antitrust Act 142
The McCarran-Ferguson Act 143
Gramm-Leach-Bliley Act (GLBA) 144
The Types of Regulators 144

Unauthorized Insurers Regulation
147
Defining The Unauthorized Insurer 147
Identifying and Avoiding Unauthorized Insurers
149

Chapter 16 -- Ethics and Fraud in The Insurance Industry 150
Establishing Ethics For Insurance Professionals 150
Considering Core Beliefs 150
Accountability 151
Integrity 152
Leadership 152
Professionalism 153
The Ethical Landscape of The Insurance Industry 153
The Need for Ethical Education 154
Ethics and Marketing 155
Understanding Ethics and Policy Replacement 155
Policy Replacement and Performance 156
Unethical Policy Replacement Issues 157
Policy Illustrations from an Ethical Aspect 157
Ethical Responsibility and Sales Illustrations 159
Deceptive Sales Practices 160
Defining Insurance Fraud 160
Fraudulent Activities 160
Commingling Funds
161
Unauthorized Insurers 161
Misrepresentation and/or False Advertising 162
Twisting 163
Two Categories of Fraud 163
The Loss Due To Insurance Fraud 164

Bibliography 166

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Chapter 1
Guide to the Basics of Homeowner's Insurance

The History of Insurance

History of insurance refers to the development of a modern laws and market in insurance against risks. Early methods of transferring or distributing risk were practiced by Chinese and Babylonian traders as long ago as the 3rd and 2nd millennia BC, respectively. Chinese merchants traveling treacherous river rapids would redistribute their wares across many vessels to limit the loss due to any single vessel's capsizing. In 2100 BC, traders in Babylonia assumed the risks of the caravan trade through loans that were repaid after the goods had arrived safely.

The growth of towns and trade in Europe brought a need to protect members of guilds from loss by fire or shipwreck. By the middle of the 14th century marine insurance was practically universal among the maritime nations of Europe. In London, Lloyd's Coffee House was a place where merchants, ship owners, and underwriters met to transact business. By the end of the 18th century Lloyd's had progressed into one of the first modern insurance companies. Edmond Halley constructed the first mortality table in 1693.

With the growth of British commerce insurance developed rapidly in the 18th century. Prior to the formation of corporations devoted solely to the business of writing insurance, policies were signed by a number of individuals, each of whom wrote his name and the amount of risk he was assuming underneath the insurance proposal - hence the term underwriter**.**

Things changed dramatically in the 17th century. In 1666 the Great Fire of London finally and forcibly demonstrated the need for fire insurance. The primitive fire-fighting methods of the day were virtually helpless against the hungry flames that roared unchecked through narrow streets reducing timbered dwellings to ashes.

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The New York Fire of 1835 called attention to the need for adequate reserves to meet unexpectedly large losses. The great fire of Chicago in 1871 showed the costly nature of fires in structurally dense cities**.** Reinsurance**,** where losses are distributed among many companies, was devised to meet such situations and is now common in other lines of insurance. There are two types of economies in human societies:

- money economies (with markets, money, financial instruments and so on);
- non-money or natural economies.

Insurance protection as we know it today can be traced to the aftermath of that tragedy and a man call Nicholas Barbon. Profoundly shaken by the Great Fire, Barbon promptly opened an office "to insure buildings." This venture was apparently successful, because in 1680 he founded a partnership and established England's first fire insurance company, The Fire Office, to insure brick and frame houses.

Defining Homeowners Insurance

Homeowners insurance provides coverage in the event of damage to property, as well as liability for injuries and damage caused to other people. Homeowners insurance provides financial protection against disasters. A standard policy insures the home itself and the things kept in it. A 2006 Insurance Research Council poll found that 96% of homeowners had homeowners insurance while 43% of renters had renters insurance.

Basic Aspects of Homeowner's Insurance

Homeowners insurance is a package policy. This means that it covers both damage to one's property and his or her liability or legal responsibility for any injuries and property damage the homeowner or any member of the family cause to other people. This includes damage caused by household pets.

Damage caused by most disasters is covered with exceptions. The most significant exception is damage caused by floods, earthquakes or poor

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maintenance. The homeowner must buy two separate policies for flood and earthquake coverage. Maintenance-related problems are the homeowners' responsibility under any circumstance.

The terms of standard home insurance policies have been defined by the Insurance Services Office (ISO), so standard coverage is not going to vary from company to company, although rates will. Homeowner's policies can also provide limited property coverage for incidental occupancy, which is the use of the residential premises for purposes not residential. Each homeowner's policy provides a combination of property and liability coverage and covers loss of use resulting from damage.

Owning a Home Without Insurance

Unlike driving a car, an individual can legally own a home without homeowners insurance. However, unless he or she paid cash for the home, the lender will most likely require the homeowner to purchase homeowners insurance coverage. Lenders must protect their investment in the case the home burns down or is badly damaged by a storm, tornado or other disaster.

If the homeowner lives in an area that is likely to flood, the mortgage lender will also require the homeowner to purchase flood insurance. Some financial institutions in earthquake prone areas may also require earthquake coverage. If an individual purchases a co-op or condominium, the board will probably require him or her to buy homeowners insurance.

After the homeowner owns the home free and clear, no one will force the purchase of homeowners insurance. But it is not advisable to cancel an existing policy and risk losing what has already been invested in the home.

Disasters Not Covered

The threat of natural disasters such as earthquakes, hurricanes, floods, tornadoes, hail, mudslides and wildfires is a reality of life for many Americans. These anomalies cannot usually be avoided, but their effects on property and life can be minimized. No matter how prepared an individual is, sometimes

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things go wrong. Having the right insurance during these times is critical. Regardless of one's situation, it is important to find the best homeowner's insurance policy.

Floods

Flood coverage can be purchased directly from a homeowner's insurance agent. However, the policy ultimately is provided by the Federal Flood Insurance Program. The homeowner can get replacement cost coverage for the structure of the home, but only actual cash value coverage is available for his or her possessions. There may also be limits on coverage for furniture and other possessions stored in the basement.

Flood insurance is available for renters as well as homeowners particularly when living in a designated flood zone. But it is also wise to consider buying it if one's house could be flooded by melting snow, an overflowing creek or water running down a steep hill. There is also a 30-day waiting period before coverage takes effect.

Earthquakes

Earthquake coverage must be a separate policy or an endorsement to an existing homeowner's policy available from most insurance companies. In earthquake prone states like California, the policy comes with a high deductible from the California Earthquake Authority.

Maintenance Damage

It is the homeowner's responsibility to take reasonable precautions to protect a home from damage. An insurance policy will not cover damage due to lack of maintenance, mold, termite infestation and infestation from other pests.

The Basics of Insurance Losses

In 2006, about 5% of insured homes had a claim, according to ISO. About 94% of those claims were for property damage, including theft. Changes in the

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percentage of each type of homeowner's loss from one year to another are partially influenced by large fluctuations in the number and severity of weather-related events such as hurricanes and winter storms. There are two ways of looking at losses:

- by the average number of claims filed per 100 policies (frequency) and
- by the average amount paid for each claim (severity).

The loss category "water damage and freezing" includes damage caused by mold. Every state except Arkansas, New York, North Carolina and Virginia has adopted an ISO mold limitation for homeowner's insurance coverage, which allows insurers to exclude the coverage unless the condition results from a covered peril.

Incurred homeowners losses decreased by 32.1% from $41.8 billion in 2005 to $28.4 billion in 2006, on a direct basis before reinsurance, according to the National Association of Insurance Commissioners.

The Basics of Insurance Needed

The type of policy one needs, depends upon the homeowner's personal situation. Generally, a home should be insured for 100% of its value (including its contents) with a replacement cost policy. The extent of coverage provided on various homeowner's policies depends on the loss settlement clause. This clause identifies property that will be valued at actual cash value, and property that will be valued at replacement cost. If the homeowner is insured for actual cash value, one will pay less for the policy, but may not receive enough money to replace the damaged property. Instead, the homeowner will receive the amount the property is worth at the time of the loss - its cost minus depreciation for age and normal wear and tear. A homeowner needs enough insurance to cover the following items:

- The structure of the home;
- Personal possessions;
- The cost of additional living expenses if the home is damaged beyond livability;

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- Homeowner's liability to others.

The first step in determining how much insurance that is needed is to make an analysis of the value of a home without the value of the land and personal property within it. In determining the value of the home, one must calculate how much it will cost to replace it if the home were totally destroyed. Chapter 2 will address the issues of determining the value of the house.

Considering The Structure

Once a homeowner has determined the approximate worth of his or her home and its contents, in most cases, the homeowner's insurance coverage will be on the home's replacement cost. The homeowner needs enough insurance to cover the cost of rebuilding a home at current construction costs. The cost of rebuilding could be more or less than the price you paid or could sell it for today. Generally, if one purchases coverage on a replacement cost basis and insures a home for at least 80% of its replacement cost, the insurance will automatically be issued on a replacement cost basis.

Some banks require the homeowner to buy homeowners insurance to cover the amount of the mortgage. If the limit of the insurance policy is based on a mortgage, it is important to make sure it is enough to cover the cost of rebuilding. For a quick estimate of the amount of insurance needed, multiply the total square footage of the home by local building costs per square foot.

Considering Building Codes

Building codes are updated periodically and may have changed significantly since a home was built. If the home is badly damaged, one may be required to rebuild a home to meet new building codes. Generally, homeowner's insurance policies (even a guaranteed replacement cost policy) will not pay for the extra expense of rebuilding to code. Many insurance companies offer an Ordinance or Law endorsement that pays a specified amount toward these costs.

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The Basics of Insuring Personal Property

A homeowner needs the proper level of protection which includes special provisions for valuables such as jewelry, computer equipment and other possessions. Most homeowner's insurance policies provide coverage for one's personal possessions for approximately 50% to 70% of the amount of insurance he or she has on the structure or "dwelling" of a home. The limits of the policy typically appear on the *Declarations Page* under *Section I, Coverages, A. Dwelling*.

To determine if this is enough coverage, the homeowner will need to conduct a home inventory. This is a detailed list of everything he or she owns and information related to the cost to replace these items if they were stolen or destroyed by a disaster such as a fire

The Basics of Home Inventory

A home inventory is a detailed list of the personal property located in a home. The homeowner should also include property that one has stored elsewhere, perhaps in a storage area or a garage on the premises. An inventory is especially important for insurance purposes. When the homeowner makes an insurance claim for damaged, lost, or stolen property, the renters policy will require an individual to show the quantity, description, actual cash value (i.e., depreciated value), and amount of loss associated with each item. The insurance company will also ask for copies of bills, receipts, or other documentation to support the figures.

It is important to include the following information for each item:

- Current value;
- Description of where (or how) the item was obtained;
- Date of purchase or age of item;
- Item description (and quantity);
- Manufacturer or brand name;
- Model number or serial number;
- Photocopies of any appraisals;
- Receipt or other proof of purchase, showing cost;

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- Replacement cost.

Keeping an up to date home inventory will ensure that the homeowner's insurance will cover all of one's belongings should there be a loss. No one can completely list everything they own off the top of their heads – however a home inventory can. It's best to also have a copy of receipts and purchase information of your items as well.

A list should include furniture, jewelry, artwork, antiques, appliances, kitchen contents, clothes, carpets, drapes, computer equipment, television sets, CD players (and other audio or audiovisual equipment), musical instruments, clocks, mirrors, linens, lawn mowers, snow equipment, tools, sports equipment, and any other item of value.

A quicker way to catalogue items is to videotape the contents of a home. Although a video is less comprehensive than individual pictures, it will still provide visual proof of what one has (or had). Video also allows the homeowner to narrate. Along the way, zoom in on details and open all doors and drawers so you don't miss anything.

It is important also to save receipts for any big-ticket items (things like electronics or furniture where prices can vary and for proof that the item was good quality). This information can be stored in a folder along with insurance information, but it is also a good idea to scan them and keep digital copies as well.

Once a full inventory of the home's contents is complete, it should be shared with the insurance agent to ensure that the current policy is adequate coverage. These pages must be stored along with receipts and photos in a safe place, such as a fireproof box or safety deposit box.

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Chapter 2
Guide to The Value of A Home

Determining the Value of a Home

Valuation is considered as one of the most critical areas in finance; it plays a key role in many areas of finance such as buy/sell, solvency, merger and acquisition. Furthermore, intellectual property (IP) valuation is considered as one of the most important management strategic issues

While the seller sets the asking price of a home, the marketplace ultimately will determine the selling price. There are two philosophies in marketing; charging what is reasonable for product based on the market and charging what the market will bear. Charging what the market will bear may not always be in the seller's best interest. A home is competing with others like it for the attention of available buyers. Most buyers will buy the home that seems to represent the best value among those that meet their desires, expectations, and needs within their price range.

Types of Value

Real estate appraisal, property valuation or land valuation is the practice of developing an opinion of the value of real property, usually its Market Value.

Appreciation Value

Appreciation Value is the increase in value of a property over time due to inflation, supply and demand, capital improvements and other factors. The amount property increases in value due to market conditions. Most real estate investors purchase income property for cash flow and capital appreciation. Property values appreciate in value over time due to inflation. Inflation is caused by an increase in the amount of money in circulation. The value of money declines when the supply of money increases and the end result is increased retail prices.

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If an individual sells appreciated property, the appreciation will generally be taxable gain; if he or she donates appreciated property, usually the fair market value of the property can be deducted, including appreciation.

Liquidation Value

Liquidation value is the likely price of an asset when it is allowed insufficient time to sell on the open market, thereby reducing its exposure to potential buyers. Liquidation value is typically lower than fair market value. Unlike cash or securities, certain illiquid assets, like real estate, often require a period of several months in order to obtain their fair market value in a sale, and will generally sell for a significantly lower price if a sale is forced to occur in a shorter time period. Liquidation value may be either the result of a *forced* liquidation or an orderly liquidation. Either value assumes that the sale is consummated by a seller who is compelled to sell and assumes an exposure period which is less than market normal.

Fair Value

Under GAAP, the fair value of an asset is the amount at which that asset could be bought or sold in a current transaction between willing parties, other than in a liquidation. On the other side of the balance sheet, the fair value of a liability is the amount at which that liability could be incurred or settled in a current transaction between willing parties, other than in a liquidation. Fair value, also called fair price, is a concept used in finance and economics, defined as a rational and unbiased estimate of the potential market price of a good, service, or asset, taking into account such factors as:

- relative scarcity
- perceived utility (economist's term for subjective value based on personal needs)
- risk characteristics
- replacement costs, or costs of close substitutes
- production/distribution costs, including a cost of capital

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In accounting, fair value is used as an estimate of the market value of an asset (or liability) for which a market price cannot be determined (usually because there is no established market for the asset). Fair Value is a valuation, in accordance with standard methodology, that is reasonable to all parties involved in a transaction in light of all pre-existing conditions and circumstances. This is used for assets whose carrying value is based on mark-to-market valuations; for assets carried at historical cost, the fair value of the asset is not used.

Appraisal Value

The appraisal value is the value of a company based on a projection of future cash flows that its owners will receive from the company's assets as well as from its current and future operations. The appraisal value is often used to measure the financial performance of insurance companies. It is also a useful tool in measuring the viability of new ventures. The appraisal value is commonly the sum of three components:

- Net Excess Assets;
- Value of In-force Business;
- Value of Future New Business.

Appraised values can also be made after a property sale. A low appraised value will affect a buyer's ability to purchase a property. This is because the loan amount would seem too high with respect to the value. Unless the buyer can come up with the difference, the buyer will unlikely be able to qualify for the loan.

Comparative Market Analysis (CMA) - Property Valuation

A CMA is a snapshot of the recent home sale market activity around the home. These are usually prepared by a REALTOR in anticipation of listing a home for sale. Generally a CMA is comprised of property listing data gathered from the REALTOR MLS. A CMA is not an appraisal of value, but rather an analysis of what recent homes sale activity has taken place in the surrounding market. It may contain value adjustments or it may simply provide the data from the

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MLS. CMA's provide a suggested list price based on comparable sales (homes that are similar in style, square footage, number of rooms, bedrooms, age, construction and amenities to the subject property)

Fair Market Value

Fair market value (FMV) is the price that property would sell for on the open market. It is the price that would be agreed on between a willing buyer and a willing seller, with neither being required to act, and both having reasonable knowledge of the relevant facts. If an individual puts a restriction on the use of property, the FMV must reflect that restriction.

Determining the value of property would be a simple matter if one could rely only on fixed formulas, rules, or methods. Usually it is not that simple. Using such formulas, etc., seldom results in an acceptable determination of FMV. There is no single formula that always applies when determining the value of property.

This is not to say that a valuation is only guesswork. An individual must consider all the facts and circumstances connected with the property, such as its desirability, use, and scarcity.

Replacement Cost

Most policies cover replacement cost for damage to the structure. A replacement cost policy pays for the repair or replacement of damaged property with materials of similar kind and quality. There is no deduction for depreciation–the decrease in value due to age, wear and tear, and other factors. If one purchases a flood insurance policy, coverage for the structure is available on a replacement cost basis.

To insure an older home, it may not be possible to buy a replacement cost policy. Instead, one may have to buy a modified replacement cost policy which repairs or replaces features typical of older homes with similar materials. So the policy will pay for repairs using the standard building materials and construction techniques in use today.

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Guaranteed Or Extended Replacement Cost Coverage

After a major hurricane or a tornado, building materials and construction workers are often in great demand. This can push rebuilding costs above homeowner's policy limits, leaving the homeowner without enough money to cover the bill. To protect against such a situation, an individual can buy a policy that pays more than the policy limits.

An extended replacement cost policy will pay an extra 20% or more above the limits, depending on the insurance company. A guaranteed replacement cost policy will pay whatever it costs to rebuild the home as it was before the fire or other disaster.

Assessing The Value of Property

Property assessments are typically conducted from one to three years, regardless of whether values have gone up or down. Instead, the goal is to determine fair market value and establish a basis for property tax bills. However, when a property is sold or refinanced then in some jurisdictions the value may be brought current to reflect the latest financing or sale changes, regardless of the most recent assessment.

In making and supporting the valuation of property, all factors affecting the value are relevant and must be considered. These include:

- The cost or selling price of the item;
- Sales of comparable properties;
- Replacement cost;
- Opinions of the expert.

Replacement cost new or reproduction cost minus used solely usually does not result in a determination of Fair Market Value. Instead, it generally tends to set the upper limit of value, particularly in periods of rising costs, because it is reasonable to assume that an informed buyer will not pay more for the real estate than it would cost to reproduce a similar property. The replacement cost

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of a building is figured by considering the materials, the quality of workmanship, and the number of square feet or cubic feet in the building. After the replacement cost has been figured consideration must be given to the following factors:

- Physical deterioration – the wear and tear on the building itself;
- Functional obsolescence – usually in older buildings with inadequate lighting, plumbing, or heating, small rooms, or a poor floor plan;
- Economic obsolescence – outside forces causing the whole area to become less desirable.

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Chapter 3
Guide to Home Appraisal

Defining Appraisal

An appraisal is a professional estimate of a property's market value, based on recent sales of comparable properties, location, square footage and construction quality. This service varies in cost depending on the price of the home. On average, an appraisal costs about $300 for a $250,000 house. As an alternative, one can get a comparative market analysis. This is an informal estimate of market value performed by a real estate agent based on similar sales and property attributes. An individual can also get a comparable sales report for a fee from private companies that specialize in real estate data.

Guide To The Basics of Appraisal

A real estate appraisal helps to establish a property's market value–the likely sales price it would bring if offered in an open and competitive real estate market. The lender will require an appraisal when an individual asks to use a home or other real estate as security for a loan, because it wants to make sure that the property will sell for at least the amount of money it is lending.

Home appraisals are a vital and important step in financing a purchase, refinancing an existing mortgage or obtaining a home equity. Appraisers weigh the location of the home, its proximity to desirable schools and other public facilities, the size of the lot, the size and condition of the home itself and recent sales prices of comparable properties, among other factors. Although there is no fixed expiration date on an appraisal, most lenders consider them outdated after six months.

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Guide to Reasons For Appraisals

A client might need an appraisal for a multitude of reasons other than financing, the primary reason that most think about is when acquiring a home mortgage or business loan.

Refinancing

When an individual is refinancing a mortgage, the goal is for the appraised value to be as high as possible. There are a number of improvements a homeowner can make to a home that will improve the appraised value of the home. A new carpet and a coat of paint will go a long way to improve the appraised value. It is unnecessary to purchase top of the line appliances because they rarely give enough of a boost in a home's value to justify the expense. The best thing to do is make sure the home is up to snuff with the neighbors as far as the amenities and add-ons that are invested in to improve a home's value.

Refinance appraisals can be more subjective than purchase loan appraisals, so they are more subject to error. When a property sells, the purchase price usually establishes the market value. Market value is the price a willing and knowledgeable buyer will pay for a property. With a refinance appraisal, the critical "willing buyer" component of the valuation equation is missing.

Mortgage Lending

To protect the interest of their investors, the mortgage lender's broker hires an appraiser to give an independent and objective evaluation of what the property or home is worth. A critical aspect of any house sale involving a mortgage is the lender's appraisal of what the house is worth. This is because the lender often decides how much it is willing to lend based on its appraisal of the property's value - or whether it will give a mortgage at all. If the appraised value is lower than the selling price, the seller will be glad that he has enlisted the services of a professional and experienced real estate agent.

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The agent can give the appraiser information about neighboring homes that have sold recently that support the seller's price. If an appeal to the appraiser is unsuccessful, some negotiations may follow. Both the seller and buyer may have to make concessions to make the transaction go through. The bank may ask the buyers to increase their down payment or the buyers may ask the sellers for a drop in price.

Most mortgage lenders combine the market-data approach with the so-called cost approach, in which the value of a home is judged in terms of what it would cost to acquire the land and build the house. More emphasis usually is placed on the market-data approach for older homes. For homes in new developments, greater emphasis generally is placed on the cost approach.

Other Ad Valorum Tax Consequences

Depending on where an individual lives, often equipment and other personal property are not supposed to be included in the fair market value that the assessor uses for calculating property taxes.

Property Tax Issues

Clients with larger real estate assets may wonder how their real estate taxes are calculated. In changing markets, this may mean that tax values do not reflect present market conditions. In addition, many taxing authorities state that taxes should be no higher than similar properties within any one neighborhood. The more unique the property, the more likelihood that the generic formulas used by the assessor may not accurately value the assets.

If property owners think that their properties are assessed very highly then the property owners can order an appraisal from an appraiser who is qualified to contest the tax assessments. In some parts of the United States, this practice is quite common but many property owners are not aware that this avenue for decreasing their tax load is available.

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To Determine Value

An appraiser comes up with a value by analyzing market data, including both historic and current comparable sales, current offers, pending sales, and proposed improvements. Then the appraiser compares the property to the broader market. The process may vary depending on why it is being done; for instance, an appraiser might weigh different factors more heavily for an insurance valuation than for a market valuation.

To Provide Information to Lender

An appraisal provides valuable information for the buyer and the seller, but the appraiser's primary mission is to protect the lender. Lenders do not want to own overpriced property any more than they relish lending money to irresponsible borrowers. That's why the appraisal takes place before the lender grants final approval of the buyer's loan.

Insurance

Homeowner's policies only cover a certain amount of household contents, so if clients suspect they have items of value, it is important to establish that value to be sure they have adequate coverage. In addition, when a loss occurs there is often dispute between the owner and the insurance company over the value of the damaged or stolen item. If an appraisal is conducted by an accredited, unbiased appraiser before a loss and is on file with the insurance company, this reduces the likelihood of a litigious situation. The value estimated in this case would be Replacement Value.

Guide To The Appraiser's Job

A real estate appraisal is performed by a licensed or certified appraiser (in many countries known as a *property valuer* or *land valuer* and in British English as a "valuation surveyor". Appraisers are licensed by individual states after completing coursework and internship hours that familiarize them with their real estate markets. If the appraiser's opinion is based on Market Value, then it

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must also be based on the Highest and Best Use of the real property. Mortgage valuations of improved residential property in the US, the appraisal are most often reported on a standardized form, such as the Uniform Residential Appraisal Report.

The appraiser should be an objective third party, someone who has no financial or other connection to any person involved in the transaction. The property being appraised is called the subject property. A certified appraisal can help with other matters, including taxes and eliminating private mortgage insurance. A licensed appraiser can also help with estate planning, analyzing the feasibility of proposed improvements, determining the best use for a property, and with insurance valuations.

Appraisers make notations about obvious problems they see, but they are not home inspectors. They do not test appliances, look at the roof, check the chimney or do any other typical home inspection tasks. Never count on an appraisal to help you determine if the home is in good condition.

An appraiser compares the sale price of a home against similar homes that have recently sold in the same area. These are called "comparables." Although there is no set rule, when a lender agrees to finance a mortgage, he wants to see a minimum of three comparables. Appraisers try to make an apple-to-apple comparison. An appraiser would not contrast a 1,700- square-foot ranch with a two-story Cape Cod that's twice the size.

Guide to Types of Appraisals

The various types of mortgage appraisals can be confusing and every lender can choose what type should be used for a particular transaction. The 3 common appraisals are the following:

- Refinance Appraisal;
- County Appraisal;
- Independent Appraisal;
- Full Appraisal;
- Exterior Only Appraisal.

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A Refinance Appraisal

When refinancing, the home appraisal is an important part of the process. It provides an accurate figure for the current market value of the home. Banks make money by lending money, so they will usually over appraise your home in order to let you borrow more money so that they can make more money.

County Appraisals

County appraisals usually do not reflect the most accurate numbers. The reason for this is that they are based on a combination of basic raw facts. These basic raw facts include the number of bedrooms and baths, square footage, finished/unfinished basement finished, subdivision etc. The flaw with this type of appraisal is that it does not take into account if one has done any updating to the home and the condition of the property, which of course has a huge impact on the value of the home.

Independent Appraisal

A homeowner can purchase an independent appraisal in which an appraiser and/or the realtor gives a value of the home today according to what has sold in the same area in the past six months. The appraiser can give a full appraisal or a "drive-by".

Full Appraisal

A full appraisal is the most complete home valuation available. A full appraisal is when the appraiser inspects the inside and the outside of the property, pulls data from all available sources (MLS, assessor, tax records) and compares the subject property with 3 recent sales of similar homes in the same area or neighborhood. An appraisal is a highly accurate opinion of value from a local, licensed appraiser. It is the standard property valuation report used by lending institutions.

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This report costs $300 or more and comes back with 2-8 pages of information about the subject property, photos of the subject from the front, back and the street scene. There are also photos of the front of the 3 comparables, plus pages of legalese stating that this is an independent opinion and was not influenced by the lender, the seller, the realtor, etc.

Exterior Only Appraisal

An "exterior only" inspection requires that the data is pulled for the subject and the comparable sales in the same manner as for a full appraisal, but the physical inspection of the house is limited to a visual confirmation that it exists where it's supposed to or perhaps the exterior is measured and photographed from front and back. This report is still pricey, but required for some loan programs that are too risky for an electronic value, but not risky enough to require a full inspection and list of condition, etc.

Electronic Appraisals

Electronic Appraisals are reports prepared from data gathered from tax records. These records are compiled from the property records department of the local county or city courthouse and give a great amount of information about recent home sales in the area surrounding the property. Often Electronic Appraisals include community information and data about nearby industry, shopping, schools etc.

Guide to Appraisal Methods

An appraisal is an opinion of value or the act or process of estimating value. This opinion or estimate is derived by using three common approaches, all derived from the market.

The Cost Approach

The cost approach is most useful for new properties, where the costs to build are known. The appraiser estimates how much it would cost to replace the structure if it were destroyed. The cost approach is based on the economic

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principle of substitution. This principle states that an investor will pay no more for an asset than the cost to obtain, by purchasing or constructing, a substitute asset of equal utility. There are several cost approach valuation methods, the most common being the historical cost, replacement cost, and replication cost.

The cost approach to determining value is to estimate what it would cost to replace or reproduce the improvements as of the date of the appraisal, less the physical deterioration, the functional obsolescence and the economic obsolescence. The remainder is added to the land value.

Sales Comparison Approach

The sales comparison approach is when the appraiser estimates a subject property's market value by comparing it to similar properties that have sold in the area. The properties used are called *comparables*, or *comps*. The comparison approach to determining value makes use of other "benchmark" properties of similar size, quality and location that have been recently sold. A comparison is made to the subject property. No two properties are exactly alike, so the appraiser must compare the comps to the subject property, making paperwork adjustments to the comps in order to make their features more in-line with the subject property's. The result is a figure that shows what each comp would have sold for if it had the same components as the subject.

The Income Approach

The income approach to determining value is of primary importance in ascertaining the value of income producing properties and has little weight in residential properties. This approach provides an objective estimate of what a prudent investor would pay based upon the net income the property produces. The Income Approach is one of three major groups of methodologies, called valuation approaches, used by appraisers. It is particularly common in commercial real estate appraisal and in business appraisal. The fundamental math is similar to the methods used for financial valuation, securities analysis, or bond pricing. However, there are some significant and important modifications when used in real estate or business valuation.

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While there are quite a few acceptable methods under the rubric of the income approach, most of these methods fall into three categories: direct capitalization, discounted cash flow, and gross income multiplier.

Guide to Tax Assessments

Some may think that tax assessments are a way of evaluating a home. However, assessments are based on a number of criteria that may not be related to property values, so they may not necessarily reflect a home's true value. Assessments have the possibility of varying greatly from neighborhood to neighborhood due to the fact that a visual inspection cannot be made on every home in every community every year. There are too many properties and not enough tax assessors to rely on tax assessment data reliable for market value pricing. Relying on tax assessments to value a home is not a good idea.

Guide to Regulations For Appraisals and Appraisers

Since the government controls how appraisals are conducted, they're awash in regulations. As a general rule in selling a home, the appraiser is hired by the lender and the lender passes the cost along to the buyer, usually in the application fee. In a refinancing or when obtaining a home equity, the homeowner pays for the appraisal.

Appraisals for government-insured loans, such as a FHA (Federal Housing Administration) loan or a VA (Department of Veterans Affairs) loan, must be done by FHA- or VA-certified appraisers.

Federal law requires states to establish minimum standards and licensing practices for real estate appraisers. In one state, trainees must take several courses, pass an examination and complete 2,000 hours of supervised experience.

If the buyer is applying for a mortgage that will be insured by the Federal Housing Administration (FHA), the appraiser must survey the physical condition of the home and disclose potential problems to the buyer. No such obligation exists for non-FHA mortgages. The new FHA disclosure

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requirement notwithstanding, an appraisal is not a substitute for a professional home inspection. The appraiser formulates an opinion of the property's value for the lender, while the inspector educates the buyer about the condition of the home and its major components.

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Chapter 4
Guide to Elements of Homeowner's Insurance

Key Elements Of The Homeowner's Insurance Policy

The home insurance policy is usually a term contract—a contract that is in effect for a fixed period of time. The payment the insured makes to the insurer is called the premium. The insured must pay the insurer the premium each term. Most insurers charge a lower premium if it appears less likely the home will be damaged or destroyed: for example, if the house is situated next to a fire station, or if the house is equipped with fire sprinklers and fire alarms. Perpetual insurance, which is a type of home insurance without a fixed term, can also be obtained in certain areas.

A home insurance policy is designed to cover the structure of your home and includes protection for various kinds of personal property as well as liability coverage.

Insurance Contract

An insurance contract determines the legal framework under which the features of an insurance policy are enforced. Insurance contracts are designed to meet very specific needs and thus have many features not found in many other types of contracts. This insurance contract between the insurer and the insured has many basic contract principles. It is often considered a personal contract where the loss that is paid is based on the loss to the person that holds the policy.

Many features are similar across a wide variety of different types of insurance policies. The insurance contract is a contract whereby the insurer will pay the insured, if certain defined events occur. Subject to the "fortuity principle", the event must be uncertain. The uncertainty can be either as to when the event will happen.

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Insurance contracts are generally considered contracts of adhesion because the insurer draws up the contract and the insured has little or no ability to make material changes to it. This is interpreted to mean that the insurer bears the burden if there is any ambiguity in any terms of the contract.

The policy is also conditional contract where the insured has certain conditions that they must meet before the insurer is required to pay any benefit. Also, since the insured typically cannot negotiate terms of terms of the contract, any uncertainties in the contract will usually conclude to the advantage of the insured party. Finally, insurance contracts are usually considered contracts of indemnity.

Insurance contracts are **aleatory** in that the amounts exchanged by the insured and insurer are unequal and depend upon uncertain future events. If one party to a contract *might* receive considerably more in value than he or she gives up under the terms of the agreement, the contract is said to be *aleatory*. Insurance contracts are of this type because, depending upon chance or any number of uncertain outcomes, the insured may receive substantially more in claim proceeds than was paid to the insurance company in premium dollars. On the other hand, the insurer could ultimately receive significantly more dollars than the insured party if a claim is never filed.

A contract may either be *bilateral* or *unilateral*. Insurance contracts are **unilateral**, meaning that only the insurer makes legally enforceable promises in the contract. The insured is not required to pay the premiums, but the insurer is required to pay the benefits under the contract if the insured has paid the premiums and met certain other basic provisions. In a bilateral contract, each party exchanges a promise for a promise.

However, in a unilateral contract, the promise of one party is exchanged for a specific act of the other party. Insurance contracts are unilateral; the insured performs the act of paying the policy premium, and the insurer promises to reimburse the insured for any covered losses that may occur. It must be noted that once the insured has paid the policy premium, nothing else is required on his or her part; no other promises of performance were made. Only the insurer

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has covenanted any further action, and only the insurer can be held liable for breach of contract.

Insurance contracts are governed by the principle of **utmost good faith** which requires both parties of the insurance contact to deal in good faith and in particular it imparts on the insured a duty to disclose all material facts which relate to the risk to be covered. This contrasts with the legal doctrine that covers most other types of contracts, caveat emptor (let the buyer beware).

Parts of The Insurance Contract

- *Definitions* - define important terms used in the policy language.
- *Insuring Agreement* - describes the covered perils, or risks assumed, or nature of coverage, or makes some reference to the contractual agreement between insurer and insured. It summarizes the major promises of the insurance company, as well as stating what is covered.
- *Declarations* - identifies who is an insured, the insured's address, the insuring company, what risks or property are covered, the policy limits (amount of insurance), any applicable deductibles, the policy period and premium amount.
- *Exclusions* - take coverage away from the Insuring Agreement by describing property, perils, hazards or losses arising from specific causes which are not covered by the policy.
- *Conditions* - provisions, rules of conduct, duties and obligations required for coverage. If policy conditions are not met, the insurer can deny the claim.

Legal Aspects of The Insurance Contract

- *Offer and Acceptance* -- When applying for insurance, the first thing the individual must do is to get the proposal form of a particular insurance company. After filling in the requested details, the form must be sent to the company (sometimes with a premium check). This is the offer. If the insurance company accepts the offer and agrees to insure the offerer, this is called an acceptance. In some cases, the insurer may agree to accept an offer after making some changes to the proposed terms.
- *Consideration* -- This is the premium or the future premiums that the insured has to pay to the insurance company. For insurers,

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consideration also refers to the money paid out should there be an insurance claim. This means that each party to the contract must provide some value to the relationship.

- *Legal Capacity* -- An individual needs to be legally competent to enter into an agreement with the insurer. If the individual is a minor or mentally ill, for example, then that particular individual will not be qualified to make contracts. Similarly, insurers are considered to be competent if they are licensed under the prevailing regulations that govern them.
- *Legal Purpose*: If the purpose of the contract is to encourage illegal activities, it is invalid.

Insurable Interest

It is an individual's legal right to insure any type of property or any event that may cause financial loss or create a legal liability to him or her. This is called insurable interest. If living in a relative's house, and this individual applies for homeowner's insurance because there is the belief that he or she may inherit the house later. Insurers will decline the offer because this individual is NOT the owner of the house and, therefore, do not stand to suffer financially in the event of a loss.

This example demonstrates that when it comes to insurance, it is not the house, car or machinery that is insured. Rather, it is the monetary interest in that house, car or machinery to which the policy applies.

It is also the principle of insurable interest that allows married couples to take out insurance policies on the lives of their spouses - they may suffer financially if the spouse dies. Insurable interest also exists in some business arrangements, as seen between a creditor and debtor, between business partners or between employers and employees.

Principle of Subrogation

Subrogation allows an insurer to sue a third party that has caused a loss to the insured and pursue all methods of getting back some of the money that it has paid to the insured as a result of the loss.

Insurance Binder

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An Insurance Binder is immediate insurance coverage that can be in oral or written form. Usually provides temporary insurance coverage for a specified time until a formal policy is accepted or denied. A Binder is insurance coverage and can be offered verbally or in writing from an agent or insurance company. Binders offer temporary insurance coverage for a stated period of time to complete underwriting and issuance of the insurance policy is finished. The actual point of coverage may be different from state to state and may also be different for depending on the policy.

"Binding authority" is agreed on between the company and the agent. An insurance agent may have a variety of different binding authorities with different companies, or products within the company. Policy language usually sets an effective date for new insurance often it's the next day at 12:01 AM. The consequence of this is that many agents may not have authority to issue a binder if it needs to be effective immediately.

Homeowner's Insurance Policy Cost

The cost of homeowners insurance often depends on what it would cost to replace the house and which additional riders—additional items to be insured—are attached to the policy. The insurance policy itself is a lengthy contract, and names what will and what will not be paid in the case of various events. Typically, claims due to earthquakes, floods, "Acts of God", or war are excluded. Special insurance can be purchased for these possibilities, including flood insurance and earthquake insurance. Insurance must be updated to the present and existing value at whatever inflation up or down, and an appraisal paid by the insurance company will be added on to the policy premium.

Trigger Theories in Homeowners Insurance

There are specific events that must occur to "trigger" insurance coverage under any given type of insurance policy. The word "trigger" is used in the insurance context as a term of art meaning the event that activates coverage under one or more insurance policies. Determining when an "occurrence" takes place is crucial in knowing what policy or policies are implicated to cover a loss. This issue of which policy or policies apply to a claimed loss hinges on the time of the occurrence, an event commonly referred to as the coverage "trigger." There are at least four trigger theories exist throughout the various jurisdictions:

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- ***Manifestation trigger;***
  The manifestation theory states that the time that a loss is discovered determines the effective policy on the risk. The manifestation trigger provides that actual damage occurs when it becomes apparent or readily identifiable. Even so, damage does not automatically qualify as apparent or identifiable merely because it is "capable of being known by testing." Or in other words, coverage would be triggered at the time the mold related property damage or bodily injury is discovered. In contrast to the exposure theory, the trigger date under the manifestation theory does not consider the date of the occurrence of the mold's ultimate cause. Analyzing coverage trigger in a property damage claim under the manifestation theory, even though a faulty roofing installation may be the ultimate cause of mold growth, coverage would not be triggered until the mold is discovered. So on the other side, for bodily injury claims, coverage is not triggered until the manifestation of the injury or disease.
- ***Exposure trigger;***
  The exposure theory states that the policy implicated is the one in effect on the date that a claimant or property is exposed to an injury-causing agent. Under this theory, the trigger date is generally considered to be the date on which the ultimate mold causing factor occurred. In a property damage claim, if the ultimate cause of mold were determined to be the result of a faulty roofing repair, the trigger date would be the date of the faulty roofing work. However, in the same incident, for a bodily injury claim, trigger would occur at the point of exposure to the mold.
- ***Continuous trigger;***
  The "continuous trigger" theory reaches further than the other trigger theories. The continuous trigger theory provides that all policies on a risk, from the time of initial exposure through the manifestation of the injury or damage are applicable thereby triggering the greatest number of policies and providing maximum coverage. Under the continuous trigger theory, if multiple policies are in place over the course of time

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from the initial exposure to manifestation, all of the policies will be triggered.

- ***Injury-in-fact trigger.***
  The "injury-in-fact" theory provides coverage under the policy in place at the time that the bodily injury or property damage actually occurs. This trigger can become complicated in mold claims because of the latent affect of mold. In the case of "latent" disease or damage, the injury may be sustained at an undeterminable date well before it is ever discovered. As mold growth occurs gradually over time, mold contamination may exist for a significant amount of time prior to its ultimate discovery. So under both property damage and bodily injury claims, utilizing the injury-in-fact theory would require an extensive, and likely costly, factual determination to pin-point the actual date of injury.

The Trigger Analysis

The trigger analysis for claims-made policies is straightforward—the policy in place at the time a "claim" is first made is the one (and typically the only one) that is triggered, provided that the claim is reported in a timely manner under the terms of the policy. The trigger analysis for occurrence-based policies, however, is less than straightforward and has produced a number of different approaches across the country.

State Applied Trigger Methods

As insurance coverage law is ultimately a state law issue, different states apply different trigger methods under similar circumstances. Despite the varying treatments among different jurisdictions, the coverage trigger determination is always crucial as it holds the ability to implicate or completely exonerate an insurer based simply on the timing of the occurrence. Different trigger theories may be applied in the same jurisdiction depending on the type of insurance policy under which coverage is sought and the type of damage allegedly suffered.

The Courts and The Trigger Issue

To date, very few courts have addressed the trigger issue with respect to mold exposure bodily injury claims. Bodily injury claims resulting from mold exposure, however, would appear to be sufficiently analogous to asbestos

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actions to allow their use for guidance on the subject. In considering coverage triggers in asbestos actions, many courts have utilized the continuous trigger theory because those claims for progressive injuries. However, more conservative courts have applied the exposure theory and manifestation theories, triggering coverage based upon the point in time at which the claimant either was exposed to the harm causing agent or discovered the injury

The Cost of Homeowners Insurance

The price of homeowners insurance will most likely differ with each insurance company because the cost is based on each company's past loss experience. The loss experience is the amount of money the insurance company has had to pay out in past on claims that have been filed against it. Consumers often overpay for homeowners insurance by including the value of the land that their home resides on. An individual only needs to insure the home itself and the possessions, not the land. Should something unfortunate occur, the land will most likely remain. If an individual does not subtract the value of the land when deciding how much homeowners insurance to buy, he or she will most likely pay more than is available should.

Increasing the safety features on a house could lower the homeowner's insurance premium. By shopping around and comparing, an individual can compare insurance quotes from leading homeowner's insurance companies.

Limitations and Exclusions

Informing a homeowner's insurance buyer about fundamental policy exclusions and special limits of coverage for specified types of valuable personal property is beneficial for all parties involved: the insured, the agent and the insurer. It minimizes the potential for disputes over uninsured losses. Sometimes it also strengthens the case for any additional insurance recommendations.

Exclusions are reasonable, reflecting years of loss experience by numerous insurers. The needs and concerns of insureds are further addressed by consumer groups that participate in discussions with forms drafters when policy forms are reviewed and periodic changes are made in coverage. Two

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major exclusions underscore the need for additional coverages in some instances.

- *Flood insurance* -- Despite efforts by the insurance industry and the federal government to acquaint people with the availability of flood insurance, there is still an ongoing problem in areas that are subject to catastrophic flooding. We often hear that insureds are shocked when they discover that flood damage was not covered under their homeowners policy Advance knowledge of this exclusion will alleviate the problem.
- *Earthquake insurance* -- Property owners in earthquake-prone areas are constantly reminded of the availability of earthquake insurance and its importance. The prominent display of the earthquake exclusion in a homeowner's policy will make it clear to the insured who reads it that special coverage is needed for this hazard.

There must be coverage limitations for certain kinds of high-risk, high-value personal property so that premiums can be held to a reasonable level. Otherwise, the majority of insurance buyers would help bear the expense of protection for those with possessions subject to extraordinary exposures.

Discounts For Homeowner's Insurance

There are a myriad of homeowners discounts that go unrecognized by many consumers. For example, even though they seem ordinary, may be able get a lower premium if the home has safety features such as dead-bolt locks, smoke detectors, an alarm system, storm shutters or fire retardant roofing material. A new home's electrical, heating and plumbing systems and overall structure are likely to be in better shape than those of an older home; therefore new homes are usually charged lower rates than older homes in the same price range.

Strong home security in the form of security systems, alarms, gated communities, double locks on both doors, etc. often afford you lower rates. Non-smokers usually get reduced rates on their homeowner's insurance policy. If the homeowner had been a smoker when purchasing a house, but have subsequently quit, many insurers may lower the rates. Smoking accounts for

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over 20,000 residential fires in the U.S. a year, so insurers often charge lower premiums to smoke-free households. Discounts exist for:

- smoke detectors;
- deadbolt locks,
- security or fire alarm systems,
- fire extinguishers in the home, etc.
- homeowner over 55 and retired -- 10% discount.

Deductible and Risk

The deductible is the amount of risk one agrees to accept before the insurance company starts paying on a claim. With the cost of homeowner's insurance escalating, it no longer makes sense to let the insurance company assume all the risk. If the insured has a low deductible of $50 to $100, the homeowner should consider raising it to at least $500 to $1,000 in order to save up to 25% on premiums.

Some companies are offering deductibles equal to 1% of the insured value of your home ($1,000 deductible on a $100,000 home). It that seems like a lot of money to pay in the event of a claim, consider this: the trends in homeowner's insurance are for insurance companies to severely penalize customers who file one or more small claims. Often the premiums are raised up or the policy is cancelled, and when the customer looks elsewhere for coverage, they may find it costs them three times what they were paying.

A Good Credit Record

Establishing a solid credit history can cut insurance costs. Insurers are increasingly using credit information to price homeowner's insurance policies. In most states, the insurer must advise an individual of any adverse action, such as a higher rate, at which time he or she should verify the accuracy of the information on which the insurer relied. To protect one's credit standing, it is important to pay bills on time, don't obtain more credit than is needed and keep credit balances as low as possible. One's credit record should be checked on a regular basis and have any errors corrected promptly so that the record remains accurate.

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Guide to Insurance Disclosures

The Homeowners' Insurance Noncoverage Disclosure Act require insurance companies to fully disclose insurance coverage and noncoverage of homeowner's insurance policies, and it would provide for enforcement by the Federal Trade Commission.

Homeowner's Liability

The Homeowners Liability section is a most important part of a homeowner's policy. Individuals face many direct and indirect exposures to liability. A homeowner may be held liable for damages from his or her home or anywhere on the insured's premises. There are many instances when an insured is liable, such as when someone slips on the doorstep and is injured, a son or daughter breaks the neighbor's window with a baseball, a tree or limb fall and crushes neighbor's car or bike, the family dog bites the mail carrier. In fact, an individual may be held liable for damages arising out of personal activities away from the home.

Individuals Covered Under Liability Insurance

A homeowner can be held liable for bodily injury, if someone given access or otherwise receives bodily injury while on land owned by him or her. The policy also states that the insurance company will provide a defense for the insured at the insurer's expense, even when the charges are groundless. The insurer's duty to defend ends once the amount it pays for damages reaches the policy limit. The standard liability limit provided for all bodily injury and property damage is $100,000. This includes any prejudgment interest awarded on any amount of a judgment the insurer is obligated to pay.

Renters Insurance

Renters insurance is insurance one buys if he or she is renting a property from someone else. It primarily covers personal belongings since the renter is not responsible for the building. Renters face the same risk as homeowners in cases of disasters striking their dwelling. The landlord or condo association may have insurance, but this only protects the building, not personal belongings in it.

Personal Property Coverage gives the renter protection for personal property at home and away from home against various hazards. Renter's policies provide

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"named peril" coverage. This means that the policy states specifically what you are insured against. Some of the named perils are:

- Accidental Discharge of Water;
- Burglary or Vandalism;
- Explosion;
- Falling Objects;
- Fire, Smoke or Lightning;
- Electrical surge damage;
- Malicious Mischief;
- Riot or civil commotion;
- Theft;
- Windstorm or hail.

Replacement Cost Coverage protects the personal property with replacement cost coverage. This additional protection assures that if a loss occurs, you will receive reimbursement for the full cost to repair or replace your property at today's market cost, up to the policy limit. Renter's Insurance policies are designed to cover one in the event of loss to one's personal property and protect him or her in the event the tenant is responsible for injury or property damage to others in the rented Apartment, Home or Condo. An estimated 75% of Renters do not have renter's insurance coverage. Landlords and complexes are now requiring Renters Insurance as a condition to rent.

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Chapter 5
Guide to Homeowner's Insurance Policies

Dwelling vs. Property

The amount of Dwelling Insurance Coverage that an individual needs depends on what it would cost to replace a home and land in the event of a total loss. While one may be able to get by with only 80% coverage, will it be possible to take the other 20% out of your pocket in the event of a total loss? The incremental cost to insure a property to full "replacement cost value" is so low it would be fool-hearty not to fully insure property at full value.

A homeowner's insurance policy is a package which covers loss not only to the dwelling structure, but other structures on the land, personal property contained in the dwelling, and liability to third parties who come onto the dwelling and surrounding land. In its purest form, a dwelling policy covers only the dwelling structure itself -- providing a much smaller amount of coverage. Though not very common, dwelling policies are used in some areas of the country to insure seasonal homes that are unoccupied for part of the year.

Fire dwelling insurance is offered to protect all listed dwellings on property such as the house, garage, sheds or other structures, from certain types of damage. Losses covered by fire dwelling insurance typically include fire, collapse, explosion, hail, lightning strike, smoke, vandalism, and wind damage. The insurance company issuing fire dwelling insurance would also provide a year's worth of rental value.

Levels of Coverage

While a homeowner should not rely exclusively on the coverage levels required by the bank or mortgage company, the homeowner's insurance policy must at least meet these minimums to prevent default. The homeowner should know that the levels of insurance required under the mortgage contract are usually designed to protect the only the house itself. These levels of insurance will not necessarily protect your possessions and will not even protect the house under certain occurrences such as earthquake and flood.

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While the loss of a home by fire is covered by homeowners insurance, most homeowners do maintain the right amount and type of coverage. For example, the Northridge, California earthquake of 1974 created over $40 billion in total losses. But according to the California Insurance Commissioner's office only about 38%, or $15 billion of the claimed loss was actually insured.

HO Coverages

In the United States, homeowner's insurance policies, also known as HOs, are labeled in different classes of insurance. These labels are the same throughout most of the United States with the exception of Texas. These labels define different levels of home insurance coverage that can be purchased in the United States and are defined by the perils that they cover. There are eight basic kinds of homeowners insurance.

Home owners insurance protects the home an individual lives in and / or the contents of the home. In the United States, there are varying degrees of insurance coverage to choose from so that one can get the right home owners insurance.

HO-1 -- Limited Coverage Policy

Basic Homeowners – HO-1 covers a dwelling and personal property against losses from 11 types of perils: fire or lightning; windstorm or hail; explosion; riot or civil commotion; aircraft; vehicles; smoke; vandalism or malicious mischief; theft; damage by glass or safety glazing material that is part of a building; and volcanic eruption. This is the most basic type of home owners insurance that people who own a home will purchase. Most people use Home Owners One as extra insurance to cover the loss of valuable possessions. It is a limited policy that offers varying degrees of coverage but only for items specifically outlined in the policy. These might be used to cover a valuable object found in the home, such as a painting.

HO-2 -- Broad Form

Basic Homeowners Plus – HO-2 covers dwelling and personal property against 11 perils plus six more: falling objects; weight of ice, snow or sleet; three categories of water-related damage from home utilities or appliances; and electrical surge damage.HO-2 is a limited policy in that it covers specific portions of a house

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against damage. The coverage is usually a "named perils" policy, which lists the events that would be covered. As above, these factors must be spelled out in the policy.

HO-3 – Special Form (See Chapter 6)

HO-4 – Renter

HO-4 covers only personal property from 17 listed perils. This is commonly referred to as renters insurance or renter's coverage. Similar to HO-6, this policy covers those aspects of the apartment and its contents not specifically covered in the blanket policy written for the complex. This policy can also cover liabilities arising from accidents and intentional injuries for guests as well as passers-by up to 150' of the domicile. Common coverage areas are events such as lightning, riot, aircraft, explosion, vandalism, smoke, theft, windstorm or hail, falling objects, volcanic eruption, snow, sleet, and weight of ice.

HO-5 – Comprehensive Form

HO-5, similar to HO-3, covers a home (not a condo or apartment), the homeowner and its possessions as well as any liability that might arise from visitors or passers-by. All risk coverage for building and personal property. This policy form is not sold very often. This coverage is differentiated in that it covers a wider breadth and depth of incidents and losses than an HO-3. This policy is quite costly and is not sold very often.

H0-6 -- Condo/Co-op

Condominium Coverage – HO-6 covers personal property from 17 listed perils along with certain building items in which the unit owner might have an insurance interest. As a form of supplemental homeowner's insurance, HO-6, also known as a Condominium Coverage, is designed especially for the owners of condos. It includes coverage for the part of the building owned by the insured and for the property housed therein of the insured.

Designed to span the gap between what the homeowner's association might cover in a blanket policy written for an entire neighborhood and those items of importance to the insured, typically the HO-6 covers liability for residents and guests of the insured in addition to personal property. The liability coverage,

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depending on the underwriter, premium paid, and other factors of the policy, can cover incidents up to 150' from the insured property, all valuables within the home from theft, fire or water damage or other forms of loss. It is important to read the Associations By-laws to determine the total amount of insurance needed on your dwelling.

Typically the HO-6 covers liability for residents and guests of the insured in addition to personal property. The liability coverage, depending on the underwriter, premium paid, and other factors of the policy, can cover incidents up to 150' from the insured property, all valuables within the home from theft, fire or water damage or other forms of loss. It is important to read the Associations By-laws to determine the total amount of insurance needed on your dwelling.

HO-8 -- Older Home

Basic Older Home – HO-8 covers dwelling and personal property from 11 perils. It differs from HO-1 in that it covers repairs or actual cash values - not rebuilding costs. This is for homes where some historic or architectural aspects make the home's replacement cost significantly higher than its market value. It is usually called "older home" insurance. It lets house owners with higher replacement cost than the market value insure them at the lower market value rate. This type of home insurance policy is designed for homes where the house's historical or architectural characteristics make the replacement cost of the home considerably higher than its market value.

In addition, a Dwelling Fire policy is generally available for non-commercial owners of rented houses, covering property damage to the structure, and sometimes to the owner's personal property (such as appliances and furnishings). The owner's liability is generally extended from their own primary home insurance, and does not comprise part of the Dwelling Fire policy. It is a counterpart to the HO-4 renter's policy.

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Chapter 6
Guide to The
Standard Homeowners Insurance Policy (HO-3)

HO-3 -- Special Form

Extended or Special Homeowners – HO-3 covers 17 stated perils stated in HO-2 plus any other peril not specified in the policy, except for flood, earthquake, war, and nuclear accident. This policy is the most commonly written policy for a homeowner and is designed to cover all aspects of the home, structure and its contents as well as any liability that may arise from daily use, as well as any visitors who may encounter accident or injury on the premises. Covered aspects as well as limits of liability must be clearly spelled out in the policy to insure proper coverage. The coverage is usually called "all risk". This policy is also called an "open perils" policy.

Section 1 — Property Coverage

Declarations

The Declarations section specifies who is insured and the location of the property, and deductibles. The persons insured include the owner of the policy and spouse, any relatives living at home, anyone living in the residence under the age of 21 and any relative who is a full-time student under the age of 24 or, if under the care of the insured, under the age of 21, who lived at the residence prior to moving away for school.

Also covered for liability are covered animals and watercraft and employees providing personal service for the insured. For instance, a housecleaner that falls and hurts himself while cleaning the home, or a dog that roams around and bites someone is covered.

Insuring Agreement

This is a short part that basically says that the insurer will provide you with insurance only if you pay premiums and follow all provisions of the policy.

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Definitions

The section of the coverage provides definitions of important terms in the contract, which removes any ambiguity in the contract. This not helps the insured to understand the contract better, but it protects the insurer, since any ambiguity in an insurance contract is construed against the insurer by the courts.

Coverage A; Coverage B

Coverage A is coverage for the Home's Structure (Dwelling Coverage) and – Coverage B is for unattached structures such as garages, sheds and barns (Other Structures Coverage). This coverage insures the structure of a home and other unattached structures on the premises from such perils as fire, lightning, explosions, theft, vandalism, snow, ice, smoke, accidental water overflow from your plumbing, damage from vehicles, falling objects and some other mishaps. It is important to pay attention to possible coverage exclusions that might require additional endorsements or an additional policy to cover. Land is specifically excluded.

Coverage C - Personal Property Coverage

Coverage C protects personal possessions from the same perils as the coverage for the home's structure. Policyholders should make an inventory of their belongings, which implies recording of the serial numbers, dates and costs of purchases for the furnishings, jewelry, artwork, household appliances and other things. Inventories should be stored either in an incombustible safe or on a computer outside the building. The total value of the insurer's belongings is normally established at half cost of the home structure's coverage.

The cash value of the insured personal belongings in the event of property loss is the original cost of the property item, minus devaluation. If you bought most of your possessions a few years ago, their current depreciated value will be much less than the total sum it would take to replace them. Bearing this in mind, it could be wise to obtain an extra endorsement (Guaranteed Replacement Coverage), which can significantly increase this coverage. You may also need additional coverage in case you own expensive jewelry, fine artwork, antiques, collectibles, firearms, musical instruments, some costly

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equipment, and other items, which cost more to replace than the limits of your Specific Personal Property coverage allow.

Coverage D - Loss of Use Coverage

Coverage D insures the homeowner for temporary living expenses, restaurant meals, car storage and even pet kennel expenses, for a certain period of time while your damaged home is being repaired or rebuilt. This coverage tends to pay up to 20% of the sum your home's structure is insured for.

Section 1 Additional Coverages

Miscellaneous coverages are listed in this section. This section also lists the deductible, which is usually $250 for each covered loss, although this can be increased to reduce the premium. For instance, increasing the deductible to $1,000 may decrease the premium by as much as 25%.

Debris removal from a covered peril is covered as well as property temporarily moved to another location for safekeeping until the main residence is repaired. Reasonable costs to protect the property from further damage are also covered. Trees, shrubs, and other plants are covered up to a limit of 5% of the main dwelling, but no more than $500 for any single plant. Other covered items include collapse of a building due to specified causes, glass, and grave markers. Furnishings owned by the insured in an apartment or room located on the insured's premises that is rented out is also covered for Coverage C perils except theft.

Perils Insured Against

Dwelling and Other Structures -- This policy is an open perils policy—thus, everything is covered except that which is specifically excluded, which is listed here: collapse of a building; freezing of water, unless adequate heat is maintained; fences, pavements, patios; theft of materials used for construction, or parts of a dwelling under construction; vandalism, if the property was vacant for the previous 60 days; mold, fungus, or dry rot; and numerous other exclusions that are generally not insurable, such as wear and tear.

Personal Property -- This section provides a named-perils coverage—only those perils listed are covered. Fire is a covered peril, even if it is a proximate cause

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of the destruction, rather than a direct cause. For instance, if firefighters have to break down a door to fight a fire, then the door is covered. However, the fire must possess two qualities before it would be considered a covered fire. There must be a flame or a glow. Scorching, for instance, would not be covered. It must also be a hostile or unfriendly fire, which the courts have defined as a fire that burns outside of where it is expected.

For instance, if some of the homeowner's personal property somehow gets into the fireplace and burns, then it would not be covered, because the fire in the fireplace is considered a friendly fire, since it is burning where it is expected. Smoke damage is covered, even from a friendly fire, as is any kind of explosion.

Windstorm, hail, and lightning are generally covered. Damage from or within vehicles is covered, so if your personal property is damaged in an auto accident, then it will be covered. Other covered perils include, with some exclusions and conditions, theft, vandalism, riot, aircraft, falling objects, weight of snow, ice, or sleet, accidental discharge or overflow of water or steam, freezing, and volcanic eruptions.

Section 1 Exclusions

This section lists more general exclusions, which are generally not insurable risks: ordinance or law; earth movement; water damage from external sources of water, such as floods, sewers, or underground water; power failure; losses caused because the insured failed to protect property after a loss; war, nuclear hazard; intentional loss; weather conditions; and defective planning and design.

Section 1 Conditions

This section lists the conditions that the insured must abide by, and also explains various details of the policy.

Duties After a Loss -- If the homeowner expects coverage, there are certain duties that one must perform after a loss. Below are some of these items:

- Promptly notify the insurer about the loss
- Protect the property from further losses
- Itemize the damaged personal property

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- Keep the damaged property for possible inspection by the insurer
- File a **proof of loss** within 60 days of the insurer's request for it.

The proof of loss will include all information that the insurer will need to ascertain that a loss has occurred and the value of the loss: date and time of loss; ownership interest in the property, and, also, all liens, if any; and any other insurance on the property.

Loss Settlement – Only the actual cash value, which cannot exceed the cost of replacing or repairing the item, of personal property losses is paid minus the deductible. This also includes structures that are not buildings, and such items as carpets and appliances. However, a replacement cost endorsement can be purchased, which covers the cost of replacing the item without any deduction for depreciation.

For the dwelling and other buildings, the replacement cost is paid, with no deduction for depreciation, but only if at least 80% of the value is insured; otherwise, a coinsurance penalty is applied.

Because some disasters can destroy a home beyond repair, or, in some cases where many homes are destroyed in the same area, the cost of materials to rebuild or repair a home could be significantly increased above what it would normally cost. For these cases, an extended replacement cost endorsement can be purchased that will pay 20% or more above the policy limits. However, the insured must insure the property for full replacement cost, and notify the insurer if there are significant alterations to the property that might change its value.

Some insurers offer a guaranteed replacement cost policy, where the policy will pay 100% of the cost of restoring the property to its previous condition, even if it is more than the policy limits. However, the insured must insure the property for 100% of its value at the time of purchase. Because of the risks for insurers due to fraud and inflated appraisals, and higher costs in a major disaster, this type of policy is becoming rarer, and, in any case, much more expensive.

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Appraisal Clause -- The appraisal clause provides for a method of appraisal that is agreeably to both insurer and insured when there is disagreement of the value of a loss. In this procedure, both the insurer and the insured select an appraiser, then the 2 appraisers select an umpire. If the 2 appraisers agree on the value of the loss, then that is the value that is binding on both parties. If there is a disagreement, then the umpire decides which value accurately represents the loss.

Mortgage Clause -- The mortgage clause protects the lender for the property. Most people borrow money to buy property, but the property must be insured before the loan is approved, with the mortgagee (lender) named in the policy. In the event of a loss, the mortgagee will be compensated to the extent of its insurable interest, even if the policy is violated by the mortgagor (borrower).

Other Provisions -- There are several other provisions in this section; many are common to all insurance contracts, such as nullifying coverage because of fraud or concealment, who is paid in the event of a loss, and a stipulation that any legal action commence within two years of the loss, and after all requirements of the policy have been complied with. Other common provisions include allowing the insurer to repair or replace property at its option, which, in many cases for personal property, it will do because it can buy many things for a lesser price than most consumers could get it for, because of the insurer's bargaining power.

Also, the insured does not have the option to abandon the property by leaving it to the insurer for the full value of the loss. In cases of total destruction, the insurer can pay the insured for his loss, or it can pay for the full value of the property and take possession of it, but the choice is the insurer's, not the insured's.

Section 2 Liability Coverage

This coverage extends to all of the home's structure and the possessions contained within it. It also covers the homeowner for personal liability that can happen in regular daily use or for people/guests that are hurt on his or her property or have an accident on the land.

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Coverage E -- Personal Liability

This coverage offers compensation for legal expenses and medical costs when an individual is found liable for damages or injuries to others on his or her property.

Insurance companies usually recommend $300,000 of the combined legal and medical expenses for a single occurrence. You can also choose to buy more liability coverage in the form of a Personal Umbrella Liability policy. Some insurance companies can include a Medical Payment Coverage section as well. For example, if a visitor suffers minor injury on your premises, Medical Payments Coverage would cover minor medical costs, such as exams and X-rays.

In cases that lead to litigation for personal liability of the insured, the insurer will pay for the defense of the insured and any claim imposed by the court on the insured, up to the policy limit. This coverage, does not cover business liability or liability arising from the use of a motor vehicle, which should be covered by separate insurance policies specific for that coverage.

The minimum amount of liability coverage is $100,000 per occurrence, which is defined as a single accident, or damage resulting from a prolonged exposure to the same set of conditions. Note that personal liability is covered regardless of where it occurs. For instance, if a homeowner breaks an antique at a shop, your homeowner's insurance will cover you.

Coverage F -- Medical Payments to Others

Coverage F covers people other than the insured, and regardless of whether the insured is legally liable for the injury. The insurer will pay reasonable medical expenses for other people who are on the insured's location, or by the activities of the insured, resident employee's of the insured, or animals owned or in the care of the insured. For instance, if the insured's dog runs away and bites someone, then the insured would be covered. In fact, dog bites account for 1/3 of the claims. Another example under Coverage F: If your child and a neighbor's child are playing in your yard, and they are both injured, the neighbor's child would be covered, but not your child.

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Section 2 Exclusions

Most of the exclusions under Section 2 are commonsensical. The 1st section applies to both Coverage E and Coverage F. There is no coverage for activities that should be covered by other, more specific policies. For instance, motor vehicles are generally not covered, nor is watercraft, aircraft, and hovercraft liability covered, except under specific conditions. Intentional torts are not covered.

Liability for business activities and professional services are generally not covered. Other specific exclusions include war; communicable diseases; sexual molestation, corporal punishment, or physical or mental abuse; and liability arising from controlled substances. Exclusions specific to Coverage E include contractual liability where the insured agrees to assume a legal liability; property owned by the insured, or property in the care of the insured that is damaged by an insured; bodily injury to an insured by an insured; nuclear energy; and any injury covered by workers compensation insurance.

Exclusions for Coverage F include injuries to resident employees outside of insured locations, and injuries to people who regularly reside at the residence who are not resident employees.

Section 2 Additional Coverages

Claim Expenses-- Most expenses related to litigation for personal liability are covered, and is over and above the policy limits for personal liability damages. This includes attorney's fees and court costs; premiums for appeal bonds; interest on judgments that accrue before payment of the claim; and reasonable expenses and up to $250 per day for lost income to compensate the insured for helping the insurer to prepare and defend the case.

Damage To Property of Others-- Any property damage caused by the insured will be paid by the insurer for replacement cost, up to $1,000 per occurrence, even if the insured is not legally liable for the damage—to preserve good neighborly relationships. Thus, if you break something at a neighbor's party, you'll be covered. However, the damage will not be covered if the cost is greater than $1,000 unless the insured is legally liable for the damage. There are many

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exclusions to this section, which can be classified as damage that should be covered by other insurance, such as business liability, or damage that is covered by another part of this policy. Any intentional damage caused by an insured who is older than 12 is not covered, and any property damage caused by an insured is not covered under this section.

Other Expenses-- Other expenses that are covered are first-aid expenses for a covered injury, and special loss assessments, such as what may be imposed on the insured by the insured's homeowners association.

Sections 1 and 2 Conditions

This section contains many conditions that are common to most insurance contracts: waiver or change-of-policy provisions, cancellation, nonrenewal of the policy, assignment of the policy, assigning subrogation rights to the insurer, liberalization clause, and what happens if the named insured or spouse dies.

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Chapter 7
Guide to Provisions, Exclusions and Endorsements, & Riders

Guide to The Provisions
There are many provisions in the Homeowner's Insurance that the individual must be made aware of before making a purchase. The provisions range from cancellation to Guaranteed Replacement Provision, etc.

Cancellation and Non-renewal Provision
Insurance companies cannot cancel a policy that has been in force for more than 60 days except when:

- Homeowner fails to pay the premium;
- Homeowner has committed fraud or made serious misrepresentations on an application.

Nonrenewal refers to either the homeowner or the insurance company deciding not to renew the policy when it expires. Depending on the state one lives in, the insurance company must give the homeowner a certain number of days' notice and explain the reason for not renewing before it drops a policy.

There are various reasons for nonrenewal, one being that the company may have decided to drop that particular line of insurance or to write fewer policies in the area concerned. The nonrenewal decision may not be because of something the homeowner did. But if the homeowner did do something that raised the insurance company's risk considerably, like committing fraud, the policy may not be renewed.

Guaranteed Replacement Provision
The replacement value of a property is a factor to be considered in ascertaining the loss payable on a claim under a homeowner's policy. It does not provide one definitive definition of the term and, in practice, insurers may "cap" their

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liability under such a clause by including additional provisions in the insurance policy.

Special Deductibles Provision

"Special" covered causes of loss encompass a broad category of all causes of direct physical loss subject to certain exclusions and limitations. The insured is informed that if a building suffers direct physical loss, coverage will be provided if the damage was caused by a covered cause of loss, and this coverage will be subject to the deductible for "Special" covered causes of loss. The Multiple Deductible Form clearly identifies $5,000 as the amount of the deductible for "Special" covered causes of loss. The higher deductible for wind damage appears as an exception to the "Special" deductible for all other causes of loss.

The Policy Premium Provision

The premium is the price of an insurance policy, typically charged annually or semiannually. Each policy will have a premium attached to it. The premium is determined by the various aspects of the policy and what endorsements, etc. may be added

Guide to The Exclusions

The first thing to know about exclusions is that they vary by policy type. An HO-1 policy covers 10 perils but has been discontinued in most states. A homeowner's policy does not provide coverage for the following perils:

- loss due to flood, or water that backs up through sewers.
- loss to building by earthquake, aftershocks and mud slides.
- loss by enforcement law or ordinance regulating construction, repair or demolition, or zoning.
- loss due to power interruption when the interruption takes place off the residence property.
- loss due to neglect of the insured to save and preserve property following a loss.
- war and nuclear perils.
- intentional loss;
- sinkhole.

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However, some of these excluded coverages may be purchased for an additional premium. Additional exclusions to Coverage E only include the following:

- liability assumed under contract or agreement;
- property damage to property owned by, used by or in the care of the insured.

Guide to Endorsements and Riders

Endorsements and riders are defined similarly and used interchangeably, and are additions, deletions, or other modifications to the original contract. The term endorsements is more prevalent in property and liability insurance, and riders are more prevalent in life and health insurance contracts. Because endorsements and riders are added for specific insureds, they generally have greater weight than other terms of the contract when there is a conflict between them, unless they violate laws as to what is required in insurance contracts.

A homeowner's first insurance concerns are usually coverage for the structure of the home and liability. But many valuable additional coverages may be purchased through endorsements to a policy. An endorsement is a written modification that either adds to or deletes one or more provisions of the general policy to serve particular needs. There are more than 100 endorsements for the standard homeowner's policy, including one for identity theft, but the following are the most common.

A rider is a separate mini-policy or clause that extends your homeowners policy to cover the extra value of items that may be excluded under contents insurance. A homeowner's policy may not cover the cost of particular expensive items like luxury watches, fine art or electronics equipment, for instance, or may limit reimbursement to an amount far below the actual value of those items.

Inflation Guard Endorsement

An inflation guard endorsement automatically adjusts the dwelling limit when one renews a policy to reflect current construction costs in the local area. The

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homeowner can purchase an inflation guard endorsement, where the amount of the insurance is increased pro rata annually by an amount that the homeowner chooses—usually 4% or 6%. For instance, if a home is insured for $100,000 and the insured chooses a 4% rate of increase, then if the insured suffers a complete loss in 6 months, the insurance will pay $102,000; if the loss occurs 9 months later, then the payment will be for $103,000; and if the loss occurs a full year later, the payment will be the full 4% annual increase—$104,000.

Because the coverages for other structures, personal property, and loss of use are a percentage of Coverage A, which insures the main residence, this increase in coverage also applies to those sections. For instance, since the limits for personal property is 50% of the main coverage, the policy limit for personal property in the above example would be $50,000, which would increase to $52,000 (4%) at the end of the 1st year.

Special Loss Settlement Endorsement

If the information is not shown on this form, refer to Supplemental Declarations if information is not shown on this form. We will amend the amount of insurance applying to Coverage A, as shown on form ML-20, subject to these conditions.

Insurance Company will:

- Increase the Coverage A amount of insurance to equal the current replacement cost of the residence should a covered loss to the residence exceed the Coverage A amount of insurance. This agreement is conditioned on your obligation to insure the residence to 100% of the value that we recommend in accordance with B2 following. One's failure to comply voids the entire obligation under this endorsement.
- Include any increased cost due to enforcement of any ordinance or law that regulates the construction or repair of the residence following a covered loss.

The insured will:

- Elect to repair or replace the residence by agreement with us; any disagreement will be resolved by arbitration or appraisal.

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- The insurance company will adjust the Coverage A amount of insurance on policy inception, renewal or anniversaries, or at agreed intervals in accordance with any property evaluation is made, as referenced on the Declarations Page.
- Notify insurance company within 60 days of completion of any improvements to the residence that exceed 5% of the amount of insurance of Coverage A and pay any additional premium. The insured's failure to comply voids this entire endorsement and any loss will be settled in accordance with that section titled "How Much We Pay for Loss or Claims" on form ML-20.

When this endorsement is applicable, the insurance company will not pay more than the lesser of:

- The replacement cost of the residence or any part of it.
- The amount actually and necessarily expended to repair or replace the residence, or any part of it, in the same construction with materials of like kind and quality at the same location.

The full cost to replace the ***residence*** should a covered loss exceed the Coverage A amount of insurance shown on the Declarations. However, the most we will pay is 125% of the Coverage A amount of insurance shown on the Declarations. When the cost to repair or replace the damage exceeds $5000, we will pay only the actual cash value of the damage until the actual repair or replacement has been completed.

Home Office Coverage Endorsement

A basic homeowner's insurance policy will general cover around $2,500 worth of office equipment. If the homeowner runs his or her own business at home and the equipment is valued at much more, it may be a good idea to increase the coverage. In the event that something happened to a valuable home office equipment, an individual would be compensated for the loss with a Home Office Coverage Endorsement.

In addition to the equipment in a home office, the homeowner may need separate liability coverage if he or she conducts business out of the home. If a

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client is injured in the homeowner's home while there on business, the homeowner policy may not cover the injuries and loss. Inventory that is kept in the home, if direct sales is involved, is not covered, nor is the replacement of office supplies and crafting materials kept on premises for business purposes. In-home business coverage is about $300 a year in most states. That coverage will provide liability protection in case a customer or client is injured in the home, as well as increasing the coverage for office and business equipment.

Additional Living Expenses Endorsement

The Additional Living Expenses Endorsement covers the necessary increase in living expense incurred by the insured in order to continue as nearly as practicable the normal standard of living of the insured's household for the applicable period. Under the broad and special dwellings forms, coverage is provided for additional living expenses in the event of a loss under Coverage A. If the insured was to temporarily lose use of the dwelling, this coverage would apply and payment could be made for expenses incurred to live elsewhere following a loss that makes the dwelling unsuitable for living.

Scheduled Personal Property Endorsement

There is some personal property, such as jewelry or musical instruments, that have low coverage limits compared to what they may be worth, because most people don't have such property so they shouldn't have to pay the premium for it, and because it is difficult to verify the value of such items.

However, the homeowner can purchase a scheduled personal property endorsement that covers specified property for a specified value that is agreeable to the insurer. Generally, this is an open risks policy that pays for any direct loss, unless it is specifically excluded. The payout is equal to the agreed value loss settlement, which is the amount that the insurer agreed to pay in the event of a complete loss. Thus, if jewelry that was stolen was insured for $10,000, the insurer will pay the insured $10,000. There is no deduction for depreciation and no deductible.

Buy Replacement Cost Insurance

If the homeowner suffers a loss to his or her personal property, the insurance company will pay the value at the date of the loss. Oftentimes this value is less

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that the actual replacement cost. This is because depreciation is deducted from the total payment. If an individual wants, he or she can pay for protection that will replace the lost property regardless of the actual worth on the date of the loss.

Personal Property Replacement Cost Endorsement

The standard homeowner's policy pays **actual cash value** for damaged or stolen personal property. Because of depreciation, actual cash value is almost always significantly less than **replacement cost**. To remedy this, the homeowner can purchase the personal property replacement cost endorsement, which will usually pay the replacement or repair cost without any deduction for depreciation.

There may be limits on how much coverage one gets for expensive items such as jewelry, silverware and furs. Generally, there is a limit on jewelry for $1,000 to $2,000. This information is in *Section I, Personal Property, Special Limits of Liability*. Insurance companies may also place a limit on what they will pay for computers.

If the limits are too low, consider buying a special personal property floater or an endorsement. These allow an individual to insure these items individually or as a collection. With floaters and endorsements, there is no deductible. The owner is charged a premium based on what the item (or collection) is, its dollar value and where you live. The value can be determined by the owner providing the agent with a recent receipt or getting the item or collection appraised.

However, it does not apply to scheduled personal property, which has a separate endorsement, and the actual payment from this endorsement is the least of the following:

- repair cost,
- replacement cost,
- total limits for personal property,
- the limit for a particular item.

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If the amount exceeds $500, then the item must be either be repaired or replaced. Besides scheduled property, other excluded property includes property in poor condition and stored property that is little used.

Earthquake Insurance Endorsement

It's said that no natural disaster can cause more damage to life and property than an earthquake. This may be why earthquake coverage is excluded from all homeowner's insurance policies. Depending on where an individual lives, it can cost a pretty penny to protect against earthquakes. In California the earthquake coverage can be almost expensive as the homeowner's insurance policy itself. This is because the chances of earthquakes are much higher there than in other parts of the USA.

Because the coverages for other structures, personal property, and loss of use are a percentage of Coverage A, which insures the main residence, this increase in coverage also applies to those sections. Since the limits for personal property is 50% of the main coverage, the policy limit for personal property in the above example would be $50,000, which would increase to $52,000 (4%) at the end of the 1st year.

Theft Endorsement

Theft coverage is not automatically included in dwelling policies, however, coverage may be added with a broad theft coverage endorsement or a limited coverage endorsement. The limited theft coverage endorsement is available for dwellings that are not owner-occupied. The broad theft endorsement is only available to owner-occupied dwellings, and can apply to on and off premise theft. Both endorsements provide coverage for theft, attempted theft, and vandalism or malicious mischief as a result of theft. Special limits apply to certain personal property, and certain property is excluded on both endorsements.

Increased Blanket Coverage

If the total value of all of the homeowner's personal property is higher than what the basic homeowner's insurance policy covers, he or she might want to increase blanket coverage. To find the total value of the property, the insurance agent can give the homeowner a personal property inventory sheet.

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Personal Injury Endorsement

Although the standard homeowner's policy covers bodily injury and property damage, it does not cover personal injury, which includes false arrest, wrongful eviction or entry, invasion of the right of privacy in a room or dwelling, slander and defamation, or the violation of the person's right to privacy—in other words, injuries that don't affect the body. The **personal injury endorsement** covers the liability that arises from a personal injury.

Building Code Coverage Endorsement

A lot of older houses no longer properly meet updated building and safety legal codes. If this is the case with a home that is damaged the local building laws might require that the entire property be destroyed, then rebuilt to code. The problem lies within the amount you are covered for, it usually won't be enough for demolition and reconstruction. If you think this situation could apply to you, look into purchasing building code coverage that will cover the costs of the demolition and rebuilding of your home.

Riders

Jewelry

The homeowner policy will cover jewelry under personal items, but the amount the homeowner can claim per item may be far below the actual value of any fine jewelry pieces. Jewelry may be the most commonly covered type of item under riders. A jewelry rider will typically cover particular pieces, and will pay out even if you lose the item outside your home. Coverage will cost about $1.50 per $100 of coverage.

Electronics Equipment

These days, the most valuable items that many people own are their electronics. A HD plasma TV, the high-end computer, the video game consoles and the home theater and stereo equipment may not be covered for their full value under a standard homeowner's policy. If an individual has a home office and count on those things to enable him or her to work, it's especially important to have them covered in a separate rider. The coverage may be limited to $1,000 for all office equipment, which might not even replace a computer. A rider extending coverage to $10,000 would cost about $100 a year.

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Art or Antiques
The homeowner may insure art or antique furniture by the piece, or with a special rider that increases a home's contents coverage. Insurance coverage for fine art pieces is surprisingly inexpensive – usually about 25 cents per $100 in coverage. In addition, any pieces covered in a separate rider won't count against the overall contents coverage.

Guide to Floaters

Personal Articles Floater
Basic coverage for homeowner's insurance policies will generally not fully cover valuables like jewels, antiques, and other prized possessions. If the homeowner has valuables like these in the home, have a homeowners insurance company identify each with an establish value. This can easily be done with receipts or an appraisal. Always keep all records in a safe, secure place. A safe deposit box at the local bank is ideal for this.

Personal Articles Floater supplements coverage for possessions of higher monetary value, such as a diamond engagement ring, a grandfather's pocket watch, artwork, or a valuable collection. While most homeowner's policies have limits on the dollar amount and type of loss that can be recovered, Personal Articles Floater will provide the protection which one needs for his or her most valuable possessions in the event of loss through theft, accident or natural disaster. Many different types of possessions can be accommodated by the Personal Articles Floater. Here's a quick listing of some of the items typically covered:

- cameras (video or still) and related equipment;
- china and crystal;
- coins (rare and current);
- firearms;
- furs;
- golfer's equipment;
- jewelry;
- musical instruments;

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- personal computers;
- stamps (rare and current);
- silverware;
- works of fine art, including paintings, etchings, pictures and other bona fide works of art of rarity, historical value or artistic merit.

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Chapter 8
Guide to Catastrophic Insurance Coverages

Guide of Catastrophic Events and Losses
Catastrophic events by definition are sudden, natural or man-made situations where change and destruction may occur without prior knowledge or preparation. Such occurrences may limit normal functions in daily living including communications and travel. Catastrophic events can dramatically affect the well-being of people throughout entire regions. Episodes such as September 11, 2001 and the 2005 tsunami in Asia have highlighted the risks borne by individuals, particularly those with limited financial resources.

A catastrophic loss exposure can be defined as "potential loss that is unpredictable and capable of producing an extraordinarily large amount of damage relative to the assets held in the insurance pool." Despite the common convention of identifying any extraordinarily large loss as catastrophic, defining catastrophic loss from an insurance standpoint is difficult because the definition is relative.

A catastrophic loss is one that is extraordinarily large relative to the amount of property or number of exposure units in an insurance pool. Insured catastrophes occur when a single event (peril) can affect a large percentage of the loss exposure units in the insurance pool. Another way of stating this definition is that catastrophic loss potential exists when insured losses are not independent. That is, catastrophic loss potential exists when a loss to one exposure unit implies a likely loss to other exposure units. Catastrophic losses from natural disasters have two general characteristics:

- They are limited in geographic impact;
- They are not accurately predictable.

The Impact of Catastrophic Losses
In light of the severe damage associated with several hurricanes in the early 1990s, insurers have reconsidered their exposure to wind damage inflicted by

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hurricanes. In recent years, several insurers have withdrawn from areas highly exposed to hurricanes, while others have tried to reduce their exposure by limiting the number of new or renewal policies they write in these areas. Hurricane Andrew caused about $16.3 billion in insured losses, the largest dollar amount of damage claims ever made on the insurance system from a single natural event. The total amount of damage done was much greater because the storm did a huge amount of damage that was not insured, including damage to roads, schools, and federal property.

Almost all insured claims were honored, though seven relatively small insurers became insolvent. As a result of this loss, financial ratings firms lowered their estimates of many insurers' claims-paying ability. After paying their claims for the damage caused by Hurricane Andrew, many insurers restricted the amount of insurance they provided in Florida, and the state legislature had to pass several new laws to prevent the disruption of its private insurance market.

The Risk of Catastrophic Events

Catastrophic risk is a natural candidate for insurance. Catastrophic risks are difficult to measure and catastrophic events are rare, making it challenging to find micro-level risk characteristics that can be linked to financial data. Risk management theory suggests insurance is the most efficient mechanism for allocating the risks of large catastrophic events.

The catastrophe insurance market fails to appropriately manage these risks as premiums appear high relative to expected losses and little catastrophe reinsurance is purchased by insurers. Consequently, capital markets may play a significant role in bearing catastrophic risks.

Catastrophic events such as hurricanes, tornadoes, earthquakes, and terrorist attacks can cost millions if not billions of dollars in damages. In August 2005, Hurricane Katrina decimated Mississippi's Gulf Coast and southeastern Louisiana. Many local governments lost facilities, equipment, vehicles, employees, and so on to the storm. In addition, many local government employees lost their homes, friends, coworkers, or family members, and they witnessed the evacuation of their families to other parts of the country.

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Guide to The Insurability of Catastrophe Risk

Even if catastrophic risk is efficiently allocated, however, quake risk should clearly reduce the value of the property. If insurance is not purchased, the owner faces the risk of property damage. If insurance is purchased, the premiums must be paid. For a given level of current earnings, the value of a property should decline in its earthquake risk.

What makes a catastrophe risk insurable are:

- A sufficiently large number of homogenous exposures;
- An identified and quantifiable risk of loss;
- The loss needs to be fortuitous in its nature;
- The loss needs to be uncertain in its timing;
- The loss then needs to be indisputable in its occurrence;
- The occurrence should be measurable;
- The exposure should be economically feasible.

The Limits to Insurability

Insurability has its limits. All the natural and man-made risks would appear to be either instinctively insurable or un-insurable. The reinsurance market has the capacity to take on more risk than is currently placed. Exception to this is probably in the USA, where ideally limits required would be close to $100,000,000,000. The quantum of the exposure plays a deciding factor:

- Too much exposure in one place may prove to be uninsurable;

The key to insurability therefore, may lie in good exposure management. The U.S. Market is probably more aware and certainly better protected in terms of the level of catastrophe protection bought. The list of natural perils is all insurable, but change the level of probability of occurrence and it changes the picture hugely. An example of this would be when insuring a house the day before a cyclone was due to hit. Man-made risks, such as War often entail such a degree of destruction (beyond the realms of normal fire and explosion losses) that the capacity to accept these risks is beyond reach:

- Either the premium becomes prohibitive or the capacity insufficient;

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- Limited war risk can be insured;
- Terrorism, especially the new breed, can be uninsurable.

Guide to Disaster Insurance

The basic difference between disaster insurance and property insurance is that disaster insurance is more specialized and covers losses against immediate occurrences that have disrupted a business, while property insurance covers property against any number of common property risks, including theft or damage from accidents.

That having been said, the trend of hybridizing everything from mutual funds to cars has also affected the insurance industry. There are now various packages that cover property from a wide range of threats and allow you to buy additional coverage for specific concerns such as flooding.

When choosing disaster insurance, you basically have two choices — a *named peril policy* or an *all-risk policy,* also known as a comprehensive policy or an open peril policy.

Named Perils Policy vs. All-Risk Policy

The primary difference between them is that one type of policy covers what is "named" (included) in the policy while the other covers what is not included. A named peril policy is often a good choice for those business owners whose business is located in an area frequently hit by natural disasters such as hurricanes, tornados, or floods. Such a policy spells out the specific events for which you are covered. The cost of the premiums will depend on the location of the business and the likelihood of the specific peril(s). Anything not specifically named in such a policy is not covered.

An all-risk policy covers a business from damages caused by any type of disaster with the exception of those specifically excluded in the policy. Floods and earthquakes are two events that are typically excluded, but coverage for these types of disasters can be added to the policy for an additional fee. The National Flood Insurance program underwrites coverage for flooding, making it more easily available to business owners.

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Guide to Mitigation

Mitigation defines "repetitive loss structure" as any insured structure incurring flood damage on at least two occasions in a 10-year period for which the cost of repair, on average, equals or exceeds 25 % of the value of structure and authorizes $20 million per-year transfer from the National Flood Insurance Fund to Mitigation Fund phase-in in three years.

Mitigation also provides grants (75 % federal - 25 % non-federal) to states and communities for mitigation planning: annual total of $1.5 million, with timing and amount limits ($150,000 per state, $50,000 per community, and not more than $300,000 in any state in each fiscal year). It provides grants (75 % - 25 %) to states and communities with approved mitigation plans, to implement technically feasible and cost-effective projects; annual total of $18.5 million, with timing and amount limits ($10 million per state, $3.3 million per community, and not more than $20 million in any state in any 5-year period).

Mitigation finally defines grant eligible activities: elevation, relocation, demolition, or flood-proofing of structures; acquisition of substantially damaged property for public use; provision of technical mitigation assistance by states to communities and individuals; minor structural projects not duplicated by other federal program (not major levees, seawall, groins, unless specifically found to be cost-effective for Mitigation Fund); beach nourishment; and other measures determined by FEMA or in mitigation plans.

One of the provisions of mitigation insurance is that it provides coverage to include cost of compliance with land use and control measures adopted by states or communities, for properties that:

- are repetitive loss structures;
- have sustained flood damage in which the cost of repairs equals or exceeds 50% of the value of the structure prior to damage; or
- have sustained flood damage on multiple occasions if FEMA determines that it is cost-effective and in the best interests of the NFIP to require compliance with floodplain measures.

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FEMA is not to charge more than $75 per policy to provide mitigation insurance coverage.

Loss Mitigation Measures

Building Code Enforcement -- The grading of local governments according to their building code standards and their level of enforcement and compliance could provide incentives to municipalities to reduce catastrophe losses. The Insurance Institute for Property Loss Reduction (IIPLR) — formerly the National Committee on Property Insurance (NCPI) — and Insurance Services Office, Inc. (ISO) are currently developing and testing a system for grading building codes and their enforcement by municipalities. Those municipalities with effective building codes that are well-enforced should exhibit better loss experience and receive a better grade.

Geographic Diversification -- Recently developed computer technology provides insurers with the tools to improve management information systems for underwriting individual risks and tracking the geographic accumulation of exposures. Such monitoring should help insurers identify geographic concentrations, measure the potential for their aggregate losses from catastrophes, assess their underwriting strategy, and more favorably position themselves for reinsurance negotiations.

Changes in Policy Forms and Coverages -- Insurers can also respond to catastrophe-induced stress by controlling costs and making affordable coverage available by changing policy forms and coverages. After 1992's catastrophes, some insurers adopted a variety of measures involving deductible changes, limits changes, and caps on guaranteed replacement coverage.

Earthquake

An earthquake is a sudden and rapid shaking of the earth caused by the breaking and shifting of rock beneath the earth's surface. This shaking can sometimes trigger landslides, avalanches, flash floods, fires, and tsunamis. Unlike other natural disasters such as hurricanes, there are no specific seasons for earthquakes. In the United States, about 5,000 quakes can be felt each year. Since 1900, earthquakes have occurred in 39 states and caused damage in all 50. One of the worst catastrophes in U.S. history, the San Francisco Earthquake of

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1906, caused direct quake losses of about $24 million and fire losses of about $500 million, according to the National Geophysical Data Center. That would be almost $10 billion in 2000 dollars.

Most earthquakes occur when great stresses building up within the earth are suddenly released. This sudden release of this stored energy causes movement of the earth's crust along fractures, called faults, and generates shock waves. These shock waves, or seismic waves, radiate in all directions from the focus, much as ripples radiate outward in two dimensions when a pebble is dropped into a pond. The two basic types of seismic waves are body waves, or primary waves, which travel through the interior of the earth, and surface waves, which travel along the earth's surface and are believed to be responsible for most earthquake damage.

There are two types of body waves: P waves, or primary waves, and S waves, or secondary waves. The faster moving P waves are compressional waves, and the slower S waves are shear waves. Compressional waves involve a "push-pull" vibration of earth material in the same direction as the P waves are moving. In contrast, shear waves "shake" material at right angles to their path. Differences in P- and S-wave characteristics have provided much information about the structure and composition of the earth's interior.

Hurricane

Hurricanes do most of their worst damage to houses and other smaller buildings. Hurricanes, like earthquakes, attack structures mainly from the sides. But there are significant differences between the stresses exerted by short-lived ground motions and those created by the relentless pressure of hurricane-force winds. The wind shoves a building again and again, sometimes pushing its frame out of alignment or even lifting it off its foundation. It jabs at openings along the surface, such as windows and doors, nibbling at weak points until it finds a way to get in.

And it picks up debris and hurls it with great force at walls and windows. Hurricane winds can cause house damage in several ways. As winds exert pressure on one side of a house, *left,* the other side experiences less pressure, and the house can be pushed off its foundation. Winds speeding over the top of

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a house, *center,* form a low-pressure area that can pull the roof away from its moorings. If the winds break into a house through a door or window, *right,* pressure inside the house exerts an outward force on the walls and roof that can make the house collapse.

When a high wind blows directly against the side of a typical wood-frame house, it exerts intense pressure on that side, the windward side, and creates a low-pressure area on the opposite side, the leeward side. Thus, walls and windows on the windward side of the house are in danger of being pushed in, while on the leeward side they may be sucked right off the house. And the moment the wind breaks in through a window or door, the sudden pressure buildup inside the house can cause doors and other weak places on the leeward side to pop right out. The wind then combines with rain to destroy the interior of the house and all its contents.

Tornado

Tornadoes hit Texas more than any other state, but every state in the union is at least in some small amount in danger of tornadoes. April, May, and June are the primary months for tornado activity, but they can occur at any time of year. Tornadoes can occur at any moment as well. They have been known to cause additional damage before, during, and after hurricanes. Tornadoes strike very quickly with little to no warning and cause great amounts of damage. These black natural disasters of pure destructive wind force can have wind speeds in the range of 200 miles per hour. At these speeds, they can easily suck up people, houses, trees, and autos with very little trouble.

The April 6-8, 2006 Tornado Outbreak was a major tornado outbreak in the Central and parts of the Southern United States that began on April 6, 2006 in the Great Plains and continued until April 8 in South Carolina, with most of the activity on April 7. The hardest-hit area was Middle Tennessee where several strong tornadoes devastated entire neighborhoods and left nine people dead. The worst damage took place in Gallatin, Tennessee. Other communities north of Nashville were also hard hit.

There were 74 tornadoes confirmed across 13 states, with the bulk of them coming on the afternoon and evening of April 7 across the South, particularly in

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Tennessee. In total, 13 deaths were reported as a result of the severe weather (12 of them in Tennessee) and over $650 million in damage was reported, of which over $630 million was in Middle Tennessee. It was the third major outbreak of 2006, hot on the heels of a major outbreak on April 2. . It was also considered to be the worst disaster event in Middle Tennessee since the Nashville Tornadoes of 1998 on April 16, 1998.

If one lives in a part of the country that is especially vulnerable to tornadoes, it is imperative every member of one's family knows in advance where to go and what to do when there is a tornado warning. Always take every warning seriously. Tornado warnings are not something to take lightly, yet unfortunately, many people do, all over the country. People who live in areas that are infrequently hit are especially prone to underestimating the damage and destruction tornadoes can cause. If one is in their house, the safest place is in the basement. If one does not have a basement, then usually the bathroom or closet is the next safest place to take refuge.

Wildfire

Although most significant wildfires occur in the West, the wildfire hazard is a national issue. Serious wildfires have occurred all across the country — from Washington to Maine to Florida. An average of 140,000 wildfires per year took place in the United States from 1916 to 1996. Wildfires burned an average of 14.5 million acres each year during that period. It is clear from recent episodes that losses will increase in the future." Although the historical record shows no clear trend in the number of wildfires, the number of acres burned each year fell from a peak of 52.3 million in 1930 to 3.6 million in 1958.

Since then, the number of acres burned each year by wildfires has remained fairly steady, ranging from a high of 7.4 million in 1988 to a low of 1.6 million in 1993. The long-term decline in the number of acres burned reflects fire suppression policies aimed at extinguishing wildfires as quickly as possible. One unintended consequence of such policies has been accumulation of brush and other vegetation — fuel to feed future wildfires. Without periodic natural fires or active measures to reduce fuel, the risk and potential intensity of future fires increase.

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Together, the accumulation of fuel and development in hazardous areas pose particular challenges for insureds and insurers, as well as government agencies responsible for fire prevention, mitigation, and suppression. In broad perspective, the challenges and their respective solutions fit into two categories. The first category consists of socio-environmental challenges associated with the unprecedented accumulation of fuel and population growth in areas prone to wildfire. The solutions to those challenges involve mitigating potential losses though increased understanding of fire behavior, public education, fire-safe building codes, landscaping ordinances, and the like.

Guide to Reinsurance

Reinsurance is a transaction whereby one insurance company - the reinsurer - agrees to indemnify another insurance company - the ceding or primary - against all or part of the loss that the latter sustains under a policy or policies that it has issued. It is the form of insurance where by the policy writing insurance company spreads its risk of loss by sharing part of its premiums with the reinsurer. It is the insurance company's insurer.

Reinsurance has been defined as a contract whereby one insurer for a consideration, agrees to indemnify another insurer, either in whole or in part, against loss or liability, the risk of which the latter has assumed under a separate and distinct contract as insurer of a third party. For this service, the ceding company pays the reinsurer a premium. The purpose of reinsurance is the same as that of insurance: to spread risk.

By spreading risk within the insurance industry, reinsurance is a mechanism that enables the insurance industry to function more efficiently. Reinsurance is a creative process and each client's requirements are unique. The reinsurer will identify a client's financial and reinsurance needs and opportunities, and then bring together a team of specialists to create customized products and services for that client. There are several reasons that a company buys reinsurance.

Reinsurance can be thought of as "insurance of an insurance company." As the result of an automobile accident, a court orders a driver to pay $2 million dollars to a pedestrian. An airplane is totally destroyed in a crash, and hundreds of people die. The total loss of lives and property is valued at $50

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million. To a large extent, the above losses are covered by insurance policies. Large loss payments can negatively affect an insurance company's financial results. To mitigate the potentially adverse financial effect of a single large loss or many smaller losses, an insurance company might pay a premium to another insurance company and, in exchange, is indemnified for some or all of its loss payments.

When a loss occurs, the second insurance company pays its share to the first insurance company, which remains responsible to the insured for the entire amount of the loss. This transaction between the two insurance companies is called reinsurance. By sharing losses with another insurer, an insurance company can increase its capacity to underwrite risks and better control its underwriting results. An insurance company that issues insurance policies is called a primary insurer, and an insurance company that indemnifies another insurer for losses is called a reinsurer. A reinsurer may even indemnify another reinsurer for losses.

A ceding company is an insurance company that purchases reinsurance and cedes, or transfers, premium and losses to a reinsurer. Reinsurance allows the reinsured to write larger amounts of insurance. It protects against a single, catastrophic loss of multiple large losses. Reinsurance is a stabilizer, helping to smooth the overall operating results from year to year and easing the strain on the reinsured's surplus during rapid premium growth. It provides a means for the reinsured to withdraw from a line of business or geographic area or production source.

The Reinsurer and The Reinsured

A reinsurance contract or policy (usually referred to as a treaty) is one of indemnity, in most cases, that reimburses the reinsured (ceding company) for claims, suits, or losses paid. Sometimes as a result of long-time association, a reinsurer will advance part of a loss before actual payment has been made to the ceding company. For the most part, they are contracts of indemnity and not promises to pay. Since the rapid development and use of bad faith and punitive damages as causes of action, primary and excess insurers have washed an increasing amount of dirty laundry in the courtrooms, and this has affected the relationship between ceding companies and their reinsurers.

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Old concepts of trust, when reinsurers practically never interfered with an insurer's handling of a claim or suit, and where, in fact, most reinsurers had no experienced claim personnel on their staff are gone. Today reinsurers have had to develop claim departments with highly trained, experienced, and sophisticated claim supervisors.

After a treaty is signed, there is often little cooperation between ceding companies and reinsurers, and the majority use the same tactics of alleging bad faith that has caused them so much consternation when used against them by the underlying plaintiff's lawyers. If trust and confidence have been established, unintentional failures to report claims and other honest mistakes on both sides are not magnified into major confrontations.

However, if the reinsured or ceding company starts to play games with its reinsurer, the result can be disastrous for both. The ceding company will then, at least, be subject to higher premiums, if it can get reinsurance at all.

Each party to the treaty has its responsibilities and its duties. In the past, the reinsurer usually didn't want to be burdened with the details of the investigation and settlement negotiations of an individual claim, and was satisfied with periodic summary notices concerning the suggested reserve to be carried by the reinsurer. As long as almost everyone in the reinsurance industry was reaping a profit, the prophets of doom were left unheard.

Today, the reinsurer no longer assumes that the ceding company will investigate adequately and defend properly, or use the best judgment in a decision of whether or not to settle a claim or suit. The reinsurer wants not only to be kept advised promptly concerning all developments, but also to be involved in some of the decisions, particularly as to whether the claim is to be settled or tried.

Reinsurance Plans and Types

Reinsurance plans are varied and many. New ones are continually being introduced and/or modified. Terminology is not always uniform, nor is there any standardization to such plans and types. Excess of loss, pro rata, or

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proportional types of reinsurance represent the most common forms, whereby the reinsurer pays a predetermined share of the settled claim or suit plus allocated expenses, in return for a predetermined share of the premiums that were paid to the reinsured or ceding company. *Allocated expenses* are those actual out-of-pocket expenditures that include:

- attorney's fees;
- fees of experts needed for trial or for a determination of severity of injury or amount of loss;
- payments for records and other such expenditures.

They do not include the regular expense of running a claim department like rental costs, wages, office equipment, and similar running costs. Such insurance may be written on an annual or continuing term for a line of business or for all of the ceding company's business. Premium is set on an overall experience basis depending on lines of insurance, previous loss experience, and other similar facts.

Stabilizing Profits

Stabilized profit and loss ratios are an important advantage in the use of reinsurance. Good business must often be shared with others, but in return, some bad business is also shared. It is usually considered more desirable to have a somewhat lower but stable level of profits and underwriting losses than it is to have a higher but unstable level. Reinsurance arrangements do not necessarily reduce average profit levels, but they do smooth out the fluctuations that normally occur.

Reinsurance does not always mean the loss of premium volume, because one of the results of reinsurance is the procurement of new business. As a member of a group of ceding companies organized to share mutual risks, one ceding company must usually accept the business of other insurers. Some companies obtain a large portion of their total premium volume in this manner, and others engage exclusively in the reinsurance business.

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Underwriting

If a firm wished to liquidate its business, it could conceivably cancel all its policies that are subject to cancellation and return the unearned premiums to the policyholders. This would be quite unusual in actual practice, because of the necessity of sacrificing the profit that would normally be earned on such business. It would most likely be impossible to recover in full the amount of expense that had been incurred in putting the business on the books.

Through reinsurance the liabilities for existing insurance can be transferred, and the policyholders' coverages remain undisturbed. If an insurer desires to retire its insurance business and to cease underwriting, it may do so through reinsurance. A life insurance policy is non-cancelable, and the policyholder has the right to continued protection. Without reinsurance, the insurer would find it difficult, if not impossible to achieve its objective of relieving itself from the obligation of seeing that the insured's coverage is continued.

Reinsurance for Catastrophic Events

As an alternative to mitigation, insurers can protect themselves against large losses through reinsurance, and thus reduce their probability of insolvency. The price of reinsurance can be quite expensive, particularly following a large-scale disaster, as was evidenced after Hurricane Andrew and the Northridge earthquake. It would be interesting to determine how much reinsurance would have to be purchased to provide sufficient protection to the insurer as a function of the amount of mitigation in place.

Such an analysis should provide an additional rationale for insurers to want to encourage homeowners to adopt mitigation, since they would then be able to reduce their expenditures on reinsurance.

Reinsurance Angle

Catastrophe bonds issued so far have been modeled on mainstream securitized products, but with a reinsurance angle. Instead of purchasing coverage from reinsurers, insurers set up a special-purpose reinsurance company. They then buy reinsurance from the special-purpose company, which in turn sells the notes to large investors. Return of the principal, interest, or both on the notes is

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tied to the promise of repayment by the insurer--usually if the catastrophe costs do not exceed a predetermined threshold.

The best-known of the catastrophe securitizations was led by USAA, the San Antonio-based insurer that primarily markets to active and retired military members. After testing the waters once without success, USAA has so far launched two successful securitization offerings. Both bonds were designed to underwrite high-claims costs should a catastrophe strike. USAA and its financiers said a major reason for going that route was to establish a track record for future securitized financings.

Despite lots of capacity and low rates, there are still some scenarios in which reinsurance coverage remains scarce or expensive. Sometimes you can get financing in the asset-backed market that an individual cannot get someplace else. If all their customers want to retire to South Florida, then USAA has to write that coverage. They cannot manage where their members want to live. Even companies that can easily obtain reinsurance are pursuing securitizations. It would appear there is little need at the moment for an alternative form of risk transfer.

In a recent report on securitization, Insurance Services Office Inc., New York, estimated that, from 1995 through September 1998, insurers issued $2.7 billion in catastrophe bonds, catastrophe options, and other tools for securitizing risk. Some experts say catastrophe-based bond offerings could top out at $40 billion to $60 billion.

The real value of securitization is that, used correctly, it allows insurers to move capital off their books and frees them to concentrate on underwriting and servicing risk. If looking at the insurance business, there's too much capital, shrinking margins, and cutthroat pricing. The commercial banking business figured out that it had to rationalize; they went from around 15,000 banks to around 8,000 or 9,000 today. It is a good idea to rationalize capital.

The Mechanics of Reinsurance

A reinsurance contract written on a **proportional** basis simply prorates all premium, losses, and expenses between the insurer and the reinsurer on a pre-

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arranged basis. The proportional approach is used extensively in property reinsurance. Excess of loss contracts require the primary insurer to keep all losses up to a predetermined retention and the reinsurer to reimburse the company for any losses above that retention, up to the limits of the reinsurance contract. In simplest terms, a retention is analogous to the deductible a policyholder may have on a personal insurance policy, such as an automobile or homeowner's policy. Insurers purchase reinsurance for essentially four reasons:

- to limit liability on specific risks;
- to stabilize loss experience;
- to protect against catastrophes;
- to increase capacity.

Depending on the ceding company's goals, different types of reinsurance contracts are available to bring about the desired result.

Limiting Liability

By providing a mechanism in which companies limit loss exposure to levels commensurate with net assets, reinsurance allows insurance companies to offer coverage limits considerably higher than they could otherwise provide. This function of reinsurance is crucial because it allows all companies, large and small, to offer coverage limits to meet their policyholders' needs. In this manner, reinsurance provides an avenue for small-to-medium size companies to compete with industry giants.

In calculating an appropriate level of reinsurance, a company takes into account the amount of its available surplus and determines its retention based on the amount of loss it can absorb financially. Surplus, sometimes referred to as policyholders' surplus, is the amount by which the assets of an insurer exceed its liabilities.

A company's retention may range from a few thousand dollars to one million dollars or more. The loss exposure above the retention, up to the policy limits of the reinsurance contract, is indemnified by the reinsurer. Reinsurance helps to

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stabilize loss experience on individual risks, as well as on accumulated losses under many policies occurring during a specified period.

Cause and Probability Factors

The mathematical principle of probability is called the law of large numbers. In insurance, a prediction must be made from actuarial experience or statistical analysis of the number of losses to be expected within a group of exposures. The law of large numbers tells us that actual losses will more accurate as the number of units of exposure increases.

Hazards are situations or factors that increase the possibility of a loss occurring, or increase the probable size of a loss should a loss occur. Hazards may be classified as physical, moral, or morale. Peril is the actual cause of the loss and is identified or referred to in the policy. Perils include such events as fire, wind, hail, and collision with another car. A named peril policy will provide coverage, only if the loss is caused by one of the perils specifically named or identified in the policy such as, fire, wind, or hail.

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Chapter 9
Guide to Flood Insurance

Guide to the Dynamics of a Floods

A flood is an overflow of an expanse of water that submerges land, a deluge. In the sense of "flowing water", the word is applied to the inflow of the tide, as opposed to the outflow or "ebb". It is usually due to the volume of water within a body of water, such as a river or lake, exceeding the total capacity of the body, and as a result some of the water flows or sits outside of the normal perimeter of the body. It can also occur in rivers, when the strength of the river is so high it flows right out of the river channel, usually at corners or meanders. These of course, are not applicable in such instances as sea flooding.

Natural processes, such as hurricanes, weather systems, and snowmelt, can cause floods. Failure of levees and dams and inadequate drainage in urban areas can also result in flooding. On average, floods kill about 140 people each year and cause $6 billion in property damage. Although loss of life to floods during the past half-century has declined, mostly because of improved warning systems, economic losses have continued to rise due to increased urbanization and coastal development.

Guide to Flood Zones

Many people assume they're not in a flood zone — somebody may even have told them that when they purchased their home. However, if one's property is in a community that participates in the National Flood Insurance Program, one lives in a flood zone. The whole community has been mapped and given zone designations based on vulnerability to flooding. The major zone categories are V and A, which have the highest risk of flooding, followed by B, C, and X, which are minimal-risk zones.

The B and C zones, which have the same insurance rates, are being relabeled X zones on new flood maps. There are a few ways to find out what zone an individual is in. Building permits are issued at the town or city hall. They should also have access to flood zone maps. When an individual is buying a

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home, the bank appraiser should be able to inform the buyer of the flood zone for that area.

Low to Moderate Risk Area

Zones B, C, and X

Zones B, C, and X are the flood insurance rate zones that correspond to areas outside the 1% annual chance floodplain, areas of 1% annual chance sheet flow flooding where average depths are less than 1 foot, areas of 1% annual chance stream flooding where the contributing drainage area is less than 1 square mile, or areas protected from the 1% annual chance flood by levees. No Base Flood Elevations or depths are shown within this zone. Insurance purchase is not required in these zones.

High Risk Areas

In communities that participate in the NFIP, all homeowners in Zone A (high-risk) areas are required to get flood insurance in order to get a loan from a federally regulated lender. These areas have a 26% chance of flooding over the life of a 30-year mortgage.

Zone A

Zone A is the flood insurance rate zone that corresponds to the 1% annual chance floodplains that are determined in the Flood Insurance Study by approximate methods of analysis. Because detailed hydraulic analyses are not performed for such areas, no Base Flood Elevations or depths are shown within this zone. Mandatory flood insurance purchase requirements apply.

Zone AE and A1-A30

Zones AE and A1-A30 are the flood insurance rate zones that correspond to the 1-percent annual chance floodplains that are determined in the Flood Insurance Study by detailed methods of analysis. In most instances, Base Flood Elevations derived from the detailed hydraulic analyses are shown at selected intervals within this zone. Mandatory flood insurance purchase requirements apply.

Zone AH

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Zone AH is the flood insurance rate zone that corresponds to the areas of 1% annual chance shallow flooding with a constant water-surface elevation (usually areas of ponding) where average depths are between 1 and 3 feet. The Base Flood Elevations derived from the detailed hydraulic analyses are shown at selected intervals within this zone. Mandatory flood insurance purchase requirements apply.

Zone AO

Zone AO is the flood insurance rate zone that corresponds to the areas of 1-percent shallow flooding (usually sheet flow on sloping terrain) where average depths are between 1 and 3 feet. Average flood depths derived from the detailed hydraulic analyses are shown within this zone. In addition, alluvial fan flood hazards are shown as Zone AO on the Flood Insurance Rate Map. Mandatory flood insurance purchase requirements apply.

Zone AR

Zone AR is the flood insurance rate zone used to depict areas protected from flood hazards by flood control structures, such as a levee, that are being restored. FEMA will consider using the Zone AR designation for a community if the flood protection system has been deemed restorable by a Federal agency in consultation with a local project sponsor; a minimum level of flood protection is still provided to the community by the system; and restoration of the flood protection system is scheduled to begin within a designated time period and in accordance with a progress plan negotiated between the community and FEMA.

Mandatory purchase requirements for flood insurance will apply in Zone AR, but the rate will not exceed the rate for an unnumbered Zone A if the structure is built in compliance with Zone AR floodplain management regulations.

For floodplain management in Zone AR areas, the property owner is not required to elevate an existing structure when making improvements to the structure. However, for new construction, the structure must be elevated (or floodproofed for non-residential structures) so that the lowest floor, including basement, is a minimum of 3 feet above the highest adjacent existing grade, if the depth of the Base Flood Elevation (BFE) does not exceed 5 feet at the

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proposed development site. For infill sites, rehabilitation of existing structures, or redevelopment of previously developed areas, there is a 3-foot elevation requirement regardless of the depth of the BFE at the project site.

The Zone AR designation will be removed and the restored flood control system will be shown as providing protection from the 1-percent annual chance flood on the National Flood Insurance Program map upon completion of the restoration project and submittal of all the necessary data to FEMA.

Zone A99

Zone A99 is the flood insurance rate zone that corresponds to areas within the 1-percent annual chance floodplain that will be protected by a Federal flood protection system where construction has reached specified statutory milestones. No Base Flood Elevations or depths are shown within this zone. Mandatory flood insurance purchase requirements apply.

High Risk - Coastal Areas

In communities that participate in the NFIP, mandatory flood insurance purchase requirements apply to all of these zones:

V -- Coastal areas with a 1% or greater chance of flooding and an additional hazard associated with storm waves. These areas have a 26% chance of flooding over the life of a 30-year mortgage. No base flood elevations are shown within these zones.

VE, V1 – 30 -- Coastal areas with a 1% or greater chance of flooding and an additional hazard associated with storm waves. These areas have a 26% chance of flooding over the life of a 30-year mortgage. Base flood elevations derived from detailed analyses are shown at selected intervals within these zones.

Undetermined Risk Zone

These are areas with possible but undetermined flood hazards. No flood hazard analysis has been conducted. Flood insurance rates are commensurate with the uncertainty of the flood risk.

Zone D

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The Zone D designation is used for areas where there are possible but undetermined flood hazards. In areas designated as Zone D, no analysis of flood hazards has been conducted. Mandatory flood insurance purchase requirements do not apply, but coverage is available. The flood insurance rates for properties in Zone D are commensurate with the uncertainty of the flood risk.

Zone V
Zone V is the flood insurance rate zone that corresponds to areas within the 1% annual chance coastal floodplains that have additional hazards associated with storm waves. Because approximate hydraulic analyses are performed for such areas, no Base Flood Elevations are shown within this zone. Mandatory flood insurance purchase requirements apply.

Zone VE
Zone VE is the flood insurance rate zone that corresponds to areas within the 1-percent annual chance coastal floodplain that have additional hazards associated with storm waves. Base Flood Elevations derived from the detailed hydraulic analyses are shown at selected intervals within this zone. Mandatory flood insurance purchase requirements apply.

One Hundred Year Flood

Rivers across the Nation seem to be rising to record flood levels almost every year. In Washington, more than one 100-year flood has happened on a few rivers in just the past several years. How can 100-year floods happen so often?

The term "100-year flood" is misleading because it leads people to believe that it happens only once every 100 years. The truth is that an uncommonly big flood can happen any year. The term "100-year flood" is really a statistical designation, and there is a 1-in-100 chance that a flood this size will happen during any year. Perhaps a better term would be the "1-in-100 chance flood."

The actual number of years between floods of any given size varies a lot. Big floods happen irregularly because the climate naturally varies over many years. We sometimes get big floods in successive or nearly successive years with several very wet years in a row.

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Fifteen years ago, after the Midwest was swamped with what was pronounced a "100-year" or even a "500-year" flood, some folks figured they would never again see such a disaster in their lifetime. Some even dropped their flood insurance. That was a big mistake. Now, with the region struck by a supposedly once-in-a-lifetime flood for the second time since 1993, some scientists and disaster officials say the use of terms like "100-year flood" should be re-evaluated because they are often misunderstood and can give the public a false sense of security.

The United States Geological Survey, almost needs to quit using the term 100-year flood It could happen twice a year, if you're unlucky. Or 200 years could go by without a 100-year flood.

The Mandatory Flood Insurance Purchase Requirement

The mandatory purchase requirement applies to all forms of federally related financial assistance for buildings located in a Special Flood Hazard Area (SFHA). This requirement affects loans and grants for the purchase, construction, repair, or improvement of any publicly or privately owned building in the SFHA, including machinery, equipment, fixtures, and furnishings contained in such buildings. Financial assistance programs affected include loans and grants from agencies such as the Department of Veterans Affairs, Farmers Home Administration, Federal Housing Administration, Small Business Administration, and Federal Emergency Management Agency.

The requirement also applies to secured mortgage loans from financial institutions, such as commercial lenders, savings and loan associations, savings banks, and credit unions that are regulated, supervised or insured by Federal agencies such as the Federal Deposit Insurance Corporation and the Office of Thrift Supervision. It also applies to all mortgage loans purchased by Fannie Mae or Freddie Mac in the secondary mortgage market. The mandatory purchase requirement does not affect loans or financial assistance for items that are not covered by a flood insurance policy, such as vehicles, business expenses, landscaping, and vacant lots.

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National Flood Insurance Program

The National Flood Insurance Program (NFIP) is a relatively recent federal program. The federal government has been actively involved in flood control since 1927, following major floods on the Mississippi River. Beginning with the Flood Control Act of 1936, Congress assigned the Corps of Engineers responsibility for flood control engineering works and later for floodplain information services. In the early 1930's, Congress created the Tennessee Valley Authority as a regional resources development agency. Flood control was provided through the construction of dams and reservoirs. In the late 1930's, Congress expanded Bureau of Reclamation authority to include building reservoirs for flood control purposes.

In the 1940's, Congress authorized the Department of Agriculture to construct 11 specifically authorized projects for flood control, and in the 1950'the department was authorized to carry out a nationwide program for upstream watershed projects. Despite these programs and rapidly rising federal expenditures for flood control, flood losses continued to rise. Federal programs continued to rely predominantly on engineering works for modifying floods. Thus it was, that in its review of Federal programs, the Task Force on Federal Flood Control Policy in 1966 urged a policy that emphasized modification of susceptibility to flooding and the impacts of flooding.

In 1968, Congress passed the National Flood Insurance Act, which created the NFIP. Congress recognized that the success of this program required that community participation be widespread, that studies be conducted to accurately assess the flood risk within each participating flood-prone community, and that insurance premium rates be established based on the risks involved and accepted actuarial principles. To meet these objectives, the 1968 Act called for: 1) the identification and publication of information for all floodplain areas that have special flood hazards; and 2) the establishment of flood-risk zones in all such areas to be completed over a 15-year period following the passage of the act.

The State Division of Emergency Management (DEM) administers the National Flood Insurance Program under cooperative agreement with the Federal

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Emergency Management Agency. Training, technical assistance, and orientation are provided under the terms of the agreement to insure program knowledge and understanding by community officials, local administrators, and residents of the community. Enrollment in the National Flood Insurance Program is initiated by a voluntary agreement between the local jurisdiction and the federal government. It is agreed that if a community implements and enforces measures to reduce the risk from flooding in special flood hazard areas, the federal government will make flood insurance available within the community to mitigate future flood losses.

It happens every year. Flood waters rise. Homes are engulfed. And satellites beam photographs of these catastrophes around the world. Observers console themselves with the thought that it couldn't happen to them. But flooding can occur just about anywhere; other than fire, it is the most common and widespread natural disaster. Hurricanes, winter runoff, and heavy rains all cause flooding. And not just for people who live near rivers and other large waterways.

The National Flood Insurance Program, is a pre-disaster flood mitigation and insurance protection program designed to reduce the exalting cost of disasters. The National Flood Insurance Program, which is a voluntary program, provides a quid pro quo approach to floodplain management, which makes federally backed flood insurance available to residents and business owners in communities that agree to adopt and adhere to sound flood mitigation measures that guide development in its floodplains.

The State of Florida has over 17 million residents and 80% of them live or conduct business along or near its coastline. A significant portion of the remaining residents and business live or conduct commerce near many of the state's historical rivers and other inland floodplains. These residents and business are concerned about protecting their lives and property from future flooding. This is evidenced by the fact that 95% of all Florida communities participate in the National Flood Insurance Program. As of June 2005, there are over 1,908,898 flood insurance policies in Florida which represents roughly 41% of total policies in effect nationwide. These policies represent $313,991,842,000 of insurance coverage, which is the first line of recovery after a flood disaster.

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In Florida, the Governor has designated the Department of Community Affairs as the state coordinating agency for the National Flood Insurance Program. The State Assistance Office for the National Flood Insurance and Flood Mitigation Assistance Programs in partnership with the Federal Emergency Management Agency Region IV staff, conducts coordination activities, and provides technical assistance on pre and post-disaster flood mitigation related activities to National Flood Insurance Program participating communities.

This coordination primarily relates to construction and development activities and serves a vital intergovernmental link between and among local communities, state and regional agencies, as well as federal agencies, especially the Federal Emergency Management Agency. Additionally, the provision of timely and accurate technical assistance to residents and building trade specialists (architects, builders, contractors and developers, engineers, realtors, surveyors, and others) is vital to the implementation of compliant flood loss reduction techniques and strategies required by various agencies.

This technical assistance consists of on-site reviews, workshops and seminars, providing answers to questions, as well as sharing appropriate federal and state publications as requested. This office also severs as the state's repository for Flood Insurance Rate Maps. As such, this office maintains a file of all receded or supersede Flood Insurance Rate Maps which are used to assist insurance agents in properly rating structures based upon dates of construction.

The implementation of pre-disaster mitigation incentives, such as the Community Rating System Program and the Flood Mitigation Assistance Program, serve Florida's residents and businesses that continue to experience high growth and development. Florida local communities constitute the largest number of participants in the Community Rating System, which provides a comprehensive approach to flood mitigation. In fact, this high level of Community Rating System participation supports the implementation of the Flood Mitigation Assistance Program, which is targeted toward the reduction of repetitive flood loss structures, and requires a Flood Mitigation Plan often prepared by Community Rating System participating communities.

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The National Flood Insurance Program (NFIP) defines flooding as "a general and temporary condition during which the surface of normally dry land is partially or completely inundated. Two adjacent properties or two or more acres must be affected." OK, so it's only slightly clearer than mud. According to NFIP's definition, flooding can be caused by any one of the following:

- the overflow of inland or tidal waters;
- the unusual and rapid accumulation or runoff of surface waters from any source such as heavy rainfall;
- the incidence of mudslides or mudflows caused by flooding which are comparable to a river of liquid and flowing mud;
- or the collapse or destabilization of land along the shore of a lake or other body of water resulting from erosion or the effect of waves or water currents exceeding normal, cyclical levels.

Many individuals have learned a lesson the hard way similar to many in the spring of 1997 in the upper Midwest, when experts predicted flood waters would be the highest in the 150 years that records have been kept. The devastation was caused by runoff from the snows that hit the upper Midwest and Rocky Mountains. Residents of North Dakota, South Dakota, and Minnesota all suffered serious losses.

Forms

Dwelling Forms

The Dwelling Policy Form is issued to homeowners, residential renters, or owners of residential buildings containing two to four units. In communities participating in the NFIP Regular Program or Emergency Program the dwelling policy provides building and/or contents coverage for:

- Detached, single-family, non-condominium residence with incidental occupancy limited to less than 50% of the total floor area;
- Two- to four- family, non-condominium building with incidental occupancy limited to less than 25% of the total floor area;
- Dwelling unit in residential condominium building;
- Residential townhouse/rowhouse;

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- Manufactured mobile homes.

General Property Form

The General Property Policy Form is issued to owners of residential buildings with five or more units, owners or lessees of non-residential buildings or units, and to owners or lessees of non-residential buildings or units. In communities participating in the NFIP Regular Program or Emergency Program the General Property Policy provides building and/or contents coverage for these and similar "other residential" risks:

- Hotel or motel with normal guest occupancy of 6 months or more;
- Apartment building;
- Residential cooperative building;
- Dormitory;
- Assisted-living facility.

And non-residential risks:

- Shop, restaurant, or other business;
- Mercantile building;
- Grain bin, silo, or other farm building;
- Agricultural or industrial processing facility;
- Factory;
- Warehouse;
- Poolhouse, clubhouse, or other recreational building;
- House of worship;
- School;
- Hotel or motel with normal guest occupancy of less than 6 months;
- Licensed bed-and-breakfast inn;
- Retail;
- Nursing home;
- Non-residential condominium;
- Condominium building with less than 75% of its total floor area in residential use;
- Detached garage;
- Tool shed;

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- Stock, inventory, or other commercial contents.

Residential Condominium Building Association Policy (RCBAP) Form

The Residential Condominium Building Association Policy Form is issued to residential condominium associations on behalf of association and unit owners. In participating NFIP Regular Program communities only, provides building coverage and, if desired, coverage of commonly owned contents for residential condominium building with 75% or more of its total floor area in residential use.

Provisions of Flood Insurance Policies

When flooding does occur, it can lead to financial upheaval or ruin if an individual does not have the proper kind of insurance. In this case, a "basic homeowner" policy will not do. An individual needs flood insurance. Flood insurance is a special policy backed by the federal government, with cooperation from local communities and private insurance companies. More than 18,000 communities have agreed to stricter zoning and building measures to control floods. Residents in these communities are entitled to purchase flood insurance through NFIP. Those who own property in certain coastal barrier areas are excluded from the federal program.

About 200 insurance companies, possibly including the company that already handles homeowner's or auto insurance, write and service the policies for the government, which finances the program through premiums. The average flood policy premium is about $350 a year; some people in low-risk zones can obtain flood insurance for as little as $106 a year.

Americans Unprotected Against Flood Loss

Even though flood insurance is relatively inexpensive, most Americans are unprotected against flood loss. According to the Federal Insurance Administration, of the approximately 10 million households in so-called Special Flood Hazard Areas — the most vulnerable to flood — no more than a quarter are covered by flood insurance. Yet in these special hazard areas, flooding is 26 times more likely to occur than a fire over the course of a typical 30-year mortgage.

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People in less hazardous zones, who are even less likely to have flood insurance, also miscalculate their risks. Almost a quarter of the claims paid out for flood damage come from the low- and moderate-risk zones, where people often think — wrongly — that flooding only happens to people living on river banks. Clearly, many Americans are gambling — and the odds are not in their favor. To landlubbers, there are many misconceptions about the power of floods and the value of having flood insurance.

Flood Insurance To Protect People

Flood insurance is the type of insurance specifically designed to protect people, financially, from losses sustained as a result of flood. Unfortunately, many property owners do not find out until it is too late that their regular insurance policies do not cover flooding. Federal flood insurance protects most valuable assets.

Actual cash value vs. replacement cost

The "Dwelling" (home) and "General Property" (commercial) insurance are both written on an actual cash-value basis, which is the replacement cost minus depreciation. This arrangement helps keep insurance rates down, but is not always an ideal situation when it's time to present a claim. There is a special consideration for single-family homes. If one lives in the home 80% of the time and carry flood insurance for at least 80% of its replacement value at the time of a flood, NFIP will pay replacement cost on the building portion of the policy, up to the limits purchased.

An example could be when the home's market value is $250,000, but the owner only purchased coverage of $200,000. The home is completely destroyed in a flood. The flood insurance will pay the costs of rebuilding the home, but only up to $200,000, the limit that was purchased. Contents are always settled on an actual cash basis. As one insurer advises, just remember, "contents equal cash."

A flood insurance policy will cover *only* against damages caused by flooding. For coverage against other perils such as fire, one will need to purchase a regular property insurance policy. Under the National Flood Insurance Program (NFIP), an owner can purchase up to $250,000 in building insurance

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and $100,000 in contents coverage for one- to four-family homes. Commercial establishments can have up to $500,000 for building and business property.

Excess coverage is available. Coverage is up to $500,000 for dwellers and up to $1 million for businesses — though these policies have the same exclusion clauses as the basic flood program policy. Flood insurance policies have separate policies to cover the building and the building's contents, thus covering them separately. Contents coverage includes personal possessions, furniture, and anything else inside the structure.

One must *ask* for the contents provision for it to be added to the policy. A separate deductible for the building and the contents portion of your policy will have to be paid. The building and contents rules involving basements are restricted and tricky. A furnace, for example, is treated as part of the dwelling, but washers, dryers, and freezers are viewed as contents.

Preferred Risk Policy

The Preferred Risk Policy is a lower-cost option covering buildings and contents in low-to-moderate risk areas. It is available for both residential and commercial properties and covers both your home and its contents for one combined price, with the same coverage limits as standard flood insurance policies.

To qualify for a Preferred Risk Policy, your building must be in a low-to-moderate risk flood zone and have had minimal losses.

- Residential Preferred Risk Policy premiums start as low as $119 per year for building and contents coverage.
- Commercial premiums start at $550 per year for combined building and contents coverage, or $145 per year for contents only.

The policy premium will be based on a number of factors, including the current risk level and the amount of coverage wanted.

Eligibility Requirements

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This inexpensive policy is available for homeowners with a 1- to 4-family residential building located in a low- to moderate-risk area, which is indicated by a B, C, or X zone on the current Flood Insurance Rate Map. The PRP is not available in the Emergency Program or in Special Flood Hazard Areas. Condominium units, except for townhouse/rowhouse type buildings, are not eligible under the PRP. However, should any of the following conditions exist, based on the building's flood loss history regardless of ownership, a Preferred Risk Policy cannot be written:

- 2 loss payments, each more than $1,000;
- 3 or more loss payments, regardless of amount;
- 2 Federal Disaster Relief payments, each more than $1,000;
- 3 Federal Disaster Relief payments, regardless of amount;
- 1 flood insurance claim payment and 1 flood disaster relief payment; (including loans and grants), each more than $1,000.

Understanding Mitigation

Mitigation is the effort to reduce loss of life and property by lessening the impact of disasters. This is achieved through risk analysis, which results in information that provides a foundation for mitigation activities that reduce risk, and flood insurance that protects financial investment.

FEMA's Mitigation Directorate manages the National Flood Insurance Program (NFIP) and implements a variety of programs authorized by Congress to reduce losses that may result from natural disasters. Effective Mitigation efforts can break the cycle of disaster damage, reconstruction, and repeated damage.

Mitigation's Value to Society

Mitigation is valuable to society in these ways:

- It creates safer communities by reducing loss of life and property damage. For example, the rigorous building standards adopted by 20,000 communities across the country are saving the nation more than $1.1 billion a year in prevented flood damages.
- It allows individuals to minimize post-flood disaster disruptions and recover more rapidly. For example, homes built to NFIP standards incur less damage from floods. And when floods do cause damages, flood

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insurance protects the homeowner's investment, as it did for the more than 200,000 Gulf Coast residents who received more than $23 billion in payments following the 2005 hurricanes.

- It lessens the financial impact on individuals, communities, and society as a whole. For example, a recent study by the Multi-hazard Mitigation Council shows that each dollar spent on mitigation saves society an average of four dollars.

FEMA and Flood Damage Mitigation

The FMA program was created as part of the National Flood Insurance Reform Act with the goal of reducing or eliminating claims under the National Flood Insurance Program (NFIP). FEMA provides FMA funds to assist States and communities implement measures that reduce or eliminate the long-term risk of flood damage to buildings, manufactured homes, and other structures insurable under the National Flood Insurance Program. Three types of FMA grants are available to States and communities:

- **Planning Grants** to prepare Flood Mitigation Plans. Only NFIP-participating communities with approved Flood Mitigation Plans can apply for FMA Project grants
- **Project Grants** to implement measures to reduce flood losses, such as elevation, acquisition, or relocation of NFIP-insured structures. States are encouraged to prioritize FMA funds for applications that include repetitive loss properties; these include structures with 2 or more losses each with a claim of at least $1,000 within any ten-year period since 1978.
- **Technical Assistance Grants** for the State to help administer the FMA program and activities. Up to ten percent (10%) of Project grants may be awarded to States for Technical Assistance Grants.

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Chapter 10
Toxic Mold Syndrome and Insurance Coverage

Guide to the Toxic Mold And Insurance Crisis

Mold is bad enough for the market to have really gone into a rather critical situation. Critical, in the sense that many consumers who are in a situation where they need to buy a policy because they are buying or selling a property, but they lack of adequate coverage is holding up the loan transaction. Mortgage lenders are grappling with insurance issues related to toxic mold that could hobble the state's lending industry. Mold has not caused problems for lenders in some states. Some lenders believe mold is not really their problem. They see it as a headache for insurers that lenders can mostly leave alone.

That could change if insurance gets scarce, too expensive or even disappears. Suddenly, the office building that's the collateral for the loan would be exposed to uninsured losses. Toxic mold has already caused the state's major insurers to temporarily cease writing new P&C policies or to alter existing coverage, without which property loans cannot be underwritten. This is an issue with huge potential ramifications in many states. The long-term consequences might be increased interest rates, because the lender would be unable to resell the loan, so there would be increased administration, time, and costs. That would be the biggest potential disruption, and it would be huge.

In Texas, huge mold lawsuit settlements caused several lenders to temporarily suspend writing new policies for homes or commercial buildings. The suspension delayed buyers from closing on loans, because it took them longer to get insurance. Texas has seen more claims for mold because homeowner's policies in the Lone Star state, unlike policies in the rest of the nation, require insurers to pay for water damage caused by maintenance problems.

Even so, some in the industry are keeping watch. For all we know, toxic mold may turn out to be the worst threat to public health since yellow fever. But right now an individual does not see toxic mold everywhere; but in full view is the publicity about toxic mold. That is the inevitable consequence of big damage

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awards such as $32 million to a family with a moldy mansion in Texas, big names such as Erin Brockovich's house in southern California is moldy too.

Concern about toxic mold and other building-related health problems did not materialize overnight, and it is not necessarily mass hysteria. Molds are undesirable when they grow where we don't want them, such as in commercial buildings. Over 270 species of mold have been identified as living in some homes. Molds that grow inside may be different from the ones found outdoors.

Characteristics of House Mold

Mold can be harmful or helpful—depending on where it grows. Mold needs moisture to grow. Molds are microscopic fungi, a group of organisms which also includes mushrooms and yeasts. Fungi are highly adapted to grow and reproduce rapidly, producing spores and mycelia in the process. Foods spoil because of mold. Leaves decay and pieces of wood lying on the ground rot due to mold.

That fuzzy black growth on wet window sills is mold. Paper or fabrics stored in a damp place get a musty smell due to the action of molds. Molds can be useful to people. The drug Penicillin is obtained from a specific type of mold. Some foods and beverages are made by the actions of molds. Molds will grow if we provide them with moisture and nutrients. If we keep things dry, molds do not grow.

High moisture levels can be the result of water coming in from the outside, through the floor, walls or roof; or from plumbing leaks; or moisture produced by the people living in the home, through daily activities like bathing, washing clothes, or cooking. Water enters the building when there is a weakness or failure in the structure. Moisture accumulates within the home when there is not enough ventilation to expel that moisture.

Since molds grow by "eating" the organic material, they gradually destroy whatever they are feeding on. Mold growth on surfaces can often be seen as a colored spot, frequently green, gray, brown, black, or white. It commonly appears as a powdery, fuzzy, or hair-like material. Actively growing molds typically produce odors, sometimes described as earthy or moldy, or like

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mildew, old dirty socks, or ammonia. Molds release thousands of microscopic spores, which are lightweight, easily airborne and carried by air currents to surrounding areas. The spores must have both food and moisture to actually start growing, similar to plant seeds.

Damage to materials is one concern. Materials get stained or discolored, and over time they are ruined. Moldy paper and cardboard disintegrate over time. Fabrics are damaged. Continued mold growth can be indicative of moisture conditions favorable for growth of fungi that cause wood rot and structural damage. When molds are growing inside the home, there may be health concerns.

Molds release chemicals and spores. Health experts indicate that, depending on the type of mold present in a home, the amount and degree of exposure, and the health condition of the occupant, the health effects of mold can range from being insignificant to causing allergic reactions and illness. Pregnant women, infants, the elderly and those with health problems, such as respiratory disease or a weakened immune system, are more at risk when exposed to mold.

Physical Signs of a Mold Problem

It is common to find mold spores in the air inside office buildings, and on most surfaces including file cabinets, walls, and furniture. Most of the time, mold spores found indoors come from outdoor sources. Routine cleaning helps to keep these levels low. Cleaning small areas of visible mold, such as mold that may occur around a shower or bathroom area, is necessary to prevent unsanitary conditions.

The level of concern greatly increases when there are large amounts of active mold growth. Large-scale mold problems are most likely to occur when there has been an on-going water leak, a flood, or very high levels of humidity in the home. Indoor mold growth may cause very high levels of airborne mold spores, which, in turn, may cause the spread of mold growth from the original source to other areas where high moisture levels exist.

Extensive mold growth can damage a building and its interior decor, such as carpets, sofas, cabinets, and chairs. In time, unchecked mold growth can cause

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damage to the structural elements. While there is no practical way to eliminate all mold in the indoor environment, keeping a building clean and dry can prevent extensive growth and its related damage.

Discoloration

Discoloration is a sign of mold. However, all discoloration is not due to mold. Carpeting near baseboards, for example, can be stained by outdoor pollution. Stains or soot may also be caused by the smoke from burning candles or cigarettes. Mold may be any color: black, white, red, orange, yellow, blue, or violet. Dab a drop of household bleach onto a suspected spot. If the stain loses its color or disappears, it may be mold. If there is no change, it probably is not mold.

Smell/Odor

Sometimes molds are hidden and cannot be seen. A musty or earthy smell often indicates the presence of molds. But a smell may not be present for all molds. Even when a smell is not noticed, wet spots, dampness, or evidence of a water leak are indications of moisture problems and mold may follow.

Mold Inspection and Testing

Indoor air quality evaluations are performed on-site with data-logging air quality monitors, surrogate gas monitors, toxic gas monitors, quantitative bio-aerosol apparatus, and traditional chemical pollutant collection techniques. Building operation, an essential diagnostic for potential indoor air quality issues, is thoroughly evaluated. Current methods for sampling, identification, testing, etc. are also complicating the issues. The problematic airborne bio-aerosols can be very difficult to quantify and qualify with "snap-shot" test methods that provide meaningful and reproducible results.

An individual may suspect hidden mold if a building smells moldy, even when the source cannot be seen or if the property owner knows that there has been water damage and residents are reporting health problems. Mold may be hidden in places such as the backside of dry wall, wallpaper, or paneling, the topside of ceiling tiles, the underside of carpets and pads, etc.

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Other possible locations of hidden mold include areas inside walls around pipes (with leaking or condensing pipes), the surface of walls behind furniture (where condensation forms), inside ductwork, and in roof materials above ceiling tiles (due to roof leaks or insufficient insulation). Investigating hidden mold problems may be difficult and will require caution when the investigation involves disturbing potential sites of mold growth.

For example, removal of wallpaper can lead to a massive release of spores if there is mold growing on the underside of the paper. If an individual believes that there is a hidden mold problem, he or she may consider hiring an experienced professional to do a thorough inspection and give remediation suggestions.

Standards and Guidelines for Testing

Regardless of which sampling technique is utilized, it is difficult to find definitive standards for comparison of fungal sample results. The instruction manual that OSHA uses for its inspectors has some recommendations for indicators of indoor contamination (these are noted in colony forming units per cubic meter of air (cfu/m3). OSHA tells its inspectors that levels of 1000 cfu/m3 or greater indoors is a matter of concern for further investigation. The American Conference of Governmental Industrial Hygienists (ACGIH) has a relatively new manual on biological contamination.

But, even that doesn't have "hard numbers" for either cultured sample or direct analysis sample results. What most of the expert guidance documents do indicate is that comparisons should be made between out-of-doors and inside the building, and between complaint areas and non-complaint areas with the levels and types of biological organisms compared to determine whether indoor amplification is present. The wide range of natural spore levels is dependent on the season, the surrounding vegetation, and even time of day. This fact makes the collection of out-of-doors comparison samples critical. However, these sorts of comparisons are not very helpful in determining the effectiveness of mold cleanups or even doing the risk assessment for the building occupants who have complaints about the indoor environments.

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In an effort to deal more effectively with such cases, a number of scientists and consultants around the country have assembled large bodies of anecdotal information that relates fungal counts from direct analysis samples to complaints and symptoms of building occupants. This data has pushed a number of experts to adopt 2000 counts of mold spores per cubic meter of air as a maximum for a clean building. In some cases, testing a building for mold may not be recommended. Testing in most instances is costly and usually produces results that have very little, if any, practical value.

At worst, test results can be misleading. There are a number of inherent limitations to mold testing. Testing is only warranted when there is a clear objective that can only be met through obtaining sampling data. In a residential setting, there are more reliable and cost effective methods for identifying environments needing intervention. A thorough visual inspection looking for mold growth or signs of water damage and wetness and locating sources of mold odors by smell is recommended.

Once mold growth has been located, appropriate actions are needed to correct the source of the moisture and remove mold contamination. Testing of moldy materials or an air sample identifies the types of molds that may be present, but does not identify the cause/source of moisture. Testing of a moldy material involves sending a swab, imprint on a Scotch tape or piece of the material to a competent laboratory. Air sampling requires specialized equipment.

An air sample typically captures mold spores in a period of minutes. Since replicate samples must be taken due to variations in the airborne molds over time (even hours) and compared with outdoor samples, air testing is both expensive and time-consuming. Interpretation of test results may not be very useful, since there are no advocated "safe levels" of indoor molds, and the results will not tell the health risks from the molds.

Spore Trap

This indoor air quality sampler is a particulate sampling cassette, Zefon Air-O-Cell Cassette, designed for rapid collection and analysis of a wide range of airborne aerosols including mold spores, pollen, insect parts and skin fragments. These types of samples are used to detect for total spore counts. It is

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useful for rapid analysis of airborne contaminants in IAQ testing, allergy testing, and flood restoration monitoring. Media is easy to store and has a long-shelf life; results are semi-quantitative and relates directly to airborne exposure; rapid analysis of results. Differentiation between viable and non-viable organisms is difficult.

Anderson N-6 Bio-aerosol Sampler

This is a single stage petri plate impacter that consists of an aluminum device held together by three spring clamps and is sealed with O-ring gaskets. A high volume of air is drawn through the sampler causing multiple jets of air to direct airborne particles toward the surface of the agar collection plate. This will lead to biological growth if any microorganisms are present in the air that is sampled. A short collection period (3-5 minutes @ 28.3 lpm) should be used to prevent the plates from being overgrown by microorganisms. The sampler should be disinfected with isopropyl alcohol between each use and the media that's expired, has cracks, or possible contamination should not be used.

Swab/Tape Sampling for Building Surfaces

A swab sample is collected with sterile cotton "Q-tip" applicator that has been moistened with sterile growth media. The area to be swabbed should be performed by a person wearing sterile latex, surgical gloves and the cotton head of the applicator is broken off into the growth solution vial. The vial and swabbed applicator sent to a lab for plate culturing and counting. This type of testing is inexpensive; non-destructive; rapid analysis for spore counts; results can be quantitative and cultured for speciation; sampling can be performed on irregular surfaces. But the results do not relate directly to airborne exposures; fungal structures may be damaged during collection, causing identification of the mold to be less accurate; spores may germinate before lab analysis; and sample collection does not work well on dry surfaces.

Environmental Control and Mold Growth

Like other organisms, mold requires food and water to grow. There are two basic objectives in mold remediation: eliminate the moisture source and eliminate the food source. Since it is virtually impossible to entirely eliminate the presence of mold spores, mold remediation instead focuses on stopping the growth and spread of mold. This is accomplished by first eliminating all

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moisture sources. Once moisture is gone, the mold can no longer spread to new locations.

Remediation then focuses on eliminating food sources (such as wood, concrete, etc.), which must be thoroughly cleaned to ensure that no mold survives. Professional mold remediation requires more than just eliminating existing mold. Mold remediation includes preventing the spread of mold and eliminating potential mold problems in the future.

Mold remediation also involves containment of existing mold (so that it does not spread), controlling the air movement, protecting the occupants from mold, protecting the technicians from the mold, proper disposal of waste materials and in-depth cleaning of the affected areas. Mold can always return. After mold remediation, it becomes the owner/occupant's responsibility to take steps so that conditions for mold growth do not reappear.

The Remediation Process

The use of respiratory protection, gloves, and eye protection is recommended during the remediation process. Extensive contamination, particularly if heating, ventilating, air conditioning (HVAC) systems or large occupied spaces are involved, should be assessed by an experienced health and safety professional and remediated by personnel with training and experience handling environmentally contaminated materials. Lesser areas of contamination can usually be assessed and remediated by building maintenance personnel.

Fungi in buildings may cause or exacerbate symptoms of allergies (such as wheezing, chest tightness, shortness of breath, nasal congestion, and eye irritation), especially in persons who have a history of allergic diseases. Individuals with persistent health problems that appear to be related to fungi or other bioaerosol exposure should see their physicians for a referral to practitioners who are trained in occupational/environmental medicine or related specialties and are knowledgeable about these types of exposures. Except in cases of widespread fungal contamination that are linked to illnesses throughout a building, building-wide evacuation is not indicated.

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Prompt remediation of contaminated material and infrastructure repair is the primary response to fungal contamination in buildings. Emphasis should be placed on preventing contamination through proper building and HVAC system maintenance and prompt repair of water damage. Emphasis should be on ensuring proper repairs of the building infrastructure, so that water damage and moisture buildup does not recur.

The Levels of Mold Remediation

There are five different levels of abatement described below. The size of the area impacted by fungal contamination primarily determines the type of remediation. The sizing levels below are based on professional judgment and practicality; currently there is not adequate data to relate the extent of contamination to frequency or severity of health effects. The goal of remediation is to remove or clean contaminated materials in a way that prevents the emission of fungi and dust contaminated with fungi from leaving a work area and entering an occupied or non-abatement area, while protecting the health of workers performing the abatement.

Level I -- This includes small isolated areas (10 sq. ft or less) which would include ceiling tiles, small areas on walls. Remediation can be conducted by regular building maintenance staff. Such persons should receive training on proper clean-up methods, personal protection, and potential health hazards. This training can be performed as part of a program to comply with the requirements of the OSHA Hazard Communication Standard (29 CFR 1910.1200).

Respiratory protection (e.g., N95 disposable respirator), in accordance with the OSHA respiratory protection standard (29 CFR 1910.134), is recommended. Gloves and eye protection should be worn, and the work area should be unoccupied. Vacating people from spaces adjacent to the work area is not necessary. Containment of the work area is not necessary. Dust suppression methods, such as misting (not soaking) surfaces prior to remediation, are recommended. Contaminated materials that cannot be cleaned should be removed from the building in a sealed plastic bag.

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Level II -- This would include mid-sized isolated areas (10 - 30 sq. ft.) which would refer to individual wallboard panels. Remediation can be conducted by regular building maintenance staff. Such persons should receive training on proper clean-up methods, personal protection, and potential health hazards. This training can be performed as part of a program to comply with the requirements of the OSHA Hazard Communication Standard (29 CFR 1910.1200). Respiratory protection (e.g., N95 disposable respirator), in accordance with the OSHA respiratory protection standard (29 CFR 1910.134), is recommended. Gloves and eye protection should be worn.

The work area should be unoccupied. Vacating people from spaces adjacent to the work area is not necessary. The work area should be covered with a plastic sheet(s) and sealed with tape before remediation, to contain dust/debris. Dust suppression methods, such as misting (not soaking) surfaces prior to remediation, are recommended. Contaminated materials that cannot be cleaned should be removed from the building in sealed plastic bags. There are no special requirements for the disposal of moldy materials. The work area and areas used by remedial workers for egress should be HEPA vacuumed (a vacuum equipped with a High-Efficiency Particulate Air filter) and cleaned with a damp cloth and/or mop and a detergent solution. All areas should be left dry and visibly free from contamination and debris.

Level III -- This would include large isolated areas (30 - 100 square feet) which would refer to several wallboard panels. A health and safety professional with experience performing microbial investigations should be consulted prior to remediation activities to provide oversight for the project. The following procedures *at a* minimum are recommended: Personnel trained in the handling of hazardous materials and equipped with respiratory protection, (e.g., N95 disposable respirator), in accordance with the OSHA respiratory protection standard (29 CFR 1910.134), is recommended. Gloves and eye protection should be worn.

The work area and areas directly adjacent should be covered with a plastic sheet and taped before remediation, to contain dust/debris. Seal ventilation ducts/grills in the work area and areas directly adjacent with plastic sheeting. The work area and areas directly adjacent should be unoccupied. Further

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vacating of people from spaces near the work area is recommended in the presence of infants, persons having undergone recent surgery, immune suppressed people, or people with chronic inflammatory lung diseases (e.g., asthma, hypersensitivity pneumonitis, and severe allergies). Dust suppression methods, such as misting (not soaking) surfaces prior to remediation, are recommended.

Level IV -- This would include extensive contamination in an area greater than 100 contiguous square feet in an area. A health and safety professional with experience performing microbial investigations should be consulted prior to remediation activities to provide oversight for the project. The following procedures are recommended: Personnel trained in the handling of hazardous materials equipped with: full-face respirators with high efficiency particulate air (HEPA) cartridges Disposable protective clothing covering both head and shoes gloves; containment of the affected area: Complete isolation of work area from occupied spaces using plastic sheeting sealed with duct tape (including ventilation ducts/grills, fixtures, and any other openings)

The use of an exhaust fan with a HEPA filter to generate negative pressurization; airlocks and decontamination room; vacating people from spaces adjacent to the work area is not necessary, but is recommended in the presence of infants (less than 12 months old), persons having undergone recent surgery, immune suppressed people, or people with chronic inflammatory lung diseases (e.g., asthma, hypersensitivity pneumonitis, and severe allergies).

Level V -- This refers to remediation of HVAC systems. Remediation can be conducted by regular building maintenance staff. Such persons should receive training on proper clean-up methods, personal protection, and potential health hazards. This training can be performed as part of a program to comply with the requirements of the OSHA Hazard Communication Standard (29 CFR 1910.1200). Respiratory protection (e.g., N95 disposable respirator), in accordance with the OSHA respiratory protection standard (29 CFR 1910.134), is recommended. Gloves and eye protection should be worn.

The HVAC system should be shut down prior to any remedial activities. The work area should be covered with a plastic sheet(s) and sealed with tape before

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remediation, to contain dust/debris. Dust suppression methods, such as misting (not soaking) surfaces prior to remediation, are recommended. Growth-supporting materials that are contaminated, such as the paper on the insulation of interior lined ducts and filters, should be removed. Other contaminated materials that cannot be cleaned should be removed in sealed plastic bags. There are no special requirements for the disposal of moldy materials.

Liability From Toxic Mold

Concern about the consequences of mold contamination has become one of today's top subjects. The implications of the emerging mold issue for insurance and the economy are serious. From the insurance perspective, damage from mold, like rust, rot and mildew is specifically excluded in the standard P&C policy. Mold contamination is covered under some property policies only if it is the result of a covered peril. For example, the costs of cleaning up mold caused by water from a burst pipe are covered under the policy, because water damage from a burst pipe is a covered peril.

But mold caused by water from excessive humidity, leaks, condensation, or flooding is a maintenance issue for the property owner, like termite or mildew prevention, and is not covered by the policy. Most people routinely clean up mold before it grows large enough to become a hazard. Caught early, mold usually can be removed by a thorough cleaning with bleach and water.

While mold has been around for millennia, the number of mold claims submitted to home insurers only increased significantly during the past few years. But if insurers are now going to be asked to pay claims for something that is not covered in the policy, the price of home insurance will inevitably rise. Should the longstanding coverage exclusion for mold be eroded by jury verdicts or judicial interpretations, the basic premises on which the property insurance contract is based will be reversed, and the economic consequences will be severe. To prevent this, corrective action by regulators and legislators is being considered. To avoid confusion, many insurers are now inserting clarifying language in their policies. Some companies may decide to cover all mold claims and price the policy accordingly.

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Others may exclude mold, but offer an attachment to the policy, called an endorsement, that allows you to add the coverage. Other companies may provide a tighter definition of what is and what is not covered, while some may prefer to create an absolute exclusion. Most major insurers have announced some form of restriction on writing water damage policies.

Potential rate increases needed to cover the cost of mold claims threaten to make home insurance coverage unaffordable for some and unavailable for others. A crisis in the price and availability of homeowner's coverage could have far-reaching effects on home sales and, as a result, the economy as a whole. As to mold in general, there are more than 100,000 species of mold of which at least 1,000 are common in the United States. According to the Center for Disease Control (CDC), there is always a little mold everywhere – in the air and on many surfaces. The CDC suggests people should take routine measures to prevent mold growth in the home, usually by stopping the accumulation of moisture. Home owners should be aware that mold should be cleaned up as soon as it appears.

Keep in mind that mold cannot grow without access to moisture. The most effective way to treat mold is to immediately correct underlying water damage and clean the affected area. The common health concerns from molds include hay fever-like allergic symptoms, the CDC reports.

Certain individuals with chronic respiratory disease may experience difficulty breathing. Individuals with immune suppression may be at increased risk for infection from molds. Anyone with these conditions should consult a qualified medical clinician. There are very few case reports that molds containing certain mycotoxins inside homes can cause unique or rare health conditions and a causal link between the mold and these conditions, has not been proven, the CDC says.

Toxic Mold Insurance Regulation

Who is ultimately responsible for paying for mold and its effects has become a national debate between insurance companies and property owners. Congress has even stepped into the fray. The U.S. House is considering a bill that would create a National Toxic Mold Insurance Program which would provide

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consumers with a second level of protection, covering losses beyond what their insurance policy pays. In the meantime, insurers, and builders are battling in the media and in the courtroom.

The United States Toxic Mold Safety and Protection Act

The growth of "toxic mold" is becoming a problem of monumental proportions. Exposure to mold growth in residential, public, and commercial buildings is believed to have caused serious medical conditions which include bleeding lungs, digestive problems, hair loss, nausea, loss of memory, reduced cognitive skills, and death. Property damage from mold growth has destroyed millions of dollars in real estate and forced homeowners to the curb.

The United States Toxic Mold Safety and Protection Act will mandate comprehensive research into mold growth, create programs to educate the public about the dangers of toxic mold, and provide assistance to victims. In addition, the Act will generate guidelines for preventing indoor mold growth, establish standards for removing mold when it does grow, provide grants for mold removal in public buildings, authorize tax credits for inspection and/or remediation of mold hazards, and create a national insurance program to protect homeowners from catastrophic losses. Taken as a whole, the Toxic Mold Safety and Protection Act will attack indoor mold growth with good science, public awareness, and tangible relief.

Provisions of the Bill

- ***Title I - Research and Public Education --*** The Bill directs the Environmental Protection Agency (EPA) and Centers for Disease Control (CDC) to examine the effects of different molds on human health and develop accurate scientific information on the hazards presented by indoor mold. The Bill directs EPA and the Department of Housing and Urban Development (HUD) respectively, to establish guidelines that identify conditions that facilitate indoor mold growth and measures that can be implemented to prevent such growth. The guidelines will also address mold inspection, testing, and remediation. The Bill asks EPA and HUD to establish guidelines for certifying mold inspectors and remediators.

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- ***Title II - Housing and Real Property Provisions --*** The Bill requires mold inspections for multi-unit residential property and mold inspections for all property that is purchased or leased using funds that are guaranteed by the federal government. The Bill also requires mold inspections in public housing. The Bill requires, to whatever extent possible, that local jurisdictions modify building codes to minimize mold hazards in new construction.
- ***Title IV - Indoor Mold Hazard Assistance --*** The Bill authorizes grants for mold removal in public buildings.
- ***Title V - Tax Provisions --*** The Bill authorizes tax credits for inspection and/or remediation of mold hazards.
- ***Title VI - National Toxic Mold Insurance Program --*** The Bill creates a National Toxic Mold Insurance Program administered by the Federal Emergency Management Agency (FEMA) to protect homeowners from catastrophic losses. Many homeowners are finding that insurance companies will not offer adequate coverage for mold.
- ***Title VII - Health Care Provisions --*** The Bill enables States to provide Medicaid coverage to mold victims who are unable to secure adequate health care.

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Chapter 11
Guide to Umbrella or Excess Liability

Defining The Umbrella Insurance Policy

Umbrella insurance is designed to give one added liability protection above and beyond the limits on homeowners, auto, and watercraft personal insurance policies. With an umbrella policy, depending on the insurance company, one can add an additional 1-5 million in liability protection. This protection is designed to "kick-in" when the liability on other current policies has been exhausted.

Umbrella and excess coverage are extensions of home insurance. Banks make people buy home insurance to get mortgages. However, there is no entity that mandates buying a policy that could turn out to be the most important part of an insurance package. An individual should buy enough liability insurance to protect all his or her assets. If this individual owns property and or has investments and savings that are worth more than the liability limits in the policy, one may consider purchasing an excess liability or umbrella policy.

Umbrella or excess liability policies provide extra coverage starting to pay after he or she has used up the liability insurance in the underlying policy. An umbrella policy is not part of a homeowner's policy as it is purchased separately. In addition to providing a higher dollar amount, an umbrella policy offers broader coverage covering one for libel, slander, and invasion of privacy.

The Umbrella Insurance Policy As Liability Coverage

Liability insurance is the portion of a homeowners or auto policy that pays for expenses such as the injured persons medical bills, rehabilitative therapy, and lost wages due to the negligence of the at fault person. The liability portion of an insurance policy also covers a legal defense representative if the negligence would happen to land the at fault person in the court room.

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After adding up all of the medical expenses for the injured and the legal fees of the negligent person, the standard liability in one's homeowners or auto policy is often not enough. Almost every state has financial responsibility laws that will hold drivers accountable for bodily injury and property damage resulting from car accidents and the "at fault" driver could be sued for the damage. Personal assets from the "at fault driver" could be seized resulting from a lawsuit. Similar laws are also in force for home and watercraft owners.

Umbrella insurance refers to insuring more than one property as opposed to insuring only one. For example the owner might get a discount for insuring both his house and car rather than insuring them with separate policies because it might cost more. Typically, an umbrella policy is pure liability coverage over and above the coverage afforded by the regular policy, and is sold in increments of one million dollars.

Guide To The Cost of Umbrella Insurance

For a small premium (around $200 a year for a $1 million policy), umbrella policies supplement the insurance that a homeowner already has through one's home coverage, adding another layer of protection for personal assets. This may seem like over kill but if someone decides to sue the insured homeowner for an amount higher than the existing policy, his or her whole way of life could be at risk.

A personal liability umbrella insurance policy can give one added liability protection without a large added cost. Additional liability insurance is often inexpensive, especially compared to the added coverage one gains. Furthermore, liability insurance covers one's non-business activities anywhere in the world. Having the added protection of a liability umbrella policy is coverage no one should go without.

The cost of an umbrella policy depends on how much underlying insurance the homeowner has and the kind of risk he or she represents. The greater the underlying liability coverage, the cheaper the policy is. Most companies will require a minimum of $300,000 on a home and a car. The cost of umbrella insurance varies by state and by your location in that state. The cost is different

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for the same reasons that traditional insurance is different, so whatever factors influence the cost of your traditional auto insurance can be expected to play a part in the cost of your umbrella policy.

A good range of cost for umbrella insurance is between $200-$300 per year. For that small amount of money, the insurance can contribute up to five million dollars of a lawsuit claim, making it well worth the small increase in the cost of premiums.

Umbrella policies are typically inexpensive. An individual may find that a million dollars worth of coverage is a few hundred dollars a year. The reason that an umbrella policy is so inexpensive is because they are not used that often. However, when one finds himself or herself in a position of being sued for exorbitant sums, an umbrella policy becomes priceless.

Guide to Coverages of The Umbrella Insurance Policy

All umbrella liability policies contain an each occurrence limit of insurance. Some umbrella liability policies may have a separate limit that applies to all personal and advertising injuries for one person or for the organization. Also, some policies are written with aggregate limits for only one type of loss. Other policies may have one or more aggregates for all losses. Umbrella policies can be written with several different variations of the aggregate limits. There are no standard umbrella policies.

Bodily Injury Liability

Bodily Injury Liability covers the cost of damages to another person's body. Examples include the cost of medical bills and/or liability claims as a result of:

- injuries to other parties due to a serious auto accident where the insured is at fault,
- harm caused to others as a result of insured's dog,
- injuries sustained by a guest in the insured's home due to a fall, or
- injuries sustained by a neighbor's child who falls while playing in the insured's yard.

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Property Damage Liability

Property Damage Liability covers the cost of damage or loss to another person's tangible property. Examples include the cost associated with:

- damage to vehicles and other property as a result of an auto accident where you are at fault,
- damage claims incurred when your pet rips a friend's priceless oriental rug to shreds, or
- damages to school property accidentally caused by your child.

Owners of Rental Units

Owners of Rental Units protects against liability that an individual may face as a landlord. Examples include the cost of liability claims as a result of:

- someone tripping over a crack in the sidewalk of rental property and suing the owner for damages, or
- the tenant's dog biting someone and the insured being held responsible for the injuries.

Coverage is also provided should the homeowner be sued for:

- slander – injurious spoken statement;
- libel – injurious written statement;
- false arrest, detention, or imprisonment;
- malicious prosecution;
- shock/mental anguish;
- other personal liability situations.

Umbrella policies do not typically cover:

- Punitive damages.
- Intentional acts.
- Liability claims related to a personally owned business (business insurance policy needed).

Guide to Provisions of the Umbrella Policy

An umbrella policy is an insurance policy that covers claims that are in excess of the coverage under your homeowner's or automobile coverage. Before

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purchasing an umbrella policy, an individual will need to have both an automobile policy and a homeowner's policy from the same insurance company. Both of these policies must have the highest liability that the insurance company provides. Once an individual has reached these limits, he or she can purchase an umbrella policy.

Affect of Limits On Homeowner's Insurance

An umbrella policy takes affect after the limits on a homeowner's insurance policy are reached. The deductible for the umbrella coverage is the limit on any other insurance policy. If the limit on a homeowner's policy is $250,000, then the deductible on the umbrella coverage is $250,000. This leaves uninterrupted coverage from the time the initial deductible is paid until the claim is paid.

Provision of High Deductible

Because of the nature of umbrella insurance, it carries a high deductible, sometimes of more that $200,000. Of course, the individual is not paying that amount out. This is the amount that "you" have to pay before it kicks in. Most companies that sell umbrella insurance will require that the individual has homeowner's insurance that is equal to the deductible. This ensures that the individual does not have to pay any more out-of-pocket than necessary.

Actual Function of The Umbrella Insurance Policy

The term "umbrella" is used because it covers liability claims from all policies underneath it, such as autos and homeowners policies. For example, if you have an auto insurance policy with liability limits of $500,000 and a Homeowners policy with a limit of $300,000, then with a million dollar umbrella, your limits become in effect, $1,500,000 on the auto policy and $1,300,000 on a homeowners liability claim. Umbrella policies are mainly used by those who have sizable unencumbered assets, such as a home with a large amount of equity to ensure that even a catastrophic claim will not allow those assets to be placed at risk.

Guide to The Benefits of Umbrella Insurance

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Umbrella insurance protects an individual and a family along with assets in the event that this individual is held personally liable for a claim. The Personal Umbrella Policy protects an individual from major claims and lawsuits in two ways:

- Provides additional liability coverage above the limits of a homeowners, auto, and boat insurance policies.
- Provides coverage for claims that may be excluded by other liability policies including: false arrest, libel, slander, and liability coverage on rental units own by the homeowner.

Umbrella policies are so inexpensive that it makes sense for anyone to purchase one. In particular, if an individual has a high risk of exposure such as a swimming pool or motorbikes, or even a teenage driver.

It may seem impossible that you will ever need a million dollars or more in insurance coverage, but, a serious injury on your property, or an automobile accident that involves several people, can quickly reach the limits of your traditional insurance coverage. With a case that goes to a jury trial, all bets are off, awards can be tremendous, and once your traditional policy limit is reached you are responsible personally if you do not have an umbrella policy. Even if the award is more reasonable, an umbrella policy will help pay court costs.

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Chapter 12
Mortgage and Title Insurance

Mortgage Insurance

Mortgage insurance often is required by the lender to protect it against a loan default by the borrower who makes a low down payment (less than 20% of the sale price). If the borrower defaults, the mortgage insurer pays the lender its money and then seeks to recover from the borrower or forecloses on the property. The premium can be paid monthly or in one large payment. Mortgage life insurance pays off the balance of a mortgage when the mortgage holder dies.

FHA Mortgage Insurance Program

FHA's mortgage insurance programs help low- and moderate-income families become homeowners by lowering some of the costs of their mortgage loans. FHA mortgage insurance also encourages lenders to make mortgages to otherwise creditworthy borrowers and projects that might not be able to meet conventional underwriting requirements, by protecting the lender against default on mortgages for properties that meet certain minimum requirements--including manufactured homes, single-family and multifamily properties, and some health-related facilities.

Section 203(b) is the centerpiece of FHA's single-family mortgage insurance programs—the successor of the program that helped save homeowners from default in the 1930s, that helped open the suburbs for returning veterans in the 1940s and 1950s, and that helped shape the modern mortgage finance system. Presently, FHA One- to Four-Family Mortgage Insurance is still an important tool for the Federal Government to expand homeownership opportunities for first-time homebuyers and other borrowers who would not otherwise qualify. These obligations are protected by FHA's Mutual Mortgage Insurance Fund, which is sustained entirely by borrower premiums.

This program provides mortgage insurance to protect lenders against the risk of default on mortgages to qualified buyers. Insured mortgages may be used to

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finance the purchase of new or existing one- to four-family housing, as well as to refinance debt. Section 203(b) has several important features:

- Downpayment requirements can be low in contrast to conventional mortgage products which frequently require downpayments of 10% or more of the purchase price of the home. Single-family mortgages insured by FHA under Section 203(b) make it possible to reduce downpayments to as little as 3% and finance approximately 97%.

- HUD sets limits on the amount that may be insured. The current FHA mortgage limit ranges from $271,050 to $729,750. These figures vary over time and by place, depending on the cost of living and other factors.

- Many closing costs can be financed meaning that in most conventional mortgages, because the borrower must pay closing costs, etc, equivalent to 2-3% of the price of the home. Borrowers pay an up-front insurance premium at the time of purchase, as well as monthly premiums that are not financed, but instead are added to the regular mortgage payment.

- Some fees are limited because FHA rules imposes limits on some of the fees that lenders may charge in making a mortgage.

Private Mortgage Insurance

Private Mortgage Insurance, known to many as P.M.I., is a necessary evil for borrowers who cannot afford the 20% down payment often required by lenders. But now, with losses mounting within the mortgage-insurance industry, some applicants are being turned away, while others will have to pay higher premiums.

At least five of the six major insurers recently changed their policy qualifications. One of them is no longer insuring mortgages obtained through brokers, and it stopped offering private mortgage insurance for condos and other attached-housing units.

Private mortgage insurance (PMI) is an amount paid by a private insurance company to a lender in order to prevent losses, in case a borrower defaults on

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his mortgage payments. When a borrower pays less than 20% of the appraised value or sale price as the down payment on a house, he is required to pay the costs of this insurance. In other words, if the ratio of the loan offered and the appraised value of the property, that is, the loan-to-value ratio or LTV ratio is more than 80%, then a borrower has to pay for private mortgage insurance.

Private mortgage insurance is typically required when down payments are below 20%. Rates can range from 1.5% to 6% of the principal of the loan based upon loan factors such as the percent of the loan insured, loan-to-value (LTV), fixed or variable, and credit score. The rates may be paid annually, monthly, in some combination of the two (split premiums).

- Borrower-Paid Private Mortgage Insurance (BPMI or "Traditional Mortgage Insurance") is a default insurance on mortgage loans provided by private insurance companies and paid for by borrowers allowing borrowers to obtain a mortgage without having to provide 20% down payment.. The US Homeowners Protection Act of 1998 requires PMI to be canceled when the amount owed reaches a balance of 78%. Often, BPMI can be cancelled earlier by submitting a new appraisal showing that the loan balance is less than 80% of the home's value due to appreciation.
- Lender-Paid Private Mortgage Insurance (LPMI) Similar to BPMI, except that it is paid for by the lender, and the borrower is often unaware of its existence. LPMI is usually a feature of loans that claim not to require Mortgage Insurance for high LTV loans. The cost of the premium is built into the interest rate charged on the loan.

Title Insurance

Owner's title insurance will cover a homeowner if a problem regarding legal ownership arises that was not discovered during the title search. The title insurance will pay attorney fees, as well as all other costs in defending the title. Although title problems are infrequent, they could result in the loss of the house, so it can be wise to act on the side of caution. The bank, or lender, will likely also insist on title insurance to protect its investment - at your expense.

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Title insurance guarantees that the homeowner is receiving full legal ownership of the commercial property which he or she is buying. If a lien later shows up or it turns out some other property owner has the right to use the parking lot, the homeownner can sue the title insurance company to recover any loss suffered.

Having a title insurance policy takes much of the legal risk out of buying a building. Usually the seller pays the insurance premium for this coverage but sometimes it is paid by both parties or the buyer alone.

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Chapter 13
Guide To Homeowner Policy Underwriting

Homeowners is the property/casualty insurance industry's third largest line of business by premium volume. But since 1980, homeowners have achieved poor financial results. Catastrophes certainly bear much of the blame. However, this study concludes that part of the problem is a pattern of enhancements insurers have made in their policy forms. The number of types of loss insured under a typical policy increased, contributing to an acceleration in losses that has outstripped premium growth.

Underwriter Responsibilities

Insurance underwriters evaluate the risk and exposures of potential clients. They decide how much coverage the client should receive, how much they should pay for it, or whether even to accept the risk and insure them. Insurance companies protect individuals and organizations from financial loss by assuming billions of dollars in risk each year—risks of car accident, property damage, illness, and other occurrences. Underwriting involves measuring risk exposure and determining the premium that needs to be charged to insure that risk.

They are needed to identify and calculate the risk of loss from policyholders, establish who receives a policy, determine the appropriate premium, and write policies that cover this risk. The function of the underwriter is to acquire or to "write" business that will make the insurance company money, and to protect the company's book of business from risks that they feel will make a loss. In simple terms, it is the process of issuing insurance policies. Underwriters decide if insurance is provided and under what terms.

Underwriters analyze information in insurance applications to determine whether a risk is acceptable and will not result in a loss. Each insurance company has its own set of underwriting guidelines to help determine whether or not the company should accept the risk. The information used to evaluate the risk of an applicant for insurance will depend on the type of coverage involved.

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Insurance applications often are supplemented with reports from loss-control representatives, medical reports, reports from data vendors, and actuarial studies. The factors that insurers use to classify risks should be objective, clearly related to the likely cost of providing coverage, practical to administer, consistent with applicable law, and designed to protect the long-term viability of the insurance program.

Underwriters then must decide whether to issue the policy and, if so, determine the appropriate premium to charge. In making this determination, underwriters consider a wide variety of factors about the applicant. The homeowners insurance policy provides a broad spectrum of property and liability coverage. However, in spite of the broad nature of the coverage, underwriters typically focus on a few key areas when making their decisions about coverage. Underwriters serve as the main link between the insurance carrier and the insurance agent. The underwriters may either decline the risk or may provide a quotation in which the premiums have been loaded or in which various exclusions have been stipulated, which restrict the circumstances under which a claim would be paid.

With the real estate market cycling ever changing, it is important to make sure the true nature of the risk is understood and that sufficient information is submitted to the underwriter for appropriate evaluation and pricing. This is a challenge for producers who are trying to assist the homeowner in asset protection, while, at the same time making an objective analysis of the risk. When the prospective insured meets the eligibility requirements, there are three key underwriting considerations. These considerations are:

- location of the premises;
- the type of construction, and;
- the values associated with the covered property;
- how the property is used.

Dwelling Environment and Risk Evaluation

When analyzing the location of the premises, the underwriter will evaluate the surrounding environment and placement of the risk. Multiple massive storms

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in the Midwest have caused underwriters to look beyond the obvious coastal hurricane zones to consider more carefully other weather-driven risks of loss: tornadoes, ice storms, and high winds, to name a few. The availability of historical weather event occurrences makes it relatively easy for the underwriter to assess the potential for storm damage, the potential extent of damage, and the effect the surrounding terrain and environment may have on any potential or expected damage. Comprehensive Loss Underwriting Exchange (CLUE) reports are used to ascertain the history of the property for further review or evaluation.

Premise Location

The second consideration regarding location of the premises is the availability of skilled, knowledgeable fire professionals to respond quickly and appropriately. It's not enough to look at hydrant placement; an evaluation of the overall capability and ability of emergency personnel to respond is required. In recent years, many counties and cities have upgraded hydrant placement, fire houses, and equipment, and have initiated advanced training procedures. The underwriter is not aware of these upgrades, if an agency, such as Insurance Services Office, Inc. (ISO), has not conducted an evaluation in the last 10 years.

Dwelling Construction

Another area which the underwriter must consider is the dwelling's construction. Frame structures are highly susceptible to fire and windstorm loss. Masonry construction is a better risk but remains susceptible to fire and windstorm loss due to weaknesses of most roof construction. New construction codes and processes are being introduced primarily along coastal areas to provide superior protection against risk of loss. Most of these new construction methods have been tested only on a limited basis and appear promising.

The underwriter will need to know if the insured has completed retro-fits by adding protective techniques to the dwelling which will reduce the overall risk of loss. Some construction has been proven to withstand very high winds—roof strapping, tie-downs, and breakage resistant glass.

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Without doubt the biggest challenge in a tumbling real estate market is proper valuation of the insured property. Methods for valuation can be inadequate and lead to inaccurate or insufficient coverage. The prospective insured may believe that the policy should cover the sales price of the dwelling, not realizing that the land is not covered by the policy, and that market value is not a factor when determining replacement cost. It is conceivable in today's market that the replacement value of a dwelling may far exceed its market value leading to a point of contention with the prospective insured and the possibility of under-insurance.

Building Ordinance

With the advent of building ordinance coverage, an additional consideration is in order. The cost of repair and replacement of an existing structure may be significantly higher due to new building codes. The cost to add wind and fire resistant roofing, reconstruction to include earthquake protection, and other improvements can be significant. Due to the additional costs that may be involved, the policy valuation may be dramatically different than the cost to repair or replace to pre-loss condition, especially for older dwellings in damage prone areas.

Personal Property Risk and Valuation

After evaluating the dwelling risk, the underwriter will consider the personal property risk and valuation. It is important for producers to consider the economic standing of the prospective insured so as to ask appropriate questions, and if possible to inspect the personal property at risk.

There is a formula percentage based on the valuation of the dwelling which is used. The dwelling valuation can be affected by many external factors including hobbies and "etc." interests are as important as a discussion of the limits in the policy. Young people who will be inheriting art and collectibles from aging relatives provides an area where unfounded assumptions can lead to inadequate coverage.

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Property Appearance

Underwriters will definitely consider the overall appearance of the property. Personal inspection and photos can help relay a true picture of the risk. Maintenance, upkeep, and general housekeeping of the external and interior premises are indicators of physical hazards that the insurer may not want to accept or hint to broader problems with the prospective insured. Photos may sway an underwriter to accept a risk despite other downfalls or contra-indicators.

It's important to determine whether the prospective insured has a home-based business that might alter the risk, or provide exposure not covered by the homeowner's policy since home-based businesses are the fastest growing segment of the economy. It is important for the insurer to understanding the extent of business activities conducted from the home, the amount of equipment or inventory stored there, and the economic gain anticipated by the prospective insured are all important considerations. All of these factors will help determine the risk involved. Many insurers include limited home-based business coverage as a standard addition to their policies, or offer endorsements which may be useful in covering the exposure.

Underwriting Guidelines

Underwriting Guidelines	Affects Coverage
AGE OF HOME Applicants may be denied coverage or they may be charged a higher rate by insurance companies because their home is too old. However, it is illegal for an insurer to deny coverage based on the age of the home.	Yes
CREDIT INFORMATION It is illegal to deny coverage based solely on the credit information but it is acceptable to use it as one element with others to deny coverage. Insurers often use "risk scores" which combine credit information with other factors.	Yes
ELECTRICAL WIRING Some companies make adverse underwriting decisions based on some condition of the electrical system of a home including the type of wiring,	Yes

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the number of circuit breakers, fuses or low amperage. Some companies require older homes to have a complete electrical system update prior insuring it.	
FOUNDATION Some companies make adverse underwriting decisions based the condition or type of the dwelling's foundation.	Yes
LOCATION OF HOME Insurance companies make adverse underwriting decisions because the applicant's home is located near substandard or commercial property or in a neighborhood with high crime and/or declining property values.	Yes
MINIMUM COVERAGE REQUIRED Insurance companies make adverse underwriting decisions because the applicant requests or requires an amount of insurance coverage below the minimum set by the company. However it is illegal for a company to deny coverage because the value of the dwelling does not meet the company's minimum requirement.	Yes
PLUMBING Some companies make adverse underwriting decisions based on the age or condition of the plumbing system. Some insurers require older homes to have the plumbing system updated prior to insuring it.	yes
PREVIOUS CANCELATION Applicants are denied a policy or required to have prior approval from the company because another insurance carrier has previously cancelled, declined or non-renewed the applicant.	Yes
SWIMMING POOL Pool Unacceptable means that applicants are denied coverage by insurance companies because there is a swimming pool on the premises. Required Features refers to applicants are denied coverage by insurance companies because the swimming pool lacks specific safety features (unfenced, no locked gate, diving board).	Yes

Chapter 21 of the Insurance Code addresses, among other things, the underwriting rules that companies who write homeowner's insurance policies

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are allowed use in order to refuse to insure, refuse to renew (or "nonrenew"), or limit the coverage available to a customer. Within these guidelines the insurance company has the discretion to adopt an underwriting rule which permits the option to not renew a homeowner's policy if there have been three paid claims within the immediately preceding three-year period totaling $750 or more without including weather-related claims, and $1,500 or more when including weather-related claims.

Underwriting and Cancellation

Cancellation of a policy an be made by either the insured or the insurer prior to the expiration or renewal date specified. If a policy is cancelled, you are entitled to receive any unearned premium, which is a prorated amount you have already paid toward your premium.

Cancellation of the insured's homeowner's insurance coverage by the insurer is allowed within the first sixty days from the time the policy is issued in a case that undisclosed risk of loss is discovered which is not related to a prior claim, fraud or increased risk are discovered or the insured has not paid his or her premium. Such cancellation requires the insurer to give the insured thirty days' notice. Generally, non-renewal involves one of two triggers. The first involves heavy losses in a certain area prone to specific types of danger like storm damage, living in a flood plain or earthquake-prone geography.

Specific claims history of policyholders; even if the insured files legitimate claims, can be a cause for concern for the insured. The insured may find himself or herself in the precarious position of having the insurer send a non-renewal notice.

And if a homeowner's insurance coverage lapses, it could put the insured in default with a Mortgage company, leading them to require the insured to purchase forced-placed coverage, which is provided by insurers of last resort who charge as much as three times normal premium rates in return for accepting higher risks.

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Issues For Underwriting Homeowners' Insurance

In addition to inadequately priced increased coverage over the years and the recent spate of costly catastrophes, several important issues continue to challenge the future profitability of underwriting homeowners insurance policies. The issues include the following:

- **Availability and affordability in high risk markets** — ***Florida*** -- After Hurricane Andrew, the Florida Legislature created the Florida Residential Property & Casualty Joint Underwriting Association as an insurer of last resort. But the JUA has grown to become the state's second largest homeowners insurer representing roughly $100 billion in exposure. This growth hinders efforts to attract private insurers back to the market. ***California*** --Since 1985, California state law has required that insurers offer earthquake coverage with every homeowners' policy. In conjunction with the 1989 Loma Prieta earthquake and the 1994 Northridge earthquake there are availability problems in the California homeowners market, as insurers try to manage their catastrophe risk. ***Hawaii*** —After Hurricane Iniki in 1992, many insurers were reported to have temporarily stopped writing property coverage in Hawaii. In response, in 1993, the Hawaii insurance commissioner expanded the underwriting authority of the Hawaii Property Insurance Association, and the Hawaii Legislature established the Hawaii Hurricane Relief Fund (HHRF). The HHRF provides hurricane coverage.

- **Catastrophe modeling** — A catastrophe model is a set of data bases and computer programs designed to simulate the frequency and severity of possible catastrophes using current exposure distributions. So far, state insurance regulators have not broadly embraced catastrophe models for ratemaking in the underwriting process but as an understanding of catastrophe models increases ISO expects that models will become accepted tools for determining the portion of an insurer's rate needed to cover catastrophe losses.

- **Capital market alternatives for managing catastrophe risk** — Since 1989, insurers have faced increased catastrophe risk and limited means

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of transferring it. Insurers have been seeking alternatives to traditional means for managing this risk. These alternatives include catastrophe options, catastrophe bonds, contingent surplus notes, contingent equity, liability-backed securities, and catastrophe swaps. Insurers were optimistic that these ventures would attract capital markets.

Rate provisions for catastrophe losses have two components:

- *loss costs;*
  The loss cost pays for expected average catastrophe losses. But large catastrophe losses are unusual and require the availability of additional capital or other funding, even if catastrophes don't occur, to support the obligation to pay claims.
- *risk load.*
  The risk load component recognizes the need for access to this additional funding by providing the returns to investors. Some regulators and insurers have not yet fully accepted the concept of risk load as a way to fund large catastrophe losses.

Underwriting and Discounts

Every insurance company that provides homeowner coverage uses its own package of "special" discounts to market its products to particular types of customers. The following list contains suggestions on how to reduce rates for the consumer.

- **Long-time customers** – Some insurers offer discounts to long-time customers with no claims history.
- **Multiple policies** – If an individual has a home, auto, liability, and other policies with the same company, it may offer a discount.
- **Non-smoker discount** – Some insurers offer a discount when all family members are nonsmokers.
- **Protection devices** – If an individual has smoke detectors, burglar alarms, or automatic sprinkler systems, the company may offer a discount.

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Chapter 14 – Guide to Specialty Endorsements

Standard homeowners insurance policies will offer financial coverage of the structural part of a home, as well as the property within the home. The homeowner can also purchase additional liability for a family, including pets. Common problems that arise and cause loss to homeowners include theft, natural disasters, etc. There are many things that are covered in the homeowners insurance policy but flood and earthquake are two major catastrophes that will require additional coverage. Many of these additions to the homeowners insurance policy have been referred to in Chapter 7. In this chapter we are going to go into more detail regarding these endorsements and riders.

The most beneficial and expensive parts of the homeowners insurance policy is the liability portion which offers protection for the entire family against lawsuits for bodily injury or property damage or for the cost of defending a homeowner in court as well as any damages the court rules for him or her to pay. The liability portion includes damage caused by pets such as a ruined couch or a bite. It is common for many companies to offer a starting level of protection at about $100,000 but it may be wise to go with more.

If the homeowner owns special antique furniture or expensive jewelry and furs then, additional coverage with an endorsement or floater policy should be considered. Under the basic or standard homeowner's insurance policy, It is common to be compensated for about $1,000 for any jewelry or furs that are burned in a fire or stolen. So if there are items in the possession of the homeowner, he or she should consider the purchase of additional coverage for protection.

Services Office (ISO) does not constitute the extent of tailoring possible with respect to homeowners forms. The ISO homeowners manual states that "in all cases not specifically provided for in this manual," the rules, rates, forms, and endorsements of individual insurers govern each coverage. This makes it possible for insurers to develop special endorsements as the need arises when the proposed risk is considered insurable and that an appropriate premium can be obtained.

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Personal Property Loss Endorsement

Scheduled Personal Property Endorsement HO 04 60; HO 04 61
Most insurance policies limit the coverage that is provided for personal property, especially certain categories of personal property. Many policies may limit the loss of money to $100 to prevent insureds from claiming a high dollar value loss of money whenever a loss does occur. Jewelry is usually covered up to a certain amount but any individual item is only covered for a stated amount, regardless of actual value.

Personal articles insurance may be written in conjunction with a homeowners policy by using endorsement HO 04 61. This makes it convenient for a homeowners insured who wishes to broaden the scope of coverage on personal property by writing the coverage on an *open perils* basis, or who has value in excess of the limits specified in the homeowners form for certain categories of property—jewelry, furs, silverware, postage stamps, and coins. Additionally, an insured may have a fine arts collection in excess of the coverage C limit of liability, and if a total loss to the residence premises occurred, there would not be enough coverage for both personal belongings and the collection—an unpleasant prospect.

The cost is usually determined on a "per thousand" dollar basis for the homeowner who has coin collections, cameras, and jewelry in excess of the stated amount of coverage for these categories. The cost per thousand is often nominal when compared with the risk of loss. If you have items of high value, make certain that there is no limitation to their coverage. If there is, have the items appraised by a certified appraiser and then get the insurance company to add a rider to cover the additional value of personal property.

Despite its appearance as a mere endorsement attached to the homeowners policy, the personal articles floater remains a separate contract. The 2000 program offers a new version of this endorsement: scheduled personal property endorsement (with agreed value loss settlement) HO 04 60. Endorsement HO 04 61 offers agreed value loss settlement only for fine arts; the HO 04 60 offers agreed value loss settlement for all articles scheduled. For example, an insured may have scheduled under an HO 04 61 a $75,000 grand piano that is damaged

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in a tornado. If the insurer elects the repair option, the insured could wind up with a shoddily-repaired instrument. But with the agreed value option, the insured is simply paid for the loss.

An important change in the HO 04 61, and incorporated into the new HO 04 60, is that the territorial restriction for fine arts to within the United States and Canada has been removed. The endorsement now provides worldwide coverage for all scheduled property.

Loss Assessment Coverage
Specially designed for condominium owners, this coverage provides protection for assessments made by a condominium association resulting from loss to the property. The policyholder can choose the limit of coverage they wish, up to $25,000, if the loss is caused by an insured peril.

Types of Theft Loss Endorsement

Theft Coverage Protection Endorsement
Most insurance policies have strict limitations with respect to coverage of personal property loss due to theft. To expand the amount of insurance for personal property due to loss by theft, purchase a rider for additional theft coverage under your homeowner's or renter's insurance policy. This particular endorsement covers up to $15,000 for expenses incurred by the insured as a direct result from identity theft. The policy deductible could be $250.

Identity Fraud Expense Coverage – HO 04 55
Introduced in 2003, this endorsement provides reimbursement of expenses incurred as a result of identity theft or fraud. Covered expenses, up to the $15,000 limit, include reasonable attorney fees to defend suits brought by merchants, financial institutions, or collection agencies, costs incurred to re-apply for any loans rejected solely because of incorrect credit information, lost income for time taken to meet with law enforcement officials or complete affidavits (maximum $200 per day; $5,000 total), and charges for long distance calls to report or discuss an actual identity fraud.

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A deductible of $250 applies. The insured must send receipts, bills, etc., documenting the claim to the insurer within sixty days of the insurer's requesting these.

Residence Rental Theft HO 04 80

This endorsement has been withdrawn with the 2000 homeowners program. It has been replaced by endorsement HO 05 41, extended theft coverage for residence premises occasionally rented to others. The major difference is that the HO 04 80 does not cover theft from that part of the rented premises if the loss is caused by a tenant, roomer or boarder, member of the tenant's household, or their employee. The HO 05 41 provides theft coverage from any part of the residence premises, even the rented part, and even if caused by the tenant, roomer or boarder, member of the tenant's household, or their employee.

Motorized Vehicle Loss Endorsement

Watercraft And Recreational Vehicle Endorsement

Many insurance policies exclude coverage for watercraft and other recreational vehicles commonly located (stored) at the primary residence. In addition, these vehicles are often excluded under standard automobile insurance policies. To obtain coverage for loss of these vehicles, many insurance companies offer an optional rider. This endorsement extends the limit of liability on the homeowner's policy to your watercraft. This does not cover for the physical loss of the watercraft.

Owned Snowmobile -- HO 24 64

Liability coverage for use of an owned snowmobile away from an "insured location" as defined in the policy may be purchased. The endorsement used with the 1991 forms appears considerably different from that used with the 2000 forms; this is because much of the exclusionary language of the earlier endorsement has been incorporated into the 2000 homeowners forms (section II "Motor Vehicle Liability"). For example, the 1991 endorsement states that the coverage does not apply to any snowmobile subject to motor vehicle registration. The 2000 endorsement refers to exclusion A.1., which states that there is no coverage if the "motor vehicle" is required by law or a governmental

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agency to be registered for use on public roads or property. It is important, therefore, to read both the policy itself and the endorsement.

Home Business Related Endorsements

Special Computer Coverage HO 04 14

This endorsement may be used with all homeowners forms except the HO 00 05, HO 00 04 with the HO 05 24 (*open perils* coverage) attached, or the HO 00 06 with the HO 17 31 (*open perils* coverage) attached. It covers computers and computer equipment against additional covered causes of loss. "Computer equipment" is defined as: (1) electronic data processing hardware, CRT screens, disk drives, printers and modems, and other "related peripheral equipment;" and (2) disks, tapes, wires, records, or other software media that are used with the equipment described in (1). Subject to certain exclusions, coverage is modified to cover such property on an *open perils* basis.

Many of the endorsement's exclusions parallel those applicable to *open perils* coverage for personal property in form HO 00 05, such as wear and tear, smoke from agricultural operations, or refinishing, renovating or repairing. The form used with the 2000 edition differs from that used with the 1991 homeowners in that the revised definition of "computer equipment" means hardware, software, operating systems or networks, and other electronic parts, equipment of systems solely designed for use with or connected to the computer.

Note that the homeowners forms exclude coverage for "business data" stored on software media but do not apply such an exclusion to personal records. An insured who loses personal records and has to spend time recreating them may recover for the time spent, although the amount of recovery will probably be minimal. Endorsement HO 04 14, which applies only to "equipment" and not to records or data, does not increase the coverage available under the form for personal data.

For an additional premium, this would broaden the coverage for your computer due to direct physical loss. For example, if the policyholder drops a glass of water on the computer, this would be covered. This endorsement is subject to the policy deductible.

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Home Day Care Coverage Endorsement -- HO 04 97

Property and liability coverage for a home day care business is available to a homeowner under endorsement HO 04 97. If the business is conducted in another structure, a limit of liability for that structure is scheduled on the endorsement. The endorsement protects personal property of the described business under the total coverage C limit.

As to the section II personal liability and medical payments coverage, bodily injury or property damage arising from the following are excluded: ownership, maintenance, use, loading, unloading, negligent supervision, or entrustment by the insured to others of draft or saddle animals, or vehicles used with them, aircraft, hovercraft, all motorized land conveyances, or watercraft, whether owned, operated, or hired by or for the insured or employee, or used by the insured for instruction in their use. Excluded also is injury to any employee of an insured, arising out of the day care operation. All other section II exclusions apply.

The endorsement also imposes a policy year aggregate limit for liability and medical payments combined. The limit corresponds to the coverage E limit shown in the declarations, with a further per person per accident sublimit for day care related medical payments equal to the coverage F limit. The sublimit applies within the aggregate limit of liability. Limits described on the endorsement apply even if they are not those contained in the policy or declarations. The severability of insurance clause specifies that coverage applies separately to insureds except with respect to the aggregate limit, so the aggregate limit remains unaffected by the number of insureds.

Home Business Insurance Coverage HO 07 01

This endorsement has been renumbered in the 2000 homeowners program. Previously it was HO 05 90. When this endorsement is attached to a homeowners coverage form, Section II liability is expanded to address the majority of situations the home businessowner may encounter. Definitions are amended or added in accordance with the coverage provided. It provides both business property and liability coverage for a variety of home businesses which is owned by the named insured, or by a partnership, joint venture, or

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organization comprised solely of the named insured and resident relatives. Coverage is provided for business property, property of others in the insured's care because of the business, and business property leased by the insured so long as there is a contractual responsibility to insure it. There is coverage for accounts receivable and valuable papers and records.

Time element coverages include business income, extended business income, extra expense, and loss of business income because of the action of civil authority (subject to a 72-hour time deductible). Liability coverage is on an aggregate basis, and includes coverage for premises operations, advertising injury, and personal injury. Coverage for the products/completed operations hazard is limited to the amount shown for coverage E; all other business liability is limited to twice the combined limits of coverages E and F.

The exclusion of liability arising out of or in connection with a "business" (2.a.) has been changed so that the exclusion does not apply to "your product" or "your work"—both defined terms. There is, however, no coverage for professional services, many of which are listed in the endorsement.

ISO has added endorsements that may be used with the home-based business coverage form to broaden or restrict liability coverage as the need arises.

- The first of these is HO 07 50 additional insured -- managers or lessors of premises leased to an insured. The definition of insured is extended to include a person or organization, but only with respect to their liability arising out of the ownership, maintenance, or use of premises leased to the insured businessowner. The person or organization and the leased premises must be designated in the schedule.
- Endorsement HO 07 51 additional insured -- vendors extends the definition of insured to include a vendor who distributes or sells the insured business's products. Liability applies only with respect to bodily injury or property damage arising out of the products. There is no coverage for the vendor's assumption of liability in a contract or agreement; however, liability for damages that the vendor would have had in absence of a contract or agreement is covered.

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- Endorsement HO 07 53 exclusion -- personal and advertising injury may be attached when, for example, the nature of the business is such that the underwriter perceives an unacceptable exposure for personal and advertising injury. This endorsement deletes all coverage for such injury.
- Finally, endorsement HO 07 59 sections I and II -- limited coverage for year 2000 computer-related and other electronic problems extends coverages E and F to apply to bodily injury or property damage arising out of computer failure. Computer failure is a defined term meaning the failure or deficiency of a computer, including hardware, software, systems, networks, or other electronic parts including media.

Weather or Natural Disaster Related Endorsements

Increase Wind & Hail Deductibles
By increasing the deductible for these types of losses, the policyholder may lower the cost of annual insurance premium. For example, increasing the regular $500 deductible to a $1000, 1% or 2% may decrease the annual premium significantly.

Sinkhole Collapse HO 04 99
This endorsement provides coverage for direct physical loss to insured property caused by "sudden settlement or collapse of the earth supporting such property and only when such settlement or collapse results from subterranean voids created by the action of water on limestone or similar rock formations." In conjunction with this coverage agreement, the endorsement removes sinkhole collapse from the earth movement exclusion.

Earthquake HO 04 54
There is no coverage for loss resulting from "earth movement" except when endorsed. An insured may add earthquake as an insured peril for coverages A (dwelling), B (other structures), and C (contents) by adding this endorsement.
The endorsement defines as a "single earthquake" all earthquake shocks occurring within a 72-hour period.

In the endorsement used with the 1991 edition (04 91), the base deductible is 5 percent of the limit that applies to all section I coverages (but not less than

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$250). The deductible may be increased for a premium credit. No other deductible applies to earthquake loss. The 06 94 edition of the endorsement eliminated the application of the deductible to coverage D and the additional coverages, which was the case of the earlier edition, and clarified the intent of the application of the deductible to the limit of insurance, not to the amount of the loss.

In the current edition, the percentage deductible is converted into a dollar deductible by multiplying either the coverage A or coverage C limit of liability, whichever is greater, by the deductible percentage. $250 is the minimum. Like other forms of earthquake insurance, the endorsement excludes flood and tidal wave, even when caused by or contributed to by an earthquake.

Structure Related Endorsements

Extended Replacement Cost on Dwelling

This endorsement can be used to increase Coverage A (dwelling) by either 25% or 50 % to better accommodate a customer's needs.

Secondary Residence Premises Endorsement

If the homeowner also owns a vacation home, it is important to maintain coverage for that residence as well as the primary residence. Like income property, many insurance companies offer secondary residence (vacation) premises coverage as a rider to the homeowner's insurance policy.

Special Loss Settlement HO 04 56

This endorsement may be used with forms HO 00 03, HO 00 03, and HO 00 05 only. The standard loss adjustment for buildings is on a replacement cost basis when the amount of insurance on the damaged building at the time of loss is at least 80% of the building's full replacement cost. Endorsement HO 04 56 is used to reduce the percentage of insurance to value that is required before losses will be adjusted on a replacement cost basis. Manual rules allow a reduction to 50%, 60%, or 70% of the property's replacement cost.

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Chapter 15
Guide to Federal Regulation and Legislation

Since the 1960s, federal legislation has primarily targeted flood hazards from an insurance perspective. The National Flood Insurance Program (NFIP) was created in 1968 to decrease federal expenditures on disaster relief and create disincentives for developing land in flood-prone areas. NFIP requires property owners in flood-risk communities to buy flood insurance. Insurance premiums are then used to compensate victims of flood damage. Additionally, differential premium costs create incentives for developers to adopt newer building standards that reduce potential flood damage.

NFIP insurance rates are set by determining a region's risk of flood. The Federal Emergency Management Agency (FEMA) uses flood maps to assess the likelihood of regional flooding. Areas that have a 1% annual chance of flooding, a standard known as "the 100-year flood," are designated Special Flood Hazard Areas (SFHA) and required to participate in NFIP. For the past several years, flood insurance legislation has targeted updating, modernizing, and digitizing FEMA's flood maps.

National Flood Insurance Reform Act of 1994

This act resulted in major changes to the National Flood Insurance Program (NFIP). The law amended the Flood Disaster Protection Act of 1973. It provides tools to make the NFIP more effective in achieving its goals of reducing the risk of flood damage to properties and reducing Federal expenditures for uninsured properties that are damaged by a floods.

The 1994 National Flood Insurance Reform Act (the 1994 Reform Act) is part of Title V of the Riegle Community Development and Regulatory Improvement Act of 1994 and amended 42 U.S.C. §4001 et seq. The 1994 Reform Act imposes significant new obligations on lenders and servicers and tightens the requirements on the receipt of disaster assistance.

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Flood Insurance Reform and Modernization Act of 2007

Representative Barney Frank (D-MA) introduced legislation on March 26, 2007 to expand the breadth of coverage of the National Flood Insurance Program (H.R. 1682). The reform of the 1968 National Flood Insurance Act directs the Federal Emergency Management Agency (FEMA) to create an appeal process for those insured by the program as well as a program to update flood maps. The bill also authorizes efforts to make the federal flood program more visible to those eligible but unaware of its availability. On June 12, 2007, the House Financial Services Subcommittee on Housing and Community Opportunity invited flood experts to discuss the bill's attributes, but no action has been taken since that hearing.

Flood Disaster Protection Act of 1973

This Act is to expand the national flood insurance program by substantially increasing limits of coverage and total amount of insurance authorized to be outstanding and by requiring known flood-prone communities to participate in the program, and for other purposes.

The Flood Disaster Protection Act of 1973, which also amended the 1968 Act, required the purchase of flood insurance by property owners who were located in special flood hazard areas and were being assisted by Federal programs, or by Federally supervised, regulated, or insured agencies or institutions. This act also severely limited Federal financial assistance in the flood hazard areas of communities which did not join the NFIP. It also required lenders to notify borrowers of federal disaster relief unavailability in non-participating communities.

In 1994, the Act went through its first major revision since the inception -the NFIP. Included in this revision were provisions that if a lender escrowed an account for anything and the structure is in the floodplain, then the lender must escrow for flood insurance. Other highlights of the revised legislation included increased flood insurance limits and the elimination of the 1362 buy-out

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program. However, the legislation did initiate the Hazard Mitigation Fund as part of the flood insurance policy.

This made it possible to cover the cost of elevating a continuously flood damaged home through the insurance policy. Also included in this legislation was the increase from a five-day waiting period to 30 days for a new policy to become effective. It also prohibits the waiver of flood insurance purchase requirements as a condition of receiving federal disaster assistance, and if the flood insurance policy is not maintained, in the event of another disaster, no disaster assistance will be made available for that structure.

From 1968 until the adoption of the Flood Disaster Protection Act of 1973, the purchase of flood insurance was voluntary. Property owners could make their own decisions whether to purchase flood insurance. However, the 1973 Act mandated flood insurance coverage for many properties. For the first time, regulated lending institutions could not make, increase, extend, or renew any loan secured by improved real estate or located in an SFHA in a participating community unless the secured building and any personal property securing the loan were covered for the life of the loan by flood insurance.

This measure was necessary because, after major flooding disasters, it became evident that relatively few individuals in eligible communities who sustained flood damage had purchased flood insurance. An eligible community is a political subdivision with the authority to enact regulations in identified SFHAs. Although nearly all the eligible communities are now in the Program, fewer than 25% of the eligible buildings are actually covered by flood insurance policies.

Homeowners Protection Act of 1998

f a homeowner puts less than 20% down on a home mortgage, lenders often require him or her to have Private Mortgage Insurance (PMI). PMI protects the lender if the homeowner defaults on the loan. The Homeowners Protection Act of 1998 - which became effective in 1999 - establishes rules for automatic termination and borrower cancellation of PMI on home mortgages. These protections apply to certain home mortgages signed on or after July 29, 1999 for

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the purchase, initial construction, or refinance of a single-family home. These protections do not apply to government-insured FHA or VA loans or to loans with lender-paid PMI.

The Homeowners Protection Act of 1998 (the Act) was signed into law on July 29, 1998, and became effective on July 29, 1999. The Act was amended on December 27, 2000 to provide technical corrections and clarification. The Act, also known as the "PMI Cancellation Act," addresses homeowners' difficulties in canceling private mortgage insurance (PMI) coverage. It establishes provisions for canceling and terminating PMI, establishes disclosure and notification requirements, and requires the return of unearned premiums.

The Homeowners Protection Act of 1998 provides that consumers can ask lenders to end PMI coverage when owners have 20% equity. Many lenders -- if asked -- already allow cancellation once the difference between market value and debt is at least 20%, the owner has a good credit history, and an appraisal confirms market value. When equity reaches 22%, PMI policies must be automatically canceled under the new federal rules.

The "cancellation date" under the automatic termination provision is defined as the date when the loan is "first scheduled to reach 78% of the original value of the property securing the loan." The optional "cancellation date" occurs when the amortization schedule requires the loan balance to be "80% of the original value of the property securing the loan" -- or sooner, if a borrower has made extra payments to reach the 80% level.

Homeowners Insurance Protection Act of 2009

The Homeowners Insurance Protection Act of 2009 is a law designed to reduce the unnecessary payment of private mortgage insurance (PMI) by homeowners who are no longer required to pay it. The Homeowners Protection Act mandates that lenders disclose certain information about PMI. The law also stipulates that PMI must be automatically terminated for homeowners who accumulate the required amount of equity in their homes.

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Homeowners Insurance Protection Act of 2009 is also to establish a program to provide reinsurance for State natural catastrophe insurance programs to help the United States better prepare for and protect its citizens against the ravages of natural catastrophes, to encourage and promote mitigation and prevention for, and recovery and rebuilding from such catastrophes, and to better assist in the financial recovery from such catastrophes.

Homeowners Insurance Protection Act of 2009 instructs the Secretary of the Treasury to establish the National Commission on Catastrophe Preparation and Protection to advise the Secretary regarding estimated loss costs associated with contracts for reinsurance coverage. It authorizes the Secretary to make homeowners protection coverage available through contracts for reinsurance coverage. This Act restricts purchase of such coverage to eligible state programs and it prescribes criteria for state eligibility.

Homeowners Insurance Protection Act of 2009 also:

- Authorizes any insurer who participates in an eligible state program to establish a Catastrophe Capital Reserve Fund to hold funds on the Secretary's behalf to offset reinsurance claims.
- Directs the Comptroller General to study the national flood insurance program and hurricane-related flooding.
- Establishes the Consumer Hurricane, Earthquake, Loss Protection (HELP) Fund to: (1) make payments to covered purchasers under contracts for reinsurance coverage for eligible losses; and (2) pay for Commission operating costs and reinsurance program administrative expenses.
- Prescribes a minimum level of retained losses and maximum federal liability.
- Requires each contract for reinsurance coverage to provide insurance coverage against residential property losses to homes, including condominium and cooperative ownership, and the contents of apartment buildings. Cites covered perils.

Understanding Insurance Regulation

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Regulation can be defined as a finding set of rules to be applied by a body charged with overseeing the economic conduct of an industry. Regulation seeks to regulation monopolies. A natural monopoly occurs when economies of scale available and the production process are so large that the relevant market can be served with the least cost by a single firm. There are some authorities in the insurance industry who see the current state system as being overly complex, anticompetitive and unduly burdensome. The reason for this doom outlook is that the cumbersome state regulations increases the cost of compliance and delays the launching of new products. The issue of federal regulation has surfaced before, but in response to different circumstances. Currently, it is being driven by concerns about competition and cost inefficiencies.

Insurance Regulation and Legislation

Insurers today must navigate a risky public policy environment, reflecting the tensions between a traditional, but sometimes challenged, state regulatory system and emerging federal legislative actions that threaten to alter the operational landscape significantly. A significant portion of our regulatory work consists of due diligence reviews related to mergers and acquisitions and other transactions in the insurance industry and of procuring requisite regulatory approvals for such actions.

The Sherman Antitrust Act

The Sherman Antitrust Act was the first United States Federal statute to limit cartels and monopolies. It falls under antitrust law. Prior to its enactment, various states had passed similar laws, but they were limited to intrastate businesses. Finally opposition to the concentration of economic power in large corporations and in combinations of business concerns led Congress to pass the Sherman Act. The Act provides that every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.

Early decisions were only a minimal protection which came between insurance practices and the federal anti-trust provisions of the Sherman Anti-trust Act. The Sherman Anti-Trust Act is aimed at making or setting prices illegal. Insurance premium rates were considered "prices" and, therefore, they came

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under the Sherman Anti-trust Act. An association of two hundred fire insurance companies and twenty-seven individuals were indicted under the Sherman Anti-Trust Act for fixing noncompetitive rates and for monopolization.

The Sherman Act authorized the federal government to institute proceedings against trusts in order to dissolve them, but Supreme Court rulings prevented federal authorities from using the act for some years. The Sherman Antitrust Act authorized the Federal Government to dissolve the trusts by beginning with a statement that stated: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal." And it established penalties for persons convicted of establishing such combinations: ". . . shall be punished by fine not exceeding $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court."

The McCarran-Ferguson Act

The McCarran-Ferguson Act was passed by Congress in 1945 after the Supreme Court ruled in U.S. vs. South-Eastern Underwriters that insurance could be regulated by the federal government via the Commerce Clause, or, in other words, that insurance was interstate commerce. The insurance industry had operated successfully under state regulation, and the industry was concerned about changes, especially those which might relate to cooperatively determining rates on the federal side of the fence. The insurance industry, in the form of the National Association of Insurance Commissioners (NAIC), drafted a proposal which later became known as the McCarran-Ferguson Act.

The McCarran-Ferguson Act provides a limited exemption to the insurance industry from the federal antitrust laws. The act provides that the Sherman Act, the Clayton Act, and the Federal Trade Commission Act apply to the business of insurance "to the extent that such business is not regulated by state law." The McCarran-Ferguson Act essentially preserved the possibility for the individual states to continue to exercise their own responsibility for insurance rate regulation. However, the McCarran-Ferguson Act did not return the regulation of insurance rates entirely to the individual states. It only exempted the

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insurance industry from federal anti-trust legislation to the extent that the insurance business is actually regulated by state law.

The McCarran-Ferguson Act declares that the business of insurance is to be subject to regulation and taxation by the states. After passage of the act in 1945, all states enacted some form of rate regulation to qualify for the exemption. The practical import of the antitrust exemption has been eroded in recent years as courts have narrowed the definition of the business of insurance and broadened the definition of boycott and as an increasing number of states have subjected the industry to state antitrust law.

The main line of the McCarran-Ferguson Act is shown by this statement from the act itself -- *"Congress declares that the continued regulation and taxation by the several states of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several states" – and -- "The business of insurance, and every person engaged therein, shall be subject to the laws of the several states which relate to the regulation or taxation of such business. No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance"*.

The NAIC and the All Industry Committee is an organization created and comprised of representatives in all parts of the insurance field for the express purpose of creating and drafting model statutes.

Gramm-Leach-Bliley Act (GLBA)

The Gramm-Leach-Bliley Act is an Act of the United States Congress which repealed the Glass-Steagall Act, opening up competition among banks, securities companies and insurance companies. The Glass-Steagall Act prohibited a bank from offering investment, commercial banking, and insurance services. The Gramm-Leach-Bliley Act (GLBA) allowed commercial and investment banks to consolidate. Many of the largest banks, brokerages, and insurance companies desired the Gramm-Leach-Bliley Act at the time. The justification was that individuals usually put more money in investments when economy is good, but they put their money into savings accounts when it turns

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bad. With the new Act, they would do both with the same company, so it would be doing well in all economic times.

The Types of Regulators

Insurance is a legal promise, or a guarantee, to pay benefits if and when a certain event occurs. Insurance products are rooted in the separate contract, tort, and social policy laws of each state where they are sold. Because of this they require a more accountable, accessible type of protection that the states can best provide. Congress endorsed state oversight of insurance in 1945 with the McCarran-Ferguson Act and specifically recognized and reaffirmed the benefits of the state system in 1999 when it modernized federal financial supervision laws in the Gramm-Leach-Bliley Act (GLBA). However, now, the insurance industry lobbyists have pushed for a federal insurance charter and an entirely new regulatory regime in Washington to diminish or supplant successful and effective state-based consumer protections.

State vs. Federal Regulators -- The debate between state vs. federal regulation for insurance has been carried on for many years. Presently the regulation is primarily on a state-by-state basis. But the debate lies in the fact that some would like it to be with an option for federal oversight. State regulation has proven to be effective for over 130 years so why the discourse now. Some are saying, let's keep the state regulation but are rallying around modernizing the existing system. Those individuals who are favor of the federal option say it would relieve competitive pressures and allow the companies to operate on a global level.

While proponents agree that the current state regulatory environment needs to be modernized, they are confident that the overall mechanism that has served the industry well for more than a century can continue as a guiding force for insurers. "While there are things that need to be done to improve state regulation, it has successfully served customers over the years.

State regulation has shown the ability to evolve as situations change, has remarkable resilience and ability to adapt to change, and, in light of the economic environment in which insurers operate, we need to be more efficient in the way we do things. As proposals designed to place regulatory control in

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the hands of the federal government continue to be brought before legislators, supporters of state regulation believe these proposals will lessen the power of state regulators, jeopardize companies' competitive market structure and hinder consumer protection.

Even though the state vs. federal regulation debate is long-standing, the proponents who have fought to keep control of insurance regulatory power in the hands of the states are the American Insurance Association and the Council of Insurance Agents and Brokers. In 2000, the NAIC asked the industry how to streamline state regulation and bring it into line with the principles set forth by the Gramm-Leach-Bliley Financial Services Modernization Act because at the end of the day it is the states who have the incentive to do the job and are responsible for insolvencies and for problems that arise.

Group Regulation -- The many different regulations of individual states vary on about every angle that is possible, however, below there are some of the requirements which are most often imposed on the underwriting practices of group insurance. The first requirement is that **the group must meet minimum size requirements.** This means that many states' statutes stipulate that a minimum number of people must make up the group, usually ten. Another requirement here is that **the group must meet minimum participation percentages.** As much as 100% of eligible employees may be required to participate in the plan when an employer sponsors a noncontributory plan. It also pays the entire premium on behalf of its employees.

Under a contributory plan where the employees contribute toward the cost of their coverage, usually 75% of eligible employees are required to participate in the plan. Another requirement which we want to looking into is **the insurance must be incidental to the group –** This means that the purchase of group insurance must be incidental to the purpose of the group. However, a group whose purpose is to purchase group life insurance possibly consists of people whose health has prevented them from purchasing individual coverage at standard premiums. Now, the last requirement is that the **group size may be a consideration.**

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The actuaries at the insurance company go by various data received to calculate their risk. One risk that the underwriter and the actuary know is that when the group's is large and that group is maintained over a long period of time, the insurer can predict long-term loss costs. Since insurance regulations are made by each state so these regulations vary. But in some states the size of the groups insured is regulated and is limited in order to best serve the interests of the public.

In addition to all of these requirements, the insurer may have its own requirements. Most state regulations permit insurers who underwrite group insurance to have their own requirements in addition to the statutory requirements from the individual states. Some of these requirements refer to factors as age, sex, the stream of persons through the group, and other determinants.

Unauthorized Insurers Regulation

All agents and brokers should understand that the sale of unauthorized insurance products can have devastating consequences. Unauthorized health insurers often claim, falsely, that they are employer-sponsored plans shielded from state licensing and regulation by the federal Employment Retirement Income Security Act (ERISA) of 1974. Another disguise is that of a labor union health plan, also exempt under ERISA. Sham unions do not engage in legitimate collective bargaining and exist only to market fraudulent health plans.

No agent or broker shall, either knowingly or without adequate investigation of the financial condition and general reputation of the insurer, place insurance under this section with financially unsound insurers or with insurers engaging in unfair practices, or with otherwise substandard insurers, without giving the applicant notice in writing of the deficiencies of the insurer. To be financially sound, an insurer must be able to satisfy standards comparable to those applied under the laws of this state to authorized insurers.

Defining The Unauthorized Insurer

An unauthorized insurer is one that does *not* hold a valid certificate of authority to do an insurance business in this state. No person may do an insurance

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business in this state if the person knows or should know that the result is or might be the illegal placement of insurance with an unauthorized insurer or the subsequent servicing of an insurance policy illegally placed with an unauthorized insurer. Any person violating these conditions is personally liable to any claimant under the policy for any damage proximately caused by the person's violation. That damage may include damage resulting from the necessity of placing the insurance with an authorized insurer or the failure of the unauthorized insurer to perform the insurance contract.

Personal Liability on Claims -- If the insurer involved is unauthorized, no safety net exists if the insurer becomes insolvent. The individual agent or broker will potentially be required to pay any outstanding claims. Any person or entity who solicits, negotiates, or sells insurance in any particular state for an unauthorized insurer is the representative of that insurer and is strictly liable for any losses or unpaid claims if an unauthorized insurer fails to pay in full or in part any claim or loss within the provisions of any insurance contract sold, directly or indirectly, by or through that person or entity on behalf of the unauthorized insurer.

Adverse Administrative Actions -- In adverse administrative actions, the personality of an offender and his state of mind at the time of his misconduct determine the value of each action. In other words, what might work well with one soldier might be useless for another. Whatever the situation, it might warrant a combination of two or more of the actions which we are going to be listing below. The citizens of the states depend on insurance agents and brokers to protect them by providing insurance coverage through bona fide insurance carriers. It is the responsibility of the Department of Insurance in each state to take adverse administrative action against agents and brokers that sell consumers health plans or products offered by unauthorized insurers. These actions may include license revocations, license suspensions and/or fines.

Withholding Privileges -- Privileges may be withheld, privileges such as, pass privileges, to maintain good order and discipline. The privileges revoked should relate directly to the act of misconduct. Withholding privileges can be an incentive for improved behavior. Like other corrective actions, the

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effectiveness of withholding privileges depends on the communicating your intent and determination to the individual concerned. It also requires that the restriction relate in importance, seriousness, and duration to the transgression and to the desired correction. Too long or disproportionate an action can easily discourage the agent or other individual involved and hinder correction. It is advised to simply inform an offender that the privilege is being withheld. When a higher authority controls the activity, there is a request, through other channels, for the revocation of the privilege.

Admonitions And Reprimands – This is when an individual issues admonitions or reprimands, either oral or written, as administrative corrective measures. They may do so where and in the manner they deem most appropriate. Written admonitions and reprimands may be filed in a soldier's military personnel records jacket (MPRJ). Immediate supervisors of may issue written reprimands or admonitions, but they may not file them in the employee's or agent's file. Regardless of the issuing authority, an admonition or reprimand may be filed in the official military personnel file (OMPF) of an enlisted soldier or officer only upon direction of a general officer or an officer exercising general court-martial convening authority over them.

Identifying and Avoiding Unauthorized Insurers

The simplest and most reliable way to avoid unauthorized insurer problems is to ask the state's Department of Insurance whether the entity is licensed to conduct the business of insurance in that particular state. If the answer is yes and the company is selling a product that is within the scope of its license, the agent's unauthorized insurer inquiry is finished.

If the answer is no, the agent can avoid potential unauthorized insurer issues by simply refusing to do business with unlicensed companies or entities regardless of any claims of exemption from state insurance regulation. In the event an agent decides to further consider representing such an unlicensed entity, the agent should understand that he or she is assuming the responsibility for thoroughly investigating the entity, and is assuming the responsibility for engaging in a complex legal analysis of whether such an entity is an unauthorized insurer.

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Chapter 16
Guide to Insurance Ethics and Fraud

Establishing Ethics for Insurance Professionals

The American Institute for Chartered Property and Casualty Underwriters (AICPCU), the American College and the Society of Financial Service Professionals founded Ethics Awareness Month in 1990. While it is impossible for all insurance professionals to reach consensus on every aspect of their ethical ideology, those professional organizations have recognized the merit in providing a platform for continued ethics awareness and discussion.

The question of ethics and the insurance industry arises frequently. Ethics is the science of human duty; values are set of individual or expressed group beliefs that provide a basis for action. Often it is the industry expressing ethical concerns about fraudulent claims but it is also in the form of agent behavior. When discussing professional ethics, it is necessary to examine the core beliefs and underlying precepts that comprise our particular value system. What forms the basis for your values--is it religion, philosophy, family, tradition, society, mentor, etc?

For the good of the society, we should not unquestioningly embrace just any value system. Rather one could consider at least three universal precepts that exist in nearly every civilized society and in most every religion: honesty, respect for other persons and respect for others' property. Those ought to be the qualifying parameters for any belief system chosen by an insurance professional.

Considering Core Beliefs

Beliefs are those convictions or doctrines that we assume to be true. A belief system forms from a person's interpretation of and response to various life experiences. People's beliefs influence their choices, decisions and life directions. People sometimes act on beliefs without testing their validity, because beliefs can become synonymous with facts in their minds.

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Defining the terms "values," "ethics," and "social responsibility" is an almost impossible task yet the first two could be interchanged. One of the core beliefs is honesty. Without honesty, there is no chance of a successful business relationship. While dishonesty is destructive in one's personal life, it usually is fatal in business. People are inclined to be more forgiving in personal relationships than they are in business relationships. One dishonest act can tarnish an entire career. Would you buy anything from someone you knew to be dishonest?

The second core belief is respect for other persons. Disrespect could manifest itself by such actions as rudeness, harassment, slander, discrimination, abuse, assault and murder. Some transgressions of this tenet, as well as the other two, are so nefarious that there are laws against such behavior. While there may be no law against rudeness, would you continue to do business with someone who was rude to you?

The third core belief is respect for a person's property. Disrespect could manifest itself by such actions as neglect, carelessness, vandalism, theft and destruction. Property and casualty insurance producers are in the express business of preserving the assets of clients. Disrespect for a person's property is the antithesis of the noble mission of an insurance professional.

Accountability

Once you have identified the basis for your values, ask what authority that basis holds over your life. A moral or ethical person can be without accountability. That seems hard to believe but it can be. Everyone is ultimately accountable to our justice system, but that is negative accountability, occurring after the deeds have been done. Each individual, particularly those who are striving for a high ethical plain have to make themselves voluntarily accountable to someone. No matter one's age or social status or career heights, it is vitally important to be accountable to someone. Me, myself, and I can become so tangled up in me, myself, and I that this individual has one perspective and one focus.

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Find your own accountability upon which to build your ethics. It may be important at this point to determine from where were your core values derived. Were they derived from your religious faith, from parents and grandparents, from philosophers? The important thing is that each individual and each professional knows where his or her ethical foundation lies and to whom you are accountable to.

Integrity

People do not always behave in a way that is consistent with their moral code. In other words, people do not act according to their beliefs at all times. Perhaps we all are hypocrites, to some degree because there is something about our nature that gets in the way of moral perfection.

Overcoming the tendency to deviate from a moral code requires discipline of will. Since many people look upon discipline as unpleasant accountability is of great assistance.

However, when an individual acts consistently with his or her beliefs, no matter what the circumstances, then he or she is considered to have integrity. Someone with integrity is the same whether they are in the light of public exposure or in the darkness of solitude. A business woman or man should look on integrity as one of the most sought after assets.

Leadership

Leadership and the gift of a moral compass are communicated by managers of a company. In an insurance agency, the insurance agents could read the moral direction by the way management treats such matters as the proper licensing of employees, fair treatment of competitors, full disclosure to insurers and faithful control over other people's money. The two areas where producers are most vulnerable are in their stewardship of money and handling of information.

Think for a moment about the impact a manager has on subordinates. If the manager has moral clarity and a disciplined will, the worker will be governed by the manager's integrity. If the manager has moral clarity but an undisciplined will, the worker will be governed by the manager's hypocrisy. If the manager has moral confusion but has a disciplined will, the worker will be

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governed by the manager's tyranny. If the manager has moral confusion and has an undisciplined will, the worker will be governed by the manager's anarchy.

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Professionalism

On one end of the spectrum are people who work solely for monetary gain, and on the other end are people who work to pursue a vocation. These individuals are referred to as professionals. Henry David Thoreau proposed this aspiration: "Aim above morality. Be not simply good; be good for something." That simple statement goes a long way toward defining a professional.

To be an insurance professional means having a passion about coming alongside people to help when they are experiencing some of the worst moments of their lives. In the Gulf States, this industry has heroes who go far beyond their job expectations and give selflessly to those in distress. Many employees toil numerous hours each week to help the industry achieve its full potential.

The Ethical Landscape of The Insurance Industry

Corporate ethics is taking on increased prominence at U.S. companies. The current investigations of the insurance industry emphasize the need for stricter adherence to ethical market conduct standards. It is not exempt from ethical dilemmas. It is a part of the fabric of so much of life – health, property, auto, fire, to name a few. But some say that the only people that will be ethical, with new laws, will be the ones that were ethical before the law was in place.

This is a new revelation that ethics happens within an individual and actually cannot be coerced from the outside. Just like those employed in other areas of business, those working in the insurance industry face a variety of ethical dilemmas on a daily basis and often encounter various factors that present challenges to their efforts to resolve these dilemmas in an ethical manner. Likewise, just as other areas of business face occasional sensational and highly publicized examples of unethical behavior by major corporations, so does the insurance industry.

There has been a recent spotlight on the insurance industry which is a powerful reminder that ethical business practices are more than just the right thing to do. The need for rigorous standards of ethical business practices is key to any

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discussion about the future of market conduct regulation. This decade, it has been the property-liability insurance industry's turn to face charges of unethical/illegal behavior on the part of its largest insurance companies and brokerage firms. Eleven issues which have received low ratings ethically in the insurance industry are:

- Failure to identify the customer's needs and recommend products and services that meet those needs;
- Lack of knowledge or skills to competently perform one's duties;
- Pursuit of personal financial gain or other personal benefits interfering with the proper performance of one's duties;
- Conflicts of interest involving business or financial relationships with customers, suppliers or competitors that influence, or appear to influence, one's ability to carry out his or her responsibilities;
- Failure to provide prompt, honest responses to customer inquiries and requests;
- Misrepresenting or concealing limitations in the ability to provide services;
- Failure to provide products and services of the highest quality in the eyes of the customer;
- False or misleading representation of products or services in marketing, advertising or sales efforts;
- Making disparaging remarks about competitors, their products or their employees or agents;
- Inaccuracy of books, records or reports;
- Failure to be objective with others in one's business dealings.

The Need for Ethical Education

Business schools have been under pressure to improve their teaching of ethics in the wake of corporate scandals over the last few years. In January 2004, business schools and the Business Roundtable, an association of CEOs, joined together to form a new ethics institute. Its function was to be to conduct research, create courses, and lead executive seminars on business ethics. The Institute is a first step toward convincing business schools to take that information and overhaul their curricula, which is what is really needed.

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Ethics and Marketing

Most theories on marketing ethics depict that organizational norms of ethics and ethical policy will affect individuals' personal ethical philosophies and subsequently influence their ethical judgment and behavior. This is based on the conceptualization of organizational ethical culture and the prior empirical evidence. An organizational environment with a positive ethical culture may lessen the potential role conflict in marketing managers.

The following hypotheses are formulated accordingly:

- Marketing managers in organizations with more ethical culture are more idealistic than those in organization with less ethical culture.
- Marketing managers in organizations with more ethical culture are less relativistic than those in organization with less ethical culture.

Understanding Ethics and Policy Replacement

Replacement, in the life insurance context, means buying a new policy with the intent and understanding that an existing policy will be canceled, or "replaced." Replacement became a huge problem in the insurance industry in the 1970s and '80s when interest rates were high. Replacement is not necessarily bad in every situation, but a new policy issue typically carries with it a new contestability period for undisclosed conditions and new start up costs, together with the fact that the policyholder usually pays a surrender charge on the canceled policy.

The NAIC has adopted the Life Insurance and Annuities Replacement Model Regulation, and various states have passed legislation to address inappropriate life insurance policy replacement. Studies have shown that up to 93% of policies should not be replaced during policy years three through ten based on a hurdle rate of 5%. Replacing a policy should be based on whether the client will be as well off, or better, after replacing one policy with a new one.

To make the insurance industry more professional, most life insurance applications now include a question asking if this new policy is replacing an old one. If so, the agent must provide a detailed explanation. Additionally, most

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states now require life insurance agents to file "notifications of replacement" with their state insurance commissions and to comply with various regulations.

Normally it is that that unwarranted replacement of life insurance policies was a regulatory and consumer protection problem stemming from agents who had inadequate tools, inefficient understanding, and limited information for consumers to properly analyze life insurance cost and performance. Replacing an existing life insurance policy with a new one generally is not in the policyholder's best interest, however, replacement is not something to be avoided altogether. The agent must realize that there are circumstances where it makes sense to replace an old policy with a new one.

It is felt by many that the current NAIC Life Insurance and Annuities Replacement Model does not adequately address the financial consequences to consumers from policy replacement. This is true because the model regulation does not include a financial decision framework that measures the performance of the existing policy and whether it is valid to replace it. Universal life policies, show that 93% of in-force life insurance policies should not be replaced during policy years three through 10.

Policy Replacement and Start-Up Costs

Usually most new policies impose start-up costs. The consequence of this is that when a consumer makes a replacement, the client might be paying those costs twice. Most new policies contain a two-year period for both suicide and contestability so a replacement policy would restart the time-period making benefits not paid for within the first two years. Under some circumstances, the surrender of a policy results in taxable income unless the transaction qualifies as a Section 1035 exchange.

Agent and company misconduct, primarily in the form of misrepresentation, has been covered in relation to what is called "replacement." Simply stated, replacement, in the life insurance context, means buying a new policy with the intent and understanding that an existing policy will be canceled, or "replaced."

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Riders add significant value to a policy by enhancing an existing policy with a customized additional benefit or keeping an existing policy "as is" and buying another.

Unethical Policy Replacement Issues

Replacement became a huge problem in the insurance industry in the 1970's and 1980's when interest rates were high. Agent and company misconduct, primarily in the form of misrepresentation, has been covered in relation to what is called "replacement. Abuses of life insurance replacement are usually referred to as "twisting" or "churning," depending on the factual setting. "Replacement" means any transaction in which a new life insurance policy or annuity contract is to be purchased and it is known or should be known to the proposing producer, or to the proposing insurer if there is no producer, that by reason of the transaction, an existing life insurance policy or annuity contract has been or is to be:

- Lapsed, forfeited, surrendered or partially surrendered, assigned to the replacing insurer, or otherwise terminated;
- Converted to reduced paid-up insurance, continued as extended term insurance, or otherwise reduced in value by the use of nonforfeiture benefits or other policy values;
- Amended so as to effect either a reduction in benefits or in the term for which coverage would otherwise remain in force or for which benefits would be paid;
- Reissued with any reduction in cash value;
- Used in a financed purchase;

There are also potential tax problems and replacements often occur in the context of Internal Revenue Code 1035 like-kind exchanges. It has been estimated that as much as 40% of the life insurance currently in force in the United States is a result of replacement.

Policy Illustrations from an Ethical Aspect

Ethics is an attitude that needs to touch every aspect of the customer relationship. It entails having great reverence for the customer's needs, being

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open to suggestions and insights that might enhance his / her comfort levels, building in riders and flexibility options that address these needs, providing assistance and clarity in documentation and upgrades, and settling claims on time. Ethics means being fully accountable, not just to the company and to its customers, but to the industry served. The inspiration for ethics comes from the highest source - from a need to impact the industry.

Computerized policy illustrations have been developed to demonstrate policy growth and changes over the policy life. These illustrations they should not be considered predictions of a policy's potential or future performance. The assumptions on which the illustration is based may or may not be valid at any point in the future. A great deal of litigation in the 1980's resulted when consumer groups charged that the insurance industry was misleading clients in not distinguishing between guaranteed values and benefits and those that are not guaranteed.

Today, insurance companies stress the assumptions inherent in policy illustrations and suggest strongly that illustrations show a variety of policy pricing schemes, with differential company and product performance examples. In addition, the American Society has developed a "Professional Practice Guideline" (PPG) and an "Illustration Questionnaire (IQ) to assist the agent's demonstration of insurance products. These tools do not predict performance, and should be used responsibly, with clarification of guaranteed versus non-guaranteed performance features.

Insurance companies do not assume responsibility for policy performance so the risk of policy shortchanging is borne by the holder of the policy. The agent has an ethical obligation to clarify these points, as well as assess risk to the buyer. Reviewing the details of a policy's purchase and the projections based on these factors will go far in elucidating significant points and assumption. In using policy illustrations, the agent should not only understand, but also communicate to the client the following things:

- A comprehensive assessment of the policy illustration's assumptions vs. their direct influence on policy performance
- Guaranteed vs. non-guaranteed values

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- Realistic assumptions realistic vs. unrealistic for specific prices and projections

Clearly understanding the paperwork often necessitates that the client receive a short education in insurance terminology. This is by no means an exhaustive list, so be sure to explain important terms and concepts with which your client may not be familiar. Life insurance policy illustrations are typically not guaranteed and are often exaggerate the financial success of an investment.

Ethical Responsibility and Sales Illustrations

When looking at the sales illustrations for various policies, the consumer should look at the items that are going to be common across all companies and compare those figures for similar policies. Illustrations are projections into the future and usually include both guaranteed and non-guaranteed elements.

Permanent policies should have both a good cash value build up and good cash surrender value, should the consumer need to terminate the policy. The cash surrender value he would receive is the cash value amount minus administrative fees. Although a consumer may be shown an illustration of cash accumulation value, this is not necessarily the amount he would receive upon surrender of the policy. If he is looking at two policies, both with the same death benefit, interest rate, and premium, the one with the higher cash surrender value is probably the better buy.

Some policy illustrations used during a sales presentation can be misleading. The advent of computer software led some companies to aggressively distribute insurance illustration software, assuming interest rates of up to 13% or 14% throughout the policy's life. Other companies figured out a way to override the maximum assumed interest rate and plug in their own numbers of as much as 19%. If the software would not allow this override, the agent would pay to have a simple spreadsheet program of his own developed for use in marketing permanent life insurance policies.

Some insurers appear to give far higher cash values than the consumer would get from similar policies, even though the premiums are similar. Those companies may be using assumptions (in future interest rates) that are

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unrealistic. Most states have adopted regulations developed by the National Association of Insurance Commissioners that should help show the consumer more realistic values when shopping for any type of life policy. Each agency should comply with this standard.

Deceptive Sales Practices

Even if the deception is unintentional, the agent has done the client a great disservice. A presentation is deceptive if:

- it gives a prospect or client the wrong impression about any aspect of an insurance policy or plan;
- it does not provide complete disclosure to a prospect or client;
- it includes misleading or inconclusive product comparisons.

Defining Insurance Fraud

Insurance fraud is any act committed with the intent to fraudulently obtain payment from an insurer. The dictionary defines fraud as the intentional perversion of truth to induce another to part with something of value or to surrender a legal right. Insurance fraud can be "hard" or "soft." Hard fraud occurs when someone deliberately fabricates claims or fakes an accident. Insurance fraud has existed ever since the beginning of insurance as a commercial enterprise. Fraudulent claims account for a significant portion of all claims received by insurers, and cost billions of dollars annually. Types of insurance fraud are very diverse, and occur in all areas of insurance. Insurance crimes also range in severity, from slightly exaggerating claims to deliberately causing accidents or damage.

Fraudulent Activities

Fraudulent activities also affect the lives of innocent people, both directly through accidental or purposeful injury or damage, and indirectly as these crimes cause insurance premiums to be higher. Insurance fraud poses a very significant problem, and governments and other organizations are making efforts to deter such activities.

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Insurance fraud involves deceptive claims, perpetrated against an insurer. While that intuitive response is correct as far as it goes, it is incomplete. Insurance fraud includes, but is not limited to, claims fraud, and it can hurt a wide range of victims including policyholders, prospective customers, employees, and the insurance company.

No one knows how much insurance fraud costs. It has been estimated that insurers lose approximately $120 billion annually in fraudulent claims alone, as follows: $95 billion in fraudulent health care claims, $20 billion in such property and casualty insurance claims, and $5 billion in life and disability claims.

Commingling Funds

Agents and brokers by law are regarded as acting in a fiduciary capacity in their handling of premium funds. They must use utmost care in what they do with these funds. The agent or broker may not commingle funds or mix premiums collected on behalf of insureds with any other funds held for business or personal use. They must have the express consent of each insurer they represent to establish a Premium Fund Trust Account (PFCA) for funds held by them due the company. However, they do not have to maintain a separate PFTA for each company as long as the funds held for each company can be reasonably determined from the agency records.

Unauthorized Insurers

Representing or aiding unauthorized insurer prohibited. No person in a state can directly or indirectly act as agent for, or otherwise represent or aid on behalf of another, any insurer not then authorized to transact such business in a particular in the solicitation, negotiation, procurement or effectuation of insurance or annuity contracts, or renewal thereof, or forwarding of applications for insurance or annuities, or the dissemination of information as to coverage or rates, or inspection of risks, or fixing of rates, or investigation or adjustment of claims or losses, or collection or forwarding of premiums, or in any other manner represent or assist such an insurer in the transaction of insurance with respect to subjects of insurance resident, located or to be performed in any particular state.

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Solicitation, effectuation or delivery of any insurance contract, by mail or otherwise, within a particular state by an unauthorized insurer, or the performance within that state of any other service or transaction connected with such insurance by or on behalf of such insurer shall be deemed to constitute an appointment by such insurer of the Commissioner and his/her successors in office as its attorney, upon whom may be served all lawful process issued within a state in any action or proceeding against such insurer arising out of any such contract or transaction, and shall be deemed to signify the insurer's agreement that any such service of process shall have the same legal effect and validity as personal service of process upon it in a particular state.

By law, only state-authorized or licensed insurers may issue policies in that state. Consequently, the insurance agent must make sure that the insurer he or she is representing is licensed to do business in that particular state. State guaranty funds operate in much the same way as the FDIC does for banks and other institutions. The funds provide a means for paying at least part of an insured's losses if the property-casualty insurer becomes insolvent and is unable to meet its obligations to its policyholders. The amount of reimbursement is subject to both a deductible and a limit of liability, depending on the state. A state's guaranty fund only covers the liabilities of authorized insurers. Anyone purchasing policies from unauthorized or unlicensed companies is at risk if those insurers cannot meet their claims.

Misrepresentation and/or False Advertising

Agents have an ethical duty to present their policies in a truthful and open manner. Misrepresentation is any written or oral statement that does not accurately describe a policy's features, benefits or coverage. States have enacted laws that penalize agents who engage in this practice. Misrepresentation or false advertising includes: issuing, circulating or making false estimates, illustrations or statements about the provisions of a policy, its benefits or advantages or about the general condition of any insurer. It is also unlawful to make any misleading representation or comparison of companies or policies to insured persons to induce them to forfeit, change or surrender that insurance.

Twisting

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Twisting is the act of distorting something so it seems to mean something it was not intended to mean. It means for the agent to use extreme or unethical pressure or influence in an effort to compel someone to act in a certain way Virtually every jurisdiction prohibits the act of twisting and harshly penalizes any offender. Twisting is the unethical act of persuading a policy owner to drop a policy solely for selling another policy, without regard to possible disadvantages to the policy owner.

By definition, twisting involves some kind of misrepresentation by the agent to convince the policy owner to switch insurance companies and/or policies. Although twisting applies largely to life insurance policies, most states have regulations in place that require agents and brokers to provide policy owners with enough information to make an informed decision concerning the replacement of any existing policy.

Two Categories of Fraud

Fraud cases fall broadly into two categories: internal and external fraud. Internal frauds are those perpetrated against a company or its policyholders by agents, managers, executives, or other employees. External fraud schemes, on the other hand, are directed against a company by individuals or entities as diverse as medical providers, policyholders, beneficiaries, vendors, and career criminals.

Internal fraud often involves theft of proprietary information or other company property, improper relationships with vendors or consultants involving conflicts of interest, diversion of policyholder or company funds by employees, use of confidential information for investment purposes, or intentional misrepresentation by agents to prospective customers about the characteristics or future performance of company products.

External fraud can involve such schemes as fraudulent automobile, life, health or disability claims, the use of tax-advantaged insurance products for concealing the origins of illicit funds, or the negotiation of counterfeit checks.

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Companies need to define insurance fraud as broadly as possible to encompass not only fraudulent claims and false statements on insurance applications, but also to include any theft or misappropriation of company or policyholder assets. The company should make it clear in word and deed that it regards any fraudulent activity as illegal and prohibited, and takes its legal and ethical responsibility for fighting fraud seriously. The responsibility for fighting fraud should clearly rest with company management as well as the employee rank and file. We suggest that the following responsibilities be established.

Consequently, in the area of fraud deterrence and detection, management should (a) identify the areas of exposure to fraud and the related fraud indicators and, (b) develop and maintain control policies and procedures specifically designed to combat fraud. The COSO principles specify that the internal control structure should include elements of the following:

- A clear statement on the organization's philosophy on ethics and integrity, including the potential penalties for violating the philosophy.
- Detailed procedures for (a) the authorization and approval of key transactions, (b) the ongoing reconciliation of key transactions and databases, (c) the separation of key functions, and (d) the assignment of responsibility for the continual monitoring of key activities, including the use of sophisticated electronic monitoring tools.
- The training of employees to understand their role and responsibilities and to recognize the indicators of potential fraud.

The Loss Due To Insurance Fraud

It is virtually impossible to determine an exact value for the amount of money stolen through insurance fraud. Insurance fraud is designed to be undetectable, unlike visible crimes such as robbery or murder. As such, the number of cases of insurance fraud that are detected is much lower than the number of acts that are actually committed. The best that can be done is to provide an estimate for the losses that insurers suffer due to insurance fraud. The Coalition Against Insurance Fraud estimates that in 2006 a total of about $80 billion was lost in the United States due to insurance fraud.

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The Coalition Against Insurance Fraud's Progress Report, 2001-2006 found that the major measurements of success, namely referrals received, cases opened and presented for prosecution, convictions and restitution ordered, increased from 2004 to 2005, but results appear to have leveled off in recent years. For instance, although referrals grew 20% during the 2004-2005 period, half of all referrals were logged in three states—New York, California and Florida.

The next measure, cases opened, grew 6.5%, but the average number of cases opened per bureau has been flat since 2001. Prosecutions and criminal convictions both were up at the same rate, but the average number of prosecutions has been flat and convictions were down at 18 bureaus. However, court-ordered restitution increased at most fraud bureaus and totaled $298 million in 2005. The CAIF notes that if all of this money is repaid, the total collected would be twice the operating costs of the 31 bureaus that provided restitution data.

A lack of ethics can have serious consequences. Litigation and costs of settlement, business losses, a reduction in ratings, and increased scrutiny are not half as damaging as the loss to image and reputation. It's a fact that good ethics makes good business sense. Of course, the mandate for good ethics always stems from the top.

According to estimates by the Insurance Information Institute, insurance fraud accounts for 10%, or about $30 billion, of losses in the property and casualty insurance industries in the United States. The National Health Care Anti-Fraud Association estimates that 3% of the health care industry's expenditures in the United States are due to fraudulent activities, amounting to a cost of about $51 billion. Other estimates attribute as much as 10% of the total healthcare spending in the United States to fraud—about $115 billion annually.

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