



PROPERTY & CASUALTY 40-Hour Course

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The objectives of this course is to expose you to a variety of contemporary insurance issues. In addition to laying a foundation of knowledge, it is hoped that these topics will stimulate your curiosity to learn more about one or several of the subjects discussed. This is a self-study course designed to help you meet your prelicensing requirement. It has been accredited by the State. For best results, you should review the complete text. To measure your knowledge, you must pass the online examinations associated with this course. For details on the examination and procedures for earning a Certificate of Completion and credit hours, go to www.preclass.com

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Section PC 1

INTRODUCTION TO PROPERTY & CASUALTY

Objectives

This unit will familiarize you with some of the basic and/or reoccurring terms and themes in insurance. That way, as you're reading through later units, you'll hardly ever bump into a concept you don't know. This unit can also be used as an addendum to the glossary. This unit includes . . .

- Introduction to Insurance
- General Insurance Concepts
- Methods of Handling Risk
- Ideally Insurable Risks
- Determining Loss/Loss Valuation

SPECIAL NOTE:

Until 2011, agents who sold homeowners, auto, commercial, professional liability, workers compensation, flood, earthquake or personal property insurance did so under one license . . . called a **Fire and Casualty License**. Today, an agent selling these products is required to have two licenses . . . A **Property Broker-Agent License** and a **Casualty Broker-Agent License**. This course prepares you for **BOTH** licenses. Similarly, our property-casualty workbook materials (provided under separate cover), that prepare you for the State Exam, cover **BOTH** Property and Casualty topics.

It is also of interest that Property and Casualty Broker-Agents today are **NOT permitted** to sell health, disability and long term care insurance products; products previously sold under the defunct Fire and Casualty License. The sale of these health insurance products

today requires a separate Accident and Health License . . . a course available from our school.

1. Introduction to Insurance

Insurance is a contract that indemnifies (repays) someone against loss, damage, or liability. An **insurance policy** is a written contract that outlines the obligations and responsibilities of the insured and the insurer.

Insurance refers to transferring the risk of a loss to an insurer under the terms and conditions of an insurance contract. The insurer will indemnify the insured against loss, damage, or liability arising from a contingent or unknown event.

Among the different types of loss/risk control, insurance is known as the transfer of risk, or risk transference. If someone chooses not to insure their valuables, then they are assuming the risk of loss.

Putting it into Context:

Here's an example of how this benefits society. Say neighborhood X experiences an average of 1 devastating house fire annually. Without insurance, the owner of the house will have to pay hundreds of thousands of dollars. Instead, everyone in neighborhood X pays \$500 in HO insurance, and in exchange they can rest assured that if their home burns down, they will be fully compensated.

Related Lingo:

The **Insured** is the person protected under the Insurance policy. The **Insurer** is the company or the individual who provides the policy. The **Named Insured** is the person/persons specifically listed in the policy as the insureds. **Insured premises** means a

location where coverage applies. **Insured residence** means the insured lives where coverage applies.

Note: Insured is more of a general label for an insurance client. For example, "The Personal Auto Policy protects the insured against damage or injuries from uninsured/underinsured motorists. Whereas, Named Insured refers to a specific person, family, or group listed in the policy. For example, "The Jones's are the named insured in the Personal Auto Policy declarations.

A. The 6 Requirements for Insurance Policies

All insurance policies must contain:

- 1) Information about the parties involved in the contract
- 2) Description of the property or the life insured
- 3) The insured's insurable interest
- 4) Information about the risks the insurance covers
- 5) The policy period
- 6) Premium rates

Legal World: An insurer's financial rating (A+, B, C, etc) is not required to be specified in an insurance policy.

B. Insurance Classes & Companies

In order to regulate the industry, California code designates different classes. These classes are:

- **Life insurance** insures someone's life and pertains to the granting, purchasing, or disposing of annuities.
- **Property insurance** protects against losses from fire, lightning, windstorm, tornado, or earthquake to:
 - o Property
 - o Accounts and documents
 - o Moneys

- **Marine insurance** includes insurance against any kind of loss, and protects:
 - o Vessels
 - o Aircraft
 - o Cars
 - o Goods/freights/merchandise
 - o Accounts and documents
 - o Moneys
- **Title insurance** protects the owners or lien holders of real or personal property.
- **Surety insurance** guarantees the behavior and performance of hired contracts.
- **Disability insurance** provides financial assistance when an insured is disabled or killed from an accident or sickness.
- **Plate Glass insurance** protects against the breaking of valuable glass.
- **Liability insurance** assists the insured in paying third-party bodily injuries or property damage that the insured is responsible for.
- **Workmen's Compensation** protects employees who are injured on the job, and employers who are legally liable to reimburse injured employees.
- **Common Carrier Liability** insures truckers for any injuries or property damages done to third-parties.
- **Boiler and Machinery** insures against losses from bodily injuries or property damage caused by explosions or accidents involving:
 - o Boilers
 - o Tanks

- o Pipes
 - o Pressure vessels
 - o Engines
 - o Wheels
 - o Electrical machinery
 - o Etc.
- **Burglary insurance** insures against losses from burglary and/or theft.
- **Credit insurance** protects insureds if a business/individual extending credit to the insured can no longer meet their financial obligations.
- **Sprinkler insurance** protects against loss through water damage if a sprinkler or pump breaks or leaks.
- **Team and Vehicle** insurance protects against damages or liability caused by the use of teams or vehicles.
- **Automobile insurance** protects anyone who owns, uses, or sells automobiles.
- **Mortgage insurance** guarantees the payment of principal, interest, and any other expenses that someone has agreed to pay under a note, bond, or contract.
- **Aircraft insurance** protects anyone who owns, uses, or sells aircraft.
- **Mortgage Guaranty** insurance protects against financial losses due to the nonpayment of principal, interest, and other fees that have to be paid under the terms of any note, bond, or contract.
- **Miscellaneous insurance** protects against direct or indirect damages from:
 - o Lightning
 - o Windstorm
 - o Tornado
 - o Earthquake

Miscellaneous insurance also protects producers in the movie industry from delays, sicknesses, death, cancellation, etc.

Property vs. Liability Coverages

Property insurance covers the financial loss we suffer when something we own is stolen, damaged or destroyed. Liability or casualty insurance is coverage for our actions or negligence which has caused another person loss or injury.

There are many types of **private insurance companies** that serve the industry. A **mutual insurance company**, simply put, is a company that is not publicly traded and therefore has no shareholders. Instead, policyholders are the ones who share in ownership of the company. By contrast a **stock insurance company** is owned by a group of stockholders, who are not necessarily policyholders. A **Reciprocal Insurance Exchange** is a form of unincorporated insurance company in which subscribers exchange policies through an Attorney in Fact (a separate entity that runs day to day operations) in transactions that share or spread their risk. USAA and Farmers Insurance Group are examples of RIEs. **Fraternal organizations** are described as any **benefits society** (without capital stock) conducted solely for the benefit of its members and their beneficiaries and not for profit. Such societies are typically voluntary groups of people affiliated through ethnicity, religion, profession or some other tie, e.g., Knights of Columbus, Modern Woodmen of America, etc, offering various types of insurance to its members.

2. General Insurance Concepts

The following concepts are key and reoccurring:

A. Indemnity

Indemnity is a type of contract, such as insurance, that serves to restore the individual to the approximate financial position occupied before a loss. To **indemnify** is to restore an individual to the approximate financial position occupied before the loss.

Alert!

Indemnity is a noun: it's a type of contract.

Indemnify is a verb: it restores the individual to their financial position before the loss.

The Principle of Indemnity means an insured can't collect more than the actual loss, or the insured can't collect twice for the same loss.

If a question asks you what indemnity means, you'll probably find the definitions for indemnify, and for the Principle of Indemnity among the choices. They mean to throw you off, so really familiarize yourself with these concepts.

B. Risk

Risk is defined as the chance of loss, on any insured property or item. The term risk is used in a general way to designate the entire subject matter of insurance covered under a policy, or upon which an application for insurance has been received. Risk is also sometimes used to designate a policyholder, i.e., he/she is a preferred or poor insurance risk.

Note: Isn't there an easier way to say that? Risk just means something could be negatively affected by an event. If there's a fire, there's the risk that John's house might be damaged.

There are **2** categories of risk:

- 1) **Pure Risk** is defined as the uncertainty as to whether or not a possible loss will actually happen. There could be a loss, but no one knows when or how.
- 2) **Speculative Risk** is a loss that's more predictable, such as gambling, business ventures, or playing the stock market.

Speculative risk assumes that, based on the person's actions/decisions, there could be a loss or a gain.

Alert!

The main difference is that Pure Risk happens accidentally and unexpectedly, whereas with Speculative Risk, the person is already aware of the risk of loss. Insurance only covers Pure Risk: trust us, that's on the final exam.

There are **5** methods of handling **risk** or the potential for financial loss:

- 1) **Avoidance** is an individual's or corporation's decision to not expose themselves to a particular risk. This could mean not going into a line of business prone to litigation, or not engaging in an activity prone to injury.
- 2) **Retention** means an individual or corporation decides against insurance, and will pay for any losses out of pocket. This is also referred to as the assumption of risk.
- 3) **Sharing** means an individual or group of individuals, corporation, or an association agrees to share any losses. Sometimes associations handle their own Workmen's Compensation. Whenever someone is injured on the job, all the members of the association share the expenses.
- 4) **Reduction** means taking measures that are specifically designed to reduce the frequency and severity of loss. This could mean disposing of hazardous materials to avoid a fire (reduced frequency), or installing a sprinkler system to keep people from being injured in the event of a fire (reduced severity).
- 5) **Transfer** means transferring the expenses of potential loss onto another party, i.e., purchasing insurance.

The following criteria describes an ideally insurable risk:

- The loss must be **measurable**
- The loss must be **accidental**
- The loss must be **predictable**
- The **law of large numbers** has to apply
- The loss must create **financial hardship**
- Insurance must be **affordable and practical**
- The loss must not be **catastrophic**

C. Insurable Events

This basically refers to any insurable circumstance that doesn't involve speculative risk. So, everything is insurable unless it's gambling, the lottery, business ventures, etc.

D. Exposure

Exposure is defined as someone's potential for loss, or their loss exposure/exposure to loss. For example, a homeowner in a particular region of the country will have different kinds of exposures than a homeowner in another region. They may be more vulnerable to hail, tornadoes, or forest fires, so they have a higher exposure to loss to those particular perils.

E. Peril

Peril refers to the specific event causing a loss, such as fire, windstorm or collision.

F. Hazard

A **hazard** is any factor that creates or increases the chance of loss.

Note: So what's the difference between a risk and a hazard? Risk is a general term used for the possibility of damages/injuries in the future. If we're using hazard that means there is something present which makes damages/injuries a lot more likely. For example, if a car has really old, malfunctioning brakes, the faulty brakes are a hazard.

There are different types of **hazards**:

A **Physical Hazard** is created by the condition, occupancy, or use of the property itself.

A **Moral Hazard** is a characteristic of the insured that increases the chance of loss. Examples of this would include arranging an accident to collect the insurance or inflating the amount of a claim. So a moral hazard basically means the insured is shady.

A **Morale Hazard** is marked by the insured's carelessness or indifference. So if Felicity goes to sleep at night without putting out the scented candles, that's considered a morale hazard.

A **Legal Hazard** is created by decisions or actions of the courts. If something could result in big, expensive lawsuits, this is considered a legal hazard.

Concurrent and Non-concurrent Policies

If a property has multiple insurance policies, the policies are said to be concurrent if the terms and conditions match. If they don't, the policies are considered Non-concurrent. The purpose of establishing this status helps to determine which policy is the "primary" policy.

G. Occurrence

An **occurrence** is an event that results in a covered cause of loss. An occurrence refers to gradual or accumulative damage without regard to exact time or place. The easiest way to understand occurrence in this context is it's more wear and tear.

H. Accident

An **accident** is the insurance opposite of an occurrence. An accident is defined as a sudden, unforeseen, and unintentional act identifiable in time and place.

Note: The insurance definition of an accident has a lot of legal implications. It's specifically designed to keep anyone from taking advantage of the system:

"Unforeseen": Unplanned

"Unintentional": Not on purpose

"Identifiable in time and place": It can be proven and documented

I. Insurable Interest

Insurable interest is a relationship or condition that loss or destruction of life or property would cause a financial loss.

Insurable interest has to exist at the time of loss. Contingent or expectant interests are not insurable.

When there is more than one person with an insurable interest in the covered property, the company's liability will be no greater than the insured's interest at the time of the loss, or for more than the limit of coverage.

Note: When the test asks you about insurable interest, that's what the answer is going to look like. However, in simpler terms, insurable

interest means X needs to cover Y, because if Y were lost or damaged, it would cost X money. Mark needs to insure his car, because if his car were lost or damaged, it would cost Mark money. Insurance exists to protect against financial losses.

J. Burglary

A **burglary** is when someone removes property illegally after forcefully obtaining entry to the premises.

K. Robbery

A **robbery** is when someone removes property illegally from another person by threatening and/or using force or violence.

L. Theft

Theft is a general term for stealing.

Note: Remember this for the test—burglary versus robbery: Burglary is a person breaking in and stealing from a location. Robbery is a person stealing from another person using threats or force.

M. Loss

Loss refers to:

- The amount sought through an insured's claim
- The amount of reduction in the value of an insured's property caused by a covered peril
- The amount paid on behalf of an insured under an insurance policy

There are **2** categories of **loss**:

- 1) **Direct Loss**, which refers to loss or damage done to the primary subject of the insurance agreement. So, if an

insurance policy insures a business against fire, and there's a fire, the damage the fire does to the property is called direct loss.

- 2) **Indirect / Consequential Loss** refers to any resulting loss of income or destabilizing of finances resulting from damages, loss, or the interruption of business operations. So, if a commercial property is damaged by a fire and it can't operate, the financial losses are the indirect losses.

Loss exposure refers to the particular losses an individual or location is more vulnerable to. For example, a homeowner in Oklahoma has a higher loss exposure to tornadoes and hailstorms, then a homeowner in California.

N. Deductibles & Self-Funding

The **deductible** is the dollar amount beyond which the insurance protection begins. The insured assumes the loss up to the deductible limit and the insurer pays the remainder up to the policy limit.

Most people are familiar with this concept, but just in case you're not, here's a basic rundown: if Mike has \$15,000 in collision coverage with a \$500 deductible, and Mike is in an accident, he pays the first \$500. Therefore, if the accident only ends up costing \$450, the insurance doesn't help pay for the damages.

Deductibles serve an important function:

- **Deductibles** reduce insignificant claims
- **Deductibles** keep the cost of insurance down

Whenever deductibles are discussed it is important to determine how they apply, especially where medical expenses are involved. For example, does the deductible apply to **multiple expenses** for one individual . . . or do the **expenses of several family members** involved in a single accident apply to the stated deductible . . . or do only **sick care expenses** apply to the stated deductible.

Much like a deductible retains a portion of the insured risk, many group insurance plans retain portions of the risk involved in insuring their employees by setting up **self-funded plans** where the employer sets aside funds to make claim payments. In the long, these plans can results in savings on insurance costs as well as increase preventative measures.

O. Certificate of Insurance

This is documentation of an insurance policy—COI if you're lazy. A certificate that's been issued by a company or producer verifies that the insurance policy is in effect for:

- The named insureds
- The stated amounts
- The stated coverages

P. Law of Large Numbers

There are two important aspects to the Law of Large Numbers:

- 1) If you take a random sample from a larger population, it's more likely to represent the whole, then if you took a random sample from a smaller population.

- 2) The more people there are, the more the chance of risk increases.

Q. Damages

Damages refer to the physical or mental harm resulting from an accident or covered cause of loss. The damage could mean someone's car is scratched, or the damage could mean someone was harassed and bullied at work until they suffered a breakdown.

In legal terms, damages have to have a determinable and compensatory value. Once the compensatory value of the damage is assessed, someone who successfully wins a lawsuit or claim can be compensated for those damages.

There are different ways damages are compensated:

- **General compensatory damages** are straightforward. Someone was injured in a car accident and those injuries amounted to \$50,000 in medical bills, so the person should be compensated for \$50,000.
- **Special compensatory damages** are harder to determine, because this has more to do with emotional or mental suffering. If someone was injured in a car accident and they were permanently disfigured, the person will ask for special compensatory damages, which is sometimes referred to as pain and suffering.
- **Punitive damages** are designed to punish the liable party. If a corporation withheld information about a toxic leak, which poisoned neighboring groundwater, exposing

the citizens to the toxins, the court could decide on punitive damages.

R. Proximate Cause

Proximate cause is the factor causing damage or loss for which there is an unbroken chain of events between the occurrence of the insured peril and the resulting injury or damage.

So, for example: a windstorm knocks over a tree, which lands on a power line, which falls over and sets fire to a garage, which collapses and damages a car. The proximate cause of damage to the car was the windstorm. So in simplest terms, the proximate cause is always that which gets the ball of destruction a-rolling.

A policy may or may not cover proximate causes. For example, if Randy's house is burning down, and the fire department puts out the fire, but causes water damage, the water damage may be covered under Randy's fire coverage by reason of proximate cause.

S. Pair and Set Clause

Loss to a pair and set provision recognize that the value of a pair or set is at its highest when all parts of the set are accounted for. In most states, this provides that loss to a part doesn't mean a total loss of the pair or set, and the company has the option to:

- Repair or replace any part of the set, to restore the set, or to pair its value before the loss.

- Pay the difference between the ACV of the property before and after the loss.

Alert!

More often than not, insurers take the second option, so the test is probably going to spring some math problems on you. We'll simplify the concept: Diane has an expensive pair of diamond earrings worth \$1,000 each, but the set is worth \$3,500. Pair and set pays the difference between the ACV of the property before and after the loss, therefore the formula would be:

$\$3,500 - \$1,000 = \$2,500$ will be reimbursed

T. Cancellation / Nonrenewal

Cancellation is the termination of a policy prior to the stated expiration date. The insured can request that their policy be cancelled, or the insurance company can decide to cancel the policy for a justifiable reason (usually non-payment of premiums).

There are different kinds of policy cancellations:

- 1) **Flat rate** cancellation just cancels the policy as of its date of inception, without any premium charge. A 100% refund is given to the client.
- 2) **Pro-rata** cancellation terminates the insurance contract, and then adjusts the premium charge to the exact time the protection was in force. The insurer keeps the earned premium and refunds the unearned premium.
- 3) **Short rate** cancellation refunds any unearned premiums minus administrative expenses. The insurer keeps earned premiums plus an extra charge.

Nonrenewal means an insurance company, agent, or insured decides not to renew an insured's policy when it expires.

Policy Cancellations in California

First, you need to understand that if a policy is cancelled, it's terminated during the policy period before the policy has expired. If a policy is nonrenewed, it means the insurer or insured decides not to renew the policy once it's reached the end of the policy period.

Next, understand that depending on the type of insurance being cancelled, California has some very specific rules about canceling policies. In general . . .

- When a policy is cancelled, the insurer must return the gross unearned premium or the premium attributed to a reduction in coverage to the insured.
- Certain policies can ONLY be cancelled by the insurer for issues like non-payment of premium, a license suspension, fraud, material misrepresentation, a conviction of the insured for a crime, failure of the insured to protect the property after a loss or if the insured has obtained replacement coverage.
- In certain cases, an insurer must offer to renew or give the insured an option (like an assigned risk pool) before canceling his policy.
- An insurer cannot refuse to renew a policy based on an insured's age or a pending claim.
- Insurers must provide the reason for canceling upon a written request by the insured.
- An insurer can't cancel an insured while he is rebuilding an insured property.
- Violation of these cancellation rules is a misdemeanor, subject to a fine of \$1,000 per violation.

U. Mysterious Disappearance

Mysterious disappearance means property disappears and no one knows for certain how. Usually it's assumed the disappearance was the result of theft, but if theft can't be absolutely determined, it's referred to as **mysterious disappearance**.

Putting it into Context:

Julian left his digital camera on a park bench and didn't realize it until nearly ten minutes later. When he ran back to get the camera, it was gone. Julian assumes the camera was stolen, but because there were no witnesses to the theft, it's considered a **mysterious disappearance**. We know it should be far **cooler** with a name like **mysterious disappearance**. It should be something like: Julian gets **sucked** into the **Bermuda Triangle** and has to battle **evil frogmen** using an **enchanted sword**—but it's **not**.

V. Vacancy / Unoccupancy

Vacancy refers to a building that doesn't have anyone living in it, using it, and it doesn't have any contents. So, vacancy means no people or stuff. A lot of times, this has a negative impact on the property's insurance. For example, in personal lines, if the property is vacant for more than **30** consecutive days, vandalism and related perils won't be covered.

Unoccupancy refers to a building that has all its intended contents, but there's no one using it. So, unoccupancy means stuff, but no people.

A vacant/unoccupied building is more vulnerable to vandalism and theft, as well as pipes/plumbing/electricity breaking down due to lack of use or neglect.

W. Reinsurance

Reinsurance is when an insurance company transfers a percentage of the obligations of a policy to one or more other companies. This can happen if a particular policy could result in an unusually high loss.

Putting it into Context:

Reinsurance can happen in any type of insurance, but we'll just use Commercial insurance for our example. We want you to bear in mind that insurance companies decide to cede HO and other types of policies.

Company A buys insurance from Company B, and the limit of liability stated on the policy is well in the millions of dollars range. Company B cedes a percentage of the policy to company C.

Now Company B is known as the Ceding Company or the Primary Insurer, and Company C is known as the Reinsurer or the Secondary Insurer.

If Company B cedes fifty percent of the policy to Company C, then they split the premium profits and any losses between them.

3. Liability

Liability is someone's debt, either immediately or in the event of a loss. Liability is pretty much the core of any Casualty insurance, because Casualty protects the insured against their own negligence or legal responsibilities to third parties. Liability insurance protects the insured against financial losses arising from:

- Bodily injuries to a third-party
- Death to a third-party
- Damage to third-party property

In English: Liability insurance protects other people and other people's stuff, never the insured or the insured's stuff.

A. The 4 Kinds of Liability

There are **4** kinds of liability:

- 1) **Direct Liability** means the liability comes directly from something the insured did, or something the insured owns. So, if the insured hops in their car and runs a red light, they're directly liable for any resultant damages or injuries.
- 2) **Indirect/Contingent Liability** means the person wasn't directly responsible for the damages or harm, but because of a significant connection with the responsible party, the insured can still be found liable. For example, if the insured hires contractors to renovate their house and something dislodges from the house and damages a neighbor's house, the insured is indirectly liable.
- 3) **Vicarious Liability** means a person is liable for the actions of/damage done by someone else. This usually refers to negligence/liability on the part of the insured's friends or family. For example, if the insured gives their intoxicated friend permission to drive their car and the friend is in a serious accident, the insured could be held vicariously liable.
- 4) **Contractual Liability** means the insured has assumed another party's liability via contract. A lot of times this applies to business deals. Someone will hire a contractor

and have the contractor sign a waiver stating that the contractor accepts any liability from his/her actions (Thus, the person hiring the contractor avoids indirect/contingent liability).

B. Liability and the Law

There are various terms that relate to the legality of liability:

- 1) **Tort** means a civil wrong (not a pastry—you'll thank us later). There's such thing as an intentional tort, which means someone intentionally wronged someone else. Someone who commits a tort is called a **tortfeasor**—as in: “Nyah-nyah! You're a smelly **tortfeasor**!” Actually, it's probably more formal than that.
- 2) **Strict Liability** means that one party is liable for damages or another party's injuries, regardless of fault. This usually applies when a consumer is hurt by a defective product, or to any Workers Compensation claims when someone is injured on the job. The important thing to remember about strict liability is the liable party is allowed to defend themselves in court.

Putting it into Context:

Paul woke up with a hangover from the night before and barely made it into work. Several people commented that he still seemed a little drunk. His boss asked him to deliver a message to someone on another floor, and on his way down the stairs, Paul tripped and broke his arm. Technically, under **strict liability**, Paul's boss will need to file a Workmen's Compensation claim. However, since Paul was noticeably under the influence, Paul's boss can deny the claim in court, and prove that Paul is liable for his own injuries.

- 3) **Absolute Liability** refers to injuries that result from obviously dangerous activities. These activities include someone keeping dangerous animals (vicious dogs included), using explosives, or doing something very dangerous for a living. A person can't defend themselves against **absolute liability**. If someone goes into the Everglades to wrestle an alligator, and that person ends up injured, he/she can't sue Florida. In that case, they are **absolutely liable** for their own injuries.

Alert!

Remember the difference between **strict liability** and **absolute liability**: in cases involving **strict liability**, the liable party is allowed to defend themselves. In cases involving **absolute liability**, the liable party is not allowed to defend themselves.

C. Other Liability Concepts

Here are **4** more liability concepts you should know:

- 1) **Bodily Injury Liability** covers the insured if there is an auto accident, and the insured is legally liable for injuries to another person.
- 2) **Property Damage Liability** covers an insured for any damage his/her insured vehicle does to another's property.
- 3) **Personal Injury Liability** covers injuries to a person's body, mind, or emotional state.
- 4) **Limits of Liability** refers to the maximum amount of money an insurance company agrees to pay in the event of a covered cause of loss.

4. Determining Loss/Loss valuation

Determining loss/loss valuation is the method the insurer uses to assess the value of something. The most common loss valuation methods are:

- 1) **ACV** is the replacement cost of property minus depreciation. For example, if a television was worth \$350 when you bought it—but that was a few years ago—ACV means you'll receive compensation for the television's depreciated value amount.

Actual Cash Value Computation: Determining ACV can be very subjective. Usage, wear and tear, obsolescence, etc are all considerations. And, the definition of "actual cash value" in the policy rules. In general, policies say it is defined as replacement cost, less depreciation. If replacement cost is determined to be \$400,000, depreciation \$99,000 and the deductible is \$1,000 the actual cash value is \$300,000. However, real world situations are not always this black and white.

- 2) **Replacement Cost** is the cost of replacing the item. Therefore if the television cost you \$350 when you bought it, the replacement cost would be \$350. In order to qualify for replacement cost coverage, insurers may require an inspection and analysis to determine that a sufficient amount of coverage (and premium) is being purchased. Where replacement cost is used, the policy limit is usually set for at least 80% of the home's replacement cost, i.e. if you fail to insure a home for at least 80% of the replacement cost, an insurer may assess a penalty. When a replacement cost claim is paid, insurers require that the property be repaired or replaced BEFORE the full amount is paid. Typically, insurers pay out the actual cash value and hold back the amount attributed to depreciation until this is done.

Replacement Cost Computation: If the replacement cost of a home is \$400,000, then coverage must be purchased for at least \$320,000 (\$400,000 X 80%).

For additional cost, a higher form of coverage is available through **guaranteed or extended replacement cost insurance**. A guaranteed policy will pay whatever it costs to rebuild the home as it was before a disaster, even if it exceeds the policy limits. Extended replacement cost policies

pay a certain percentage over the policy limit – typically 20 to 25 percent.

While both optional coverages can provide protection against sudden increases in construction costs due to a shortage of building materials (typical after a major disaster) or rising costs in general, neither routinely cover the cost of upgrading a house to comply with current building codes. An ordinance or law coverage endorsement is required here.

Agent World – Replacement Cost Effects: In assessing the valuation of a client's home and the coverage needed, it should be noted the advice you give can effect your client. For example, recommending the purchase of replacement cost insurance is good, but without optional guaranteed or extended options, complete replacement of the dwelling may not occur. And, while even these additional coverages can provide protection against sudden increases in construction costs due to a shortage of building materials (typical after a major disaster) or rising costs in general, neither routinely cover the cost of upgrading a house to comply with current building codes. An ordinance or law coverage endorsement is required here. Also consider that replacement cost coverage may only apply to the residence, not other structures. Under terms of the policy, for instance, a garage may be valued using actual cash value, not replacement cost. Further, if a lost property was a rental, the loss of rent that results from a disaster may clear limits in the policy. Likewise, liability (bodily injury for example) claims your client incurs as a result of a disaster could have very specific limitations as specified in the declarations page of the policy. So, while replacement cost coverage is advisable, you and your clients need to be aware that gaps can still occur.

- 3) **Functional Replacement Cost** is the cost of replacing an item with an item that is the functional equivalent of the damaged/lost item. For example, if someone wrecks their Corvette, under functional replacement cost, the person would receive enough compensation to buy a much cheaper car. The focus is on the function of the lost/damaged item, not on the item itself.

- 4) **Market Value** means how much the item/property could be sold for in the current marketplace.

Note: We'll stick with the above example of the Corvette. If the Corvette was a classic Corvette and the loss valuation was based on market value, then the person would receive the amount that particular model of Corvette would go for in the current marketplace.

- 5) **Agreed Value** means the insurer and the insured come to a decision on the value of something, and then that's its replacement cost if its lost or damaged. This happens a lot with art and jewelry.
- 6) **Stated Amount** is the amount stated on the policy. This is the amount that will be compensated—no matter what the actual value of the property—in the event of a covered cause of loss. Usually stated amount policies pay the lesser of: the cost to replace, repair, or the ACV.
- 7) **Valued Policy** means the policy gives the exact value of the covered items. This is the value that will be paid in the event of a covered cause of loss. Valued policies are used more for expensive items, such as furs, fine art, and jewelry.

5. The Coinsurance Clause

This is a concept you're going to run into on the final exam. Before we dive in, memorize this formula (for it will be your very best friend):

(Insurance carried / Insurance required) x Amount of loss = Recovery

Now for the nuts and bolts: **coinsurance** usually relates to commercial policies. If a building is worth a certain amount, an insurer might require a certain percentage of insurance on that property. So, if a building is worth \$500,000, and there's an 80% coinsurance requirement, that means the insured is required to carry at least \$400,000 in insurance. This doesn't mean the insured will actually purchase that much: that's just the coinsurance requirement.

Therefore if a building worth \$500,000 with an 80% coinsurance requirement, and the owner only buys \$200,000 of insurance, they're underinsured, and this will affect how much money their policy will cover in the event of a loss. If there is a loss, and the loss is \$60,000, how much will the insured's policy pay based on the coinsurance formula? So, plug the numbers into the formula:

$(\text{Insurance carried}) \$200,000 / (\text{Insurance required}) \$400,000 \times \$60,000 = \$30,000$. Therefore, in this situation, the insured's policy will only cover \$30,000 of the damages.

How about this question: Ingrid's building is worth \$600,000 with an 80% coinsurance requirement. Therefore she should carry: $\$600,000 \times .80 = \$480,000$ in insurance.

Ingrid decides to carry \$420,000 in insurance. There is a covered cause of loss, and Ingrid's expenses amount to \$420,000. Therefore $(\$420,000 / \$480,000) \times \$420,000 = \$367,500$.

So, even though Ingrid is insured for the same amount of the loss, she didn't meet her coinsurance requirement. Therefore, Ingrid's insurance policy will only pay \$367,500 for the loss.

Alert!

There's a chance the exam will just want to test your basic knowledge of coinsurance, with easy questions like this: "If Bob's building is worth \$100,000 and it has an 80% coinsurance requirement, how much insurance is Bob required to carry?" We know this because that's the question we ended up with. We'd been planning for very complex coinsurance math problems, so the ones they gave us were so easy, we could answer them with our eyes closed. We'd suggest you take this same approach: know coinsurance inside and out so by the time you get to the actual exam, you fly through it in time to catch the next matinee.

6. Negligence

Negligence is the result of carelessness, thoughtlessness, or inaction, but it's never intentional.

A. The 4 Elements of Negligence

Before a court will award any damages to an injured party due to another's negligence, the 4 elements of negligence must be present:

- 1) **Legal duty** means the person has a legal responsibility to take the necessary precautions to avoid being negligent.
- 2) **Breach of duty** means the person failed to uphold their legal duty.
- 3) **Damage or losses** occurred as a result.
- 4) **The breach of duty** caused the damages or losses.

Here's a surreal story to help you remember the 4 elements:

Bob decided to put quicksand outside his driveway. He thought to himself, "I should really tell people about this here quicksand." (Legal duty) When Gwen was walking by, she said, "Is that safe?" Bob forgot about the quicksand, and said, "Yep. Safe as safe can be!" (Breach of duty) Trusting him, she went on her way, and was promptly sucked into the quicksand. Luckily, she just happened to have a copy of "How to Escape from Quicksand," so she survived, but she still lost one of her tennis shoes. (Damages or losses)

"Hey," she said, "I lost one of my tennis shoes because you said it was safe!" (Damages or losses caused by the breach of duty)

True, it's a weird story, but we're sure you'll remember the **4** elements of negligence long after you've developed senility and forgotten everything else.

Note: If these **4** elements of negligence are present, the injured party has a good chance of winning a lawsuit.

B. Legal Defenses Against Negligence

The legal defenses someone can employ to defend themselves against accusations of negligence are:

- **Assumption of Risk** means the person knew it was dangerous and did it anyway. Therefore, if they end up injured, they can't blame anyone else for negligence.
- **Contributory Negligence** means if the person is even a little bit responsible for their injuries or the damages, they won't be reimbursed. This defense is considered way too strict, and it's not used that often.
- **Comparative Negligence** is the answer to the black and white nature of contributory negligence. Comparative negligence takes the percentage of responsibility of each party into account. So, if someone is 10% responsible for what happened, and another person is 90% responsible for

what happened, person A will pay 10% and person B will pay 90%.

- **Doctrine of Last Clear Chance** means the injured person had time to avoid the conflict. This defense is employed a lot of times in auto versus pedestrian cases.

7. Damages

Damages are the physical or mental result of an accident or covered cause of loss.

The damage could mean someone's car is scratched, or the damage could mean someone was harassed and bullied until they suffered a nervous breakdown.

In legal terms, damages have to have a determinable compensatory value. Once the compensatory value of the damage has been assessed, someone who successfully wins a lawsuit or claim can be compensated for those damages.

A. Compensation for Damages

There are different ways damages are compensated:

- **General Compensatory** damages are straightforward. Someone was injured in a car accident and those injuries amounted to \$50,000 in medical bills and property damage, so the person should be compensated \$50,000.
- **Special Compensatory Damages** are harder to determine, because this has more to do with emotional or mental suffering. If someone was injured in a car accident and they're permanently disfigured as a result, the person would ask for compensation for pain and suffering.

- **Punitive Damages** are designed to punish the liable party. If a corporation withheld information about a toxic leak, which poisoned neighboring groundwater, and citizens were exposed to the toxins, the court could decide on punitive damages.

8. Underwriting

The object of underwriting is to assess the applicant's individual risk exposures and determine whether or not that applicant qualifies as a desirable insurance risk.

Underwriters try to assess whether the applicant will end up having a loss that's different from the predicted loss when the rates were first formulated.

A. The 3 Methods of Rate Determination

There are **3** main methods of determining what an applicant's rates should be:

- 1) **Manual/Class Rating/Pure Method** refers to set rates that apply to a specific risk exposure that falls within a determined class or group. The groups are set up so that loss data is easy to collect, and anyone who falls into a specific group/class is charged the same rate.
- 2) **Loss Ratio, Expense Ratio and Combined Ratio Methods**
Insurers need to determine profitability. This is done using one of these three methods: The loss ratio measures the success in covering current losses out of premium income, i.e., claims divided by premiums. The expense ratio measures the percentage of premium dollars used to cover

company expenses, i.e., company expenses divided by premiums; the combined ratio adds the loss ratio and the expenses ratio to determine breakeven, measured at 100%, i.e., claims plus company expenses divided by total premiums.

- 3) **Individual/Merit Rating Method** takes the individual characteristics of a specific risk into account and then rates that risk accordingly.

Loss Cost Rating

Rating is the process of examining and rating a building's construction, hazards, public and private fire protection, occupancy, and other exposures. Companies such as **ISO (Insurance Services Office)** provide this service in order for insurers to "rate" or price policies. The **California Workers' Compensation Inspection Rating Bureau** provides rating information for workers' compensation and employer's liability insurance. In addition, there are out-of-state rating organizations like the **National Council on Compensation Insurance (NCCI)**.

B. The 3 Classes

- 1) Preferred risks have strong records and low risk exposures. They'll end up with the best rates.
- 2) Standard risks have average records and/or average risk exposures. They'll end up paying a higher premium than the preferred risks.
- 3) Poorer risks have a history of insurance claims and/or very high risk exposures. They'll end up paying the highest premiums to justify the cost of covering the risk.

9. Claim Terms

There are some basic claim concepts you must understand:

First Party Claim: The insurance policy pays directly to the named insured, less any deductible.

Third Party Claim: The insurance policy pays to a third party on behalf of the insured who might have otherwise been liable himself.

Subrogation: The policy pays the insured for his loss caused by another party in exchange for the insured giving up his right to collect or sue the person at fault. The insurer then is able to pursue the liable party in the shoes of the insured.

Arbitration: An independent or third party settles the loss between insureds and/or insurers in dispute.

Loss Reserves: Estimated funds an insurer is required to set aside to cover claims due but not yet payable.

10. Methods of Policy Valuation

When claims are paid, various methods of valuing property are used:

Actual Cash Value (ACV): *Replacement cost minus depreciation.*

The insurer determines the replacement cost and subtracts an amount for depreciation.

Replacement Cost: The insurer agrees to pay a cash settlement to allow the purchase of new property to replace the lost or damaged property.

Market Value: Insurers pay the claim based on the market value of the property rather than actual cash value.

Stated Value: The insurer agrees to pay the full amount stated in the policy without regard to current value or appraisal, i.e., the loss is predetermined.

Section PC 2

NUTS & BOLTS OF A POLICY

Objectives

This unit is designed to put contract law into a context that's easy to understand. Section 2 goes into the framework of your everyday insurance contract.

This unit includes:

- D.I.C.E
- Other parts of the Policy
- Common Policy Provisions
- Other Insurance Concepts
- Named Insured Provisions
- Insurer Provisions
- Third-Party Provisions

1. D.I.C.E

It's easy to remember the basic parts of an insurance policy by using the acronym **D.I.C.E**, as in: "*Come on, baby, come on!*"

Daddy needs a new pair of shoes!"

- **D**eclarations
- **I**nsuring agreement
- **C**onditions
- **E**xclusions

A. Declarations and Agreement

The **declarations**—“face sheet” or “dec page,” for you swingin’ insurance industry cool cats—is part of the policy contract. The **declarations** lists:

- Insured’s name and address
- When coverage begins and ends
- Coverage amounts
- Premium
- Deductibles
- Any endorsements
- Schedule of coverage
- Property description
- Insurer (insurance company)

Note: In the **declarations**, “**you**” and “**your**” refer to the insured. “**We**,” “**us**” and “**our**” refer to the insurer.

B. Insuring Agreement

The **insuring agreement** is considered to be the core of any insurance contract. It states what the insurer won’t do, and what the insurer will do regarding claims, in exchange for premium payments.

C. Conditions

The policy **conditions** explain the insured’s responsibilities and duties in the event of a loss, and how the insurance company will settle that loss.

The **conditions** include:

- The insured's rights and duties
- The policy period
- The effect of concealment, fraud, or any other dishonest act
- Cancellation and nonrenewal provisions
- Valuation determination and claims settlements
- How the insurer will handle a loss if that loss is covered by more than one policy

Alert!

We're going to nag and nag. You will run into questions on the final exam like this one:

"Where would you find the policy period in the insurance policy?"

Just make sure you're absorbing what each policy section includes, because they like to try to catch you on the details.

D. Exclusions

The **exclusions** section of the policy contract specifies any losses that aren't covered by the policy.

Note: You should recognize that property insurance policies contain many items but NOT the insured's property address. The actual property address of the insured is typically only found in the declarations page.

2. Other Parts of the Policy

Along with the standard parts of a policy, there are some additional parts that are found in most policies. Some of these

parts can be added to a policy to give an insured extra coverage, or to individualize the policy.

Many forms, riders, contracts and policies can be obtained through the Insurance Services Office (ISO) . . . a provider of standardized forms serving ISO serves insurers, reinsurers, agents and brokers, insurance regulators, risk managers, and other participants in the property/casualty insurance marketplace.

A. Additional / Supplemental Coverages

These are coverages that can be added to a policy to provide the insured with extra protection. For example, a basic dwelling policy protects the insured against fire, lightening, and explosion perils. If the insured wants to add hail coverage, that coverage would be an **additional** or **supplemental** coverage.

B. Endorsements

Coverages are added to an insurance policy through **endorsements**. A more refined definition would be: **endorsements** are a modification to an insurance policy that changes the contract of insurance.

Note: Additional/Supplemental coverages and endorsements sound a lot alike. Can they be used synonymously? Actually, they are two completely different concepts. **Additional / supplemental coverages** are completely new coverages that are added to the policy. An **endorsement** modifies the policy when it adds the additional/supplemental coverage. Think of it this way: the

additional/supplemental coverages are the extra pages that change the story, and the endorsement is the staple.

C. Definitions

The **definitions** section of a contract carefully defines any term or concept to eliminate any chance of misinterpretation. It's very important that the meanings are clear. More insurance related cases end up in court because the interpretation of words in insurance contracts might be misinterpreted.

3. Policy Period

In simplest terms, the policy period is when the policy contract takes effect through when it ends. That seems pretty easy! Except you probably won't get too many test questions that look like this:

"A _____ is when the policy begins through when it ends:"

- a. Policy period
- b. General average
- c. Commercial General liability
- d. Property Insurance

It's possible they'll throw you one or two tokens, but it's more likely that you'll bump into a question like this:

"If Marge's policy is for 6 months and it began June 7th at 3:30 in the afternoon, when will Marge's policy end?"

- a. December 7th at 3:30 PM
- b. December 7th at 12:01 AM
- c. December 7th at 3:31 AM
- d. December 7th at 12:01 PM

If a policy is scheduled to terminate on December 7th, it terminates at **12:01 AM**: all policies terminate **1 minute** into the day they're scheduled to end.

4. Policy Territory

The **policy territory** is the geographical area covered under a specific policy. Some policies (homeowners, dwelling, etc.) cover property at a specific address, whereas some policies (personal floaters) cover property anywhere in the world. This really depends on the policy and the needs of the insured.

The main areas covered by insurance policies include:

- The US
- US Territories
- Canada
- Puerto Rico

For example, the minimum automobile liability coverage required in California is **15/30/5**: **\$15,000** bodily injury per person, **\$30,000** bodily injury per accident, and **\$5,000** for property damage.

Canada, on the other hand, has one of the highest minimum liability requirements at 100/300/50! But, because Canada is still considered part of the policy territory, you're still covered if you get into an accident in Canada. If you have the minimum coverage required in California and you drive to Canada, your

coverage automatically goes up to match their minimum requirements.

5. Deductibles

Once the chosen deductible is paid, then the insurance protection begins. The insured assumes the loss up to the deductible limit, and the insurer pays the remainder, up to the policy limit.

Most people are familiar with this concept, but just in case you're not, here's a basic rundown: if Mike has \$15,000 of collision coverage for his car with a \$500 deductible, and Mike is in an accident, Mike pays the first \$500. Therefore, if Mike's accident ends up costing \$450, then the insurance won't help pay for the damages.

Deductibles serve a couple of important functions:

- **Deductibles** reduce insignificant claims
- **Deductibles** keep the cost of insurance down

E. Limits of Liability

The **limits of liability** refer to the MAXIMUM amount an insurance policy will pay. This could be per event, or per individual. **Limits of liability** are written in a variety of ways, such as:

- **Per occurrence / accident** means the limit of liability is expressed as a MAXIMUM that will be paid per event. An occurrence/accident could cause a variety of expenses

ranging from property damage to medical bills. If the occurrence amount is \$50,000, every expense related to the event is covered until the \$50,000 has been exhausted.

- **Per person** means the limit of liability extends to each individual. Therefore if the limit of liability is \$25,000 per person, no one person involved in the accident will receive more than \$25,000, even if the accident/occurrence amount is higher.

Alert!

We know for a fact they'll try to trick you with the "per person" concept on the test. Say the maximum amount allowed per occurrence/accident is \$50,000, but there's a \$25,000 per person limit of liability. So, if the insured is driving his/her carpool to work, and there's an accident, everyone in the car has up to \$25,000 in coverage without going over the maximum amount of \$50,000 per accident. If there are four people in the car, and they all have \$4,000 in medical expenses, then \$16,000 will be covered.

- **Aggregate** means the limit of liability are handled annually instead of split per person or per accident. So, the insured knows they are covered for \$100,000 a year for losses. If they exhaust that \$100,000 of coverage, the insurance won't pay for any other claims until the following year.
- **Split** means the limits of liability are divided into sections. You usually see this with automobile insurance. For example, the minimum split limits in California are expressed as **15 / 30 / 5**. Therefore, the limits of liability are:

\$15,000 for bodily injuries per person/per accident, \$30,000 for bodily injuries per accident, \$5,000 for property damage.

- **Combined single** is basically the same as per occurrence/accident. Instead of dividing up the limits of liability, there is one maximum sum that has to cover all expenses relating to one event.

7. Named Insured Provisions

The insured has certain options and obligations relating to his/her policy, such as:

A. Duties after a Loss

This is a biggie. After a covered cause of loss occurs, the insured has to perform certain duties, otherwise they may not receive any compensation from their insurance policy. Those duties are:

- The insured must notify the police if any law has been broken.
- The insured must notify the insurer immediately after a covered cause of loss.
- The insured has to send the insurer any legal documents that relate to the claim.
- The insured has to cooperate with the insurer to help settle the claim, including attending any hearings or trials.
- The insured can't voluntarily make payments or incur any expenses, unless he/she wants to pay for it themselves.

Alert!

There are **2** big no-nos related to **duties after a loss**:

- 1) Settling the claim without the insurance company
- 2) Having the damages assessed without the insurance company

B. Assignment

Assignment means that rights are transferred from one party to another, usually in writing. In insurance, the insured assigns certain rights under contract to their insurer. The party granting the right transfer is called the **assignor** and the party receiving the rights is called the **assignee**.

Here are a few examples of this: if someone has automobile insurance and someone else hits them, they're not allowed to accept money from the person that hit them, and from the insurance company. They have **assigned** the right to recover payment from the at-fault party to the insurer.

8. Insurer Provisions/Obligations of the Insurance Company

The insurer has certain options and obligations relating to the insured, such as:

A. Subrogation

Subrogation is the right of the insurance company to go after the liable/at fault party for compensation for claims paid.

Subrogation also keeps the insured from collecting twice for the same loss. So, if Joe's actions result in damages to Blake's property, the insurance company reimburses Blake, and then goes after Joe for recovery. This is **subrogation**.

Note: Sometimes you'll run into a question that looks like this:

"Bob tossed his cigarette into a dumpster, which caused a fire at Raphael's apartment complex. After Raphael's insurance company

pays her for the damages, the company goes after Bob for compensation. Which word best describes this situation?”

- a. Assignment
- b. Duties after a loss
- c. Salvage
- d. Coinsurance

You're immediately looking for **subrogation**, but remember, Raphael has **assigned** her right to recover payment from the at fault party to her insurance company.

B. Liberalization

This means that if the state or national legislature broadens policies or endorsement forms, and an increase in premiums isn't required, the same coverage will be automatically broadened in existing policies.

C. Claim Settlement Options

There are different ways to settle claims. There are 2 basic options:

- 1) The insurer pays the claim in a lump sum.
- 2) The insurer makes a series of payments until the financial obligation is fulfilled.

D. Duty to Defend

This means the insurance company is responsible to defend their clients no matter who is at fault. Certain types of policies include defense expenses, but that's not part of the duty to defend.

Simply put, the **duty to defend** means the insurance company

won't desert their client if a claim is made against him/her. The company will see the claim through to the end, always trying to swing things in the insured's favor.

9. Third-Party Provisions

If a policy involves a third-party, then the third-party has certain options and obligations relating to the policy, such as:

A. Standard Mortgage Clause

If the insured borrowed money from a bank or some other lender to finance property, then that third-party also has an insurable interest in the property. To protect the mortgagee, the **standard mortgage clause** is used almost universally. It states that the mortgagee has the following rights:

- The mortgagee will continue to receive any losses or damage payments **regardless** of the property owner's insolvency, **regardless** of any increase of hazards, and **regardless** of any change of ownership.
- The mortgagee will receive at least **10** days notice if a policy is going to be cancelled.
- The mortgagee can sue under the policy.

In exchange for those rights, the mortgagee is obligated to do the following:

- Notify the insurer if there is any change in ownership, occupancy, or the hazards increase on a property.
- The mortgagee has to pay the insurance premium if the owner fails to pay. This only applies if the mortgagee wants to continue that coverage.

- The mortgagee must submit a proof of loss to the insurer just in case the owner fails to do so.
- The mortgagee must surrender any claims it has against the owner to the insurer, if the mortgagee has received payments from the insurer. (Assignment/subrogation)

B. Loss Payable Clause

This simply means that the insurer can make a loss payment to a person (mortgagee/loss payee) other than the insured, if the mortgagee/loss payee has an insurable interest in the property.

The only downside to the **loss payable clause** is if the insured fails to make the premium payments or violates the insurance policy, the mortgagee can't collect either. Basically, if the insured has no rights to collect, neither does the mortgagee.

C. No Benefit to Bailee

No benefit to bailee means that no one but the insured can benefit from an insurance policy. That sounds obvious, except certain Inland Marine policies involve leaving property with bailees. If the property is damaged, the bailee won't benefit from the insurance (the bailee needs his/her own insurance for that).

10. Binders

A **binder** gives the insured temporary coverage on his/her property until the insurance policy arrives. An insured may have just requested or applied for the insurance, and he/she doesn't actually have the official documentation in hand, but the **binder** means the insurer has agreed to provide temporary coverage pending approval.

Someone can receive a binder and still be denied insurance. If the insurance company gives the person a binder while the insurance application is being processed, that binder doesn't guarantee a certificate of insurance. If the insurance company decides not to insure someone, the company has to issue a legal notice of cancellation. Until then, the binder will continue to provide coverage.

11. Sources of Insurability Information

Sources of insurability refer to any information that confirms whether or not someone is a desirable insurance risk. The primary source of insurability is **the application for insurance**.

Other sources include:

- The producer/agent report
- Consumer reports
- Inspections
- Insurance reporting agencies

Alert!

You may run into this question on the test: "What's the primary source of insurability?" And you may be tempted to answer: appraisal, credit report, photographs, etc. The primary source of insurability is the application: the application is the primary source of insurability. So, if someone asks you what the primary source of insurability is, you'll answer:

THE APPLICATION

12. Fair Credit Reporting Act

The **Fair Credit Reporting Act** means that the applicant has to know in advance if an insurance agency is going to request a copy of their consumer report. If the applicant is denied because of any information in that report, the applicant has the right to find out what information affected either the issuance of an insurance policy, or an increase in the premium rate.

Not only does this serve to protect people's privacy as much as possible, it also helps to maintain accurate information.

The **Fair Credit Reporting Act**—or **FCRA** if you're lazy—only allows insurers to use information from consumer reports under certain conditions:

- The insurer has to get the applicant's consent before obtaining medical information.
- The insurer has to give the applicant written disclosure within **3** days of requesting a consumer report.
- If the insurance coverage is denied because of the consumer report, the consumer can find out what that information is, just in case it's inaccurate.

If the person receives an adverse notice report, that report has to include:

- The contact information for the consumer reporting agency
- A legal statement that the consumer reporting agency didn't have anything to do with the person getting denied for insurance

- A notice that the applicant has the right to dispute the information in the report. Upon request, the consumer reporting agency (NOT THE INSURER) will then supply the person with a free copy of the report within **60** days

13. Notice of Claim

A notice of claim is the insured letting the insurer know that a covered cause of loss has occurred, and he/she/they think they should be reimbursed for that loss.

14. Claims Made Policies versus Occurrence Form Policies

There are **2** kinds of policies relating to claims:

- 1) **Claims Made Policies** cover claims that are reported during the policy period. If an occurrence took place in an earlier year, the insured is only covered if he/she/they purchased the same insurance year after year.
- 2) **Occurrence Form Policies** cover claims that occurred during the policy term, regardless of when the loss was reported.

Putting it into Context:

If Bob is exposed to asbestos in the sixties, and the health problems don't surface until the nineties, Bob is still covered under an **Occurrence Policy form**—even if Bob only had insurance for that year and then never renewed. On the other hand, if Bob is covered by a **Claims Made form**, he can't make a claim in the nineties that started in the sixties unless he purchased the same insurance year after year.

Note: A claims-made policy is more flexible. Because a claim has not been made yet, you can increase your limits or buy new coverage that you did not have when you started. Occurrence policies, on the other hand, are more permanent. You are protected forever by the policy you had that year with no need to renew or buy tail coverage.

Here are some associated terms you should know:

Retroactive Date & Prior Acts: A policy may be endorsed to cover incidents which occurred prior to the policy start date.

Tail Coverage: Coverage for incidents that have not been reported during the policy term.

Basic Extended Reporting Period: Begins when the policy period ends. Activated when the policy is cancelled or non-renewed.

15. Loss Settlement Provision

This provision defines the method that will be used to determine the amount of money the insured will receive for a claim.

Usually this provision stipulates that claims will be paid on an ACV or replacement basis. This provision also determines how claims will be paid per item, per loss. Therefore, items A, B, and C are all covered on an ACV basis, but items X, Y, and Z are covered on a replacement basis.

16. Consent to Settle a Loss

With certain kinds of lawsuits, it's less expensive to settle than to defend the claim. This is especially pertinent with Professional Liability, such as Malpractice insurance.

This is a tricky concept, because settling a claim can sometimes damage a person's professional reputation. If a doctor is wrongly accused, and he/she settles to save on cost, in the public eye it can seem like an admittance of guilt. His/her practice could suffer as a result.

If a policy has a Consent to Settle Provision, it may mean that the insurance company decides if a claim will be settled or defended based on what's more cost efficient.

Some companies offer Professional Liability insurance without this provision, stipulating that their client's reputation is more important than money. It's important to note their wording: "*If you are wrongly accused, then...*" It could be financially crippling to an insurance company to defend a justified lawsuit.

Summary

That should give you an idea of the inner workings of insurance policies. You'll need to have an understanding of a policy's makeup as well as its applications for the final exam.

Section PC 3

CONTRACT LAW

Objectives

You need to know about the different kinds of insurance contracts. This unit includes:

- The Elements of a Legal Contract (C.L.O.C)
- Characteristics of an Insurance Contract
- Legalities

1. The Elements of a Legal Contract (C.L.O.C)

There are certain elements that make a contract a legal contract, and therefore a legally binding contract. The term legally binding means that the terms of the contract will be upheld by a court of law.

There are **4** important elements to a legal contract:

- 1) **Competent Parties** means the people entering into the contract have to be considered “legally capable” (of age, mentally stable, etc.).
- 2) **Legal Purpose** means a contract has to have a lawful purpose. If it doesn't have a lawful purpose, it's not enforceable.
- 3) **Offer and Acceptance** means both parties agree on the terms of the contract and now the contract is considered legally binding.

- 4) **Consideration** means the physical return both parties get from the contract. In insurance terms, the consideration the insurer gets is premium payments, and the consideration the insured gets is insurance coverage.

Note: Notice that the **4** elements almost spell “clock.” This is how most people remember it. We prefer the mnemonic: “**C**an **L**ucy **O**vercome **C**laustrophobia?” We pride ourselves on being more creative than all those other blah pre-licensing schools.

2. Characteristics of an Insurance Contract

There are different characteristics of insurance contracts that can change the entire tone of the contract. These include the following:

A. Contract of Adhesion

This kind of contract means “take it or leave it.” In this type of contract, one party has all the bargaining power, and the other party has no bargaining power. This type of contract doesn’t allow for negotiation or quibbling over contract wording.

B. Aleatory Contract

This kind of contract means the amount of money paid by one party could be a lot more or less than the other party. Most insurance contracts are considered **aleatory contracts**, because the insured could make premium payments for years for an occurrence that never happens, or the insurer could end up compensating an insured after only a few premium payments.

C. Unilateral Contract

This kind of contract means that someone promises to do or not do something in return for consideration. This is also referred to as a “one-sided contract.” A very simplified example of this would be: if you pay me \$500, I’ll paint your house.

D. Conditional Contract

This type of contract depends entirely on an event actually happening. An easy example of this is if someone is selling their house, they won’t get paid until the house actually sells.

E. Personal Contract

This type of contract insures the person who owns the property, but does not insure the actual property.

3. Legalities

Here are some important legal characteristics affecting contracts:

A. Indemnity

This refers to a type of contract, such as insurance, that serves to restore the individual to the approximate financial position occupied prior to the loss.

B. Representations / Misrepresentations

Representations are statements made by the applicant for insurance before the policy is issued. These statements aren’t considered set in stone: usually the wording is “the above is true to the best of my knowledge.”

Legal World: A representation made by an applicant for insurance may be altered or withdrawn before the insurance goes into effect, but

not afterwards. A representation is considered false when the facts fail to correspond with its assertions or stipulations.

If the information turns out to be incorrect, this is called a **misrepresentation**. Intentional **misrepresentations** can void an insurance policy, because it affects the determination of potential risks.

Putting it into Context:

Here's an example of intentional **misrepresentation**: Chris's Health insurance application asked if Chris has any family history of heart problems. Chris is completely healthy, but there is an extensive history of heart problems in Chris's immediate family. Worried that checking "yes," would affect her premiums, Chris checked "no." If the producer/agent finds out about Chris's intentional misrepresentation, it could keep Chris from being insured, or it could void Chris's policy.

C. Warranties

A **warranty** is a statement made by the applicant that becomes a condition of the contract. False warranties void the entire contract.

Putting it into Context:

Mona wants Boatowners insurance. She tells her insurer she's only going to use her sailboat on rivers and lakes. The hazards of using a sailboat on rivers and lakes are different from the hazards of using a sailboat on the open seas, so this becomes a condition of Mona's insurance contract. This is Mona's **warranty**.

A warranty is either:

- **Expressed** warranties are in written form and attached to the policy.
- **Implied** warranties are not written but still exist under the law. Some representations may qualify as implied warranties.

Legal World:

A representation in an insurance contract qualifies as an ***implied warranty***.

D. Concealment

Concealment means withholding important information regarding a loss or the events surrounding a loss. **Concealment** immediately voids coverage.

Putting it into Context:

Victor's roommate backed her truck into Victor's parked car. Victor wants to repair the damages, but he doesn't want to adversely affect his roommate's auto insurance. If Victor reports the claim, but leaves out the fact that his roommate hit his car, this is **concealment**.

E. Fraud

This is a dishonest or deceptive act meant to cheat or gain an advantage.

For example, if an insured signs a claim form for a fraudulent claim, they would be committing a fraudulent act.

The California Department of Insurance has set up a Fraud Division to handle the possibility of insurance fraud.

An insurance claims analysis bureau is set up specifically to:

- Compile information and data concerning insurance claims
- Provide information to insurers/subscribers about insurance claims to avoid attempts to defraud the industry
- Help develop programs to further insurer fraud prevention, fraud investigation, and fraud prosecution
- Provide all California data and information regarding claims to the Commissioner

An Insurance Contract Does NOT Need . . .

Information that DOES NOT need to be communicated in an insurance policy is:

- Known information
- Information that should have been known
- Information which the other party waives
- Information not material to the risk

F. Waiver and Estoppel

This is a really interesting legal concept. If someone gives up one of their known rights, this is known as a **waiver**.

For example, Angie's house burns down and she loses everything. Because she's having a really difficult time coming up with an inventory of items lost to submit her proof of loss form on time, her insurance company tells her they'll give her an extra 30 days to submit the form. Even though the insurance company has the legal right to demand the form by a certain date, they are **waiving** that right.

Estoppel is a court/judge blocks someone from asserting the original right they chose to **waive**. The exact definition of this can be along the lines of: If someone behaves in a manner that's inconsistent with their behavior in the past. This is a very circuitous way of saying, "if someone goes back on their word," but look out for that answer on the final exam.

An example of **estoppel** would be if Angie's insurance company suddenly changed their minds and said they wouldn't reimburse her loss because she didn't submit her Proof of Loss on time. Angie takes the company to court and the judge issues an **estoppel**, which forces the insurance company to honor the conditions of the **waiver**.

G. Reasonable Expectations

An insurance contract has to give the insured reasonable expectations. It can't confuse the insured with complex legal language, or promise the sun and the moon if it won't deliver. It's up to the insurance company to make the insurance policy as clear to the insured as possible to guarantee that the insured has reasonable expectations.

H. Utmost Good Faith

Insurance policies are considered contracts of **utmost good faith**, which basically means all the parties involved were completely honest and disclosed any and all relevant information and facts. Utmost good faith means mutual trust during the negotiation of a contract.

I. Materiality

Materiality has to do with facts and information relevant to an insurance policy. Materiality can be determined using three questions concerning the information:

- 1) Can the information convince or dissuade either party to enter a contract?
- 2) Does the information create a disadvantage for either party?
- 3) Does the information have any affect on the risk or insurability involved?

Materiality concerns both the insurer and the insured. Each party involved in the contract have to have all the relevant information that could have any positive or negative affect on the contract.

Real World:

Materiality of concealment is the rule used to determine the importance of misrepresentation, i.e., someone is considered to have misrepresented an answer on an application if the concealment is considered material.

J. Ambiguities in a Contract of Adhesion

Basically, this means something was unclear and because it wasn't clear it was misinterpreted. If a contract of adhesion has ambiguities, the courts will usually rule in favor of the insured.

K. Rescission

Rescission means the same as revoke or remove. An insurer could legally rescind an insured's policy if:

- There's been intentional or unintentional concealment
- There's been an intentional and fraudulent omission

- A misrepresentation comes to light after a policy has gone into effect
- A material warranty or a material policy provision has been violated

L. Premium Rating

The California Insurance Code specifies that premium rates can't be excessive, discriminatory, or inadequate. If any insurer wishes to change their rate, they have to file a complete rate application with the Commissioner. The rate change will be approved unless a consumer requests a hearing within 45 days.

If the rate change exceeds **7 %** of the usual rate for Personal Lines, or **15 %** for Commercial Lines, the Commissioner has to hold a hearing.

If all goes smoothly, the rate change application should be approved **180** days after the Commissioner receives the rate change application.

The different systems used to ascertain whether or not a premium rate is fair and adequate, are:

- **File and Use System** means the company can use a rate as soon as it's filed.
- **Prior Approval System** means the company has to have the rate approved before they can use it.
- **Mandatory System** means that the premium rate is determined by the federal government, and then all companies have to abide by that rate.

After a basic rate has been determined, the insurance company then has to apply that rate to individuals with different needs. There are different ways an insurance company determines a premium rate. Those ways are:

- **Judgment Rating** is based on the individual's risks or risk exposure. The underwriter uses its own best judgment to determine a rate.
- **Merit Rating** rates the individual by what group or class they belong to, and then the rate is tailored to that person's unique situation.
- **Manual Rating** means the underwriter only assesses the person's group or classification to determine the rate.
- **Retrospective Rating** means the premium can be credited back at the end of the period if it turned out to be too high based on the person's actual losses. The premium can also be adjusted if the person's losses were higher than expected.
- **Experience Rating** modifies the Manual Rating, by putting the person in their group or classification, and then adjusting the rate based on that person's loss history.

M. Unearned vs. Earned Premium

Unearned versus earned premiums are based on whether or not someone has paid for future coverage.

If someone pays an annual premium, and six months have gone by, then they have six months of:

- **Unearned premium**, for the six future months that are prepaid
- **Earned premium**, for the six months that have already gone by

Section PC 4

PERSONAL LINES INSURANCE

Objectives

This unit explains the importance of protecting your client's "domestic sphere," that is, his/her non-professional life. No matter the client's particular insurance needs or type of property, unit 4 explains how to insure it all.

This unit includes:

Part A: Dwelling Insurance

- Dwelling Forms
- Extended Coverage Perils
- Dwelling Form Coverages A-E
- Other Coverages
- General Exclusions

Part B: Personal Liability

- Personal Liability

Part C: Homeowners Insurance

- Homeowners Insurance

Part D: HOP Section 2

Introduction: The History of Fire Insurance and the "Standard Fire Insurance Policy"

New York developed the first Standard Fire Insurance policy during the early 1900s. That policy was used throughout most of the United States, because it was so well designed. This policy became known as the 165-line policy.

The SFP is the only insurance policy that has its wording standardized by law. The SFP used to be included in all fire insurance policies, even though it was never a complete contract by itself. Obviously, the insurance industry continues to evolve along with people's needs, so the original SFP isn't used any longer. However, many of the same perils, exclusions, and provisions that could be found in the original SFP are still found in current insurance forms.

California created their own California Standard Form Fire Insurance Policy, also known as the Standard Fire policy (SFP). It contains similar provisions to the industry standard form with the exception that the California SFP coverage can also provide "equivalent to or more favorable coverage".

The California Insurance Code states that: "All fire policies on subject matter in California shall be on the standard form, and except as otherwise provided shall not contain additions thereto."

Associated terms you should know include the following:

Open Policy: The value of the coverage is not agreed upon, it's left open.

Valued Policy: The thing being insured is valued at a specified sum.

Warranty: A statement in a policy that imports there is an intention to do or not to do a thing which materially affects the risk. It can relate to the past, present or future. Can be

expressed or implied. If it relates to a person or thing insured it is expressed.

Return of Premium: An insured is entitled to a return of his premium if the policy is canceled, rejected, surrendered, rescinded or voidable (due to known or unknown fraud or misrepresentation). The return can be whole if the insurer has not been exposed to any risk or proportionate with the unexpired time.

No homeowner policy may contain a provision that mandates that premiums are fully earned upon the happening of any contingency.

Part A: Dwelling Insurance

1. Dwelling Forms (DP Forms)

Dwelling insurance is used more frequently for landlord (tenant) properties and homes that don't qualify for "standard" or "preferred" Homeowners insurance policies.

Dwelling policies are similar to Homeowners policies. Both provide property insurance for:

- Residential dwellings and contents
- Appurtenant structures/other structures on covered premises
- Loss or damage to the dwelling

Eligible and/or ideal Dwelling policy properties are:

- Rental properties (1-4 units or apartments)
- Older and/or lower-valued homes

- Homes with minor cosmetic problems
- Homes with a market value that's below replacement cost
- Customers with credit and/or loss problems
- Dwellings under construction, vacation homes, or rentals
- Permanent mobile homes—a mobile home that isn't on wheels
- Offices, studios, or storage facilities

Under certain circumstances, an insured could prefer a Dwelling policy (DP) over a Homeowners policy (HOP). A DP would be preferable if:

- The property is vacant
- The insured isn't living in the dwelling, but could be renting it
- Up to five roomers or boarders occupy the dwelling
- The dwelling is rated poor to good based on condition, value, and age
- The insured is required to only carry coverage protecting the dwelling

Note: Under a Homeowners form, the contract includes personal property and liability coverage. Under a dwelling form, the insured can choose the coverages they need, and exclude the coverages they don't need.

Note: The standard deductible for a DP is **\$250**.

There are **3** Dwelling forms:

- 1) Basic Form (DP 01)
- 2) Broad Form (DP 02)
- 3) Special Form/Open Peril (DP 03)

A. Basic Form (DP 01)

The **Basic form** (DP 01) policy is the simplest and most affordable Dwelling policy. This policy might be used to cover a residential home, rental properties (1-4 families), seasonal homes, qualifying vacation homes and homes that are being renovated. Coverage is based on ACV.

Note: Just a reminder—ACV is computed on the basis of replacement cost minus depreciation.

The coverages provided are **named perils**: including coverage on the dwelling against the **3** main perils:

- 1) Fire
- 2) Lightning
- 3) Internal Explosion

Note: An example of an internal explosion would be if a furnace or water heater explodes.

Note: We're going to provide you with mnemonics whenever possible, even if they're not the coolest mnemonics you've ever seen. So, for the basic perils, just remember F.L.I, as in, "Shoo F.L.I, don't bother me," or, "Say, waiter. There's a F.L.I in my soup." We know it's a stretch, but humor us.

B. Extended Coverage Perils

Since the basic form is so bare bones, the insured can add extended coverage perils to the Basic form for an extra premium.

Although it's a bit on the colorless side, you can memorize the extended coverage perils by using the acronym **W.H.A.R.V.E.S**:

- **W**indstorm, which includes tornadoes and hurricanes.
- **H**ail is external coverage only, unless the weather makes a hole in the roof or walls.
- **A**ircraft insures property against a plane crash or objects falling off a plane—there has to be actual physical contact with the insured property.
- **R**iot or **C**ivil **C**ommotion insures property that's stolen or damaged during a riot.
- **V**ehicle coverage applies if a car crashes into the property or a passing car kicks up objects that damage the property.

Note: This coverage doesn't apply if the vehicle in question belongs to the insured.

- **V**olcanic **E**ruption insures buildings and their contents against volcanic eruption. Damage caused by ash, smoke, lava flow, or airborne shockwaves is covered.

Note: If a volcanic eruption causes an earthquake, earth movement, or other land born shockwaves that cause damage to the dwelling, the

dwelling isn't covered under volcanic eruption. Earthquake, flood, and mudslides are all excluded.

- **Explosion** covers both internal/external sudden and accidental explosions, which occur either on or off the insured's premises.

Note: This coverage doesn't apply to the insured's steam boiler.

- **Smoke** covers sudden and accidental smoke damage.

Note: Smoke doesn't cover damage caused by a fireplace or nearby industrial factory.

For an extra premium, the insured can also choose to have the additional extended coverage peril Vandalism and Malicious Mischief (V&MM). V&MM covers losses or damages to property that happen either intentionally or randomly.

Note: This coverage doesn't protect dwellings that were vacant for more than **30** consecutive days before the loss.

Fun Factoid:

Benjamin Franklin and associates began of the first American fire insurance companies. After a horrible fire ravaged Philadelphia in 1730, Benjamin Franklin began writing articles about fire safety and prevention. Franklin's recommendations led to the formation of Philadelphia's first official fire brigade. Shortly thereafter, Franklin and other great thinkers started an insurance company called, "The

Philadelphia Contributionship for the Insuring of Houses from Loss by Fire.”

C. The Broad Form (DP 02)

The **Broad form (DP 02)** covers dwellings on a broad named perils basis. The Basic form is much more limited, but the Broad form automatically includes the extended coverage perils and V&MM. Coverage is on an ACV basis.

In addition to the basic coverages, the Broad form policy includes the following **additional named perils**:

- **Damage by burglars** covers the damage done by burglars, but doesn't replace stolen property. For example, if a burglar broke down a door and stole jewelry, the door repairs would be covered, not the jewelry.

Note: Coverage doesn't apply if the building was vacant for more than **30** consecutive days before the break-in.

- **Weight of Ice, Snow, or Sleet** covers damage to a building and its contents, but doesn't cover any losses to external items (patios, porches, etc.).
- **Falling Objects** covers loss or damage caused by falling objects, such as trees, branches or the Kal-El meteorite. Coverage is mainly external, but contents on the inside are covered if the building was initially damaged by a falling object. For example, if a tree falls on a house and creates an opening in the roof, any objects damaged inside the

home as a result of the hole in the roof are covered up to policy limits.

- **Accidental Discharge or Overflow of Water or Steam** covers loss or damage caused by sudden and accidental water damage from the plumbing system, or broken appliances.

Note: Coverage doesn't apply if the water overflow is the result of freezing, due to the building being poorly maintained or vacant for more than **30** consecutive days.

- **Freezing** covers freezing of plumbing or household appliances.

Note: Coverage doesn't apply if the freezing is due to the building being poorly maintained or vacant for more than **30** consecutive days.

- **Sudden and Accidental Damage from Artificially Generated Electrical Current**, which is a fancy way of saying, damage from any man-made, non-lightening, electrical source.
- **Sudden and Accidental Tearing Apart, Cracking, Burning, or Bulging** of an Appliance for Heating Water covers household appliances, steam and hot water heating systems, air conditioning systems, and fire sprinkler systems.

There are **3** coverage extensions, which are expanded in the DP 02:

- 1) **Explosion** isn't as restricted in the DP 02 as it is in the DP 01. Steam boiler explosions are covered on or off the insured's location if it damages covered property.
- 2) **Vehicles** provide some coverage for vehicles owned by the insured (unlike in the DP 01, which provides no coverage for vehicles owned by the insured). This coverage won't cover fences, driveways, or walkways. So, if the insured runs his/her car into the house, the damages are covered. However, if the insured runs his/her car into the fence, the damages aren't covered.
- 3) **Smoke** in the DP 02 covers any losses caused by smoke from a fireplace. For example, if the insured starts a fire in the fireplace, and forgets to open the damper, the resultant smoke damage is covered.

Note: Losses under the DP 02 are on an ACV basis. Therefore, the current cost of the damaged property minus depreciation applies to both the dwelling and separate structures.

B. All Risk/Open Peril (DP 03)

An all risk/open form policy insures property and other structures against any direct physical loss perils, except the perils that are excluded by the policy. This type of policy doesn't list the perils that are insured, but instead lists the perils that are excluded. So, the policy could specify that earthquake coverage is excluded, which means every other peril except earthquake is covered.

It's important to remember that the **Open Peril** (named exclusions) coverages apply only to the dwelling and appurtenant structures. Personal property is covered on a **Broad Form Named Peril Basis**. The Special form provides coverage that's *specifically* designed for any customers who need broader, more comprehensive coverage.

The Special form (DP 03) policy is intended for:

- Owner-occupied homes
- Rental properties (1-4 units)
- Seasonal homes

C. Special Form Exclusions

The following are DP 03 *exclusions*:

- Weather damage to satellite dishes (wind, hail, ice, snow, or sleet)
- Collapse, unless this is covered separately by collapse coverage
- Freezing in dwellings that are poorly maintained, unoccupied, or under construction
- Theft to uninsured property or property under construction
- V&MM if the dwelling has been unoccupied for more than **30** consecutive days
- Any leakage from appliances or plumbing that's been constant or has repeated over a period of time
- Wear and tear or gradual damage/deterioration caused by air pollution, smoke, rust, mold, settling, cracking, or shrinking

- Any non-human (birds, insects, rodents, domesticated animals, aliens, etc.)

Note: Collapse is additional coverage that can be added in dp 03, but not DP 01

Note: Special form losses are settled on a replacement cost basis, which means depreciation isn't deducted from the current value of the property. Therefore, if the insured loses a couch in a fire, under the DP 03, he/she will be able to replace the couch with a new, similar couch at today's price.

Microbial Matter Exclusions: A common exclusion in current personal lines policies is microbial matter (mold, mildew, viruses) which includes fungi and bacterial matter which reproduces through the release of spores living or not.

2. Personal Property Coverage and Contents

All of the Dwelling forms settle losses on an ACV basis for personal property and content losses. Personal property coverage is on a Broad Form Named Peril basis, therefore, the same exclusions that apply to the Broad form (DP 02), also apply to the Special form (DP 03) personal property perils.

3. Dwelling Form Coverages A-E

All **3** Dwelling forms (DP 01, 02, and 03) offer the same basic policy coverages, which are referred to as Coverages **A-D**:

- **Coverage A:** Dwelling

- **Coverage B:** Appurtenant Structures (other buildings on the property that aren't attached to the main dwelling)
- **Coverage C:** Personal Property
- **Coverage D:** Fair Rental Value

All of the Dwelling forms offer Coverages A-D. However, the **Broad form** and **Special form** also offer **Coverage E—Additional Living Expenses**.

The main idea behind **Coverage E** is to cover the additional expense of functioning after a covered loss. So, if the insured has to stay in a motel and eat fast food for a week, because he/she can't be in their home, those expenses are covered by **Coverage E**.

Therefore:

Coverages A-C cover **direct losses**:

Coverage A—Dwelling

Coverage B—Appurtenant structures

Coverage C—Personal Property

Coverages D-E cover **indirect losses**:

Coverage D—Fair Rental Value

Coverage E—Additional Living Expense

Note: The best way to memorize the information is to take it out of the official insurance-eeze, and put it in a real world context. It's presented to you in this formal way, because that's how it's going to appear on the final exam, and that's how you'll get used to reading it

and referring to it as a licensed producer. But for the sake of easy memorization:

Coverage A: The main house

Coverage B: Other buildings

Coverage C: Stuff

Coverage D: Any income lost if renters can't use the property

Coverage E: The cost of getting by after a covered cause of loss

Note: Liability insurance isn't automatically included in the DP. If the insured wants liability, they'll have to add a Comprehensive Personal Liability policy, or, if they're insuring a rental dwelling, they could extend liability coverage onto the rental using their Homeowners policy (HOP). More on liability later in the unit.

A. Coverage A—Dwelling

Coverage A covers the dwelling and any items or materials used to maintain the dwelling. Coverage A doesn't include land.

Coverage A includes:

- The dwelling and structures attached to the dwelling (i.e. an attached garage)
- Materials/supplies on the premises that are used to service/repair/construct the premises
- Building and outdoor equipment used to service/maintain the premises (i.e. lawnmowers, etc.)

Note: If an insured has their riding lawnmower specifically named under Coverage C—Personal Property, then it won't be covered by Coverage A. Make sense? In that way, it's not covered twice and the

insured can't collect twice for the same loss. So, it's either covered under A or C, but never both.

B. Coverage B—Separate (Other) Structures

Coverage B covers appurtenant structures that are located on the same premises as the dwelling. Such structures could include a detached garage, pool, or storage shed. Coverage B doesn't cover land, or any structures that are used for commercial or farming purposes.

Requirements for **Coverage B** include:

- The appurtenant structures have to be completely separate from the dwelling
- The only connections allowed between the appurtenant structure and the dwelling, are impermanent connections like fences or utility lines.

Note: All **3** DP forms limit Coverage B to **10 %** of the Coverage A Dwelling amount. This doesn't reduce the Coverage A amount, it just places a cap on the Coverage B amount.

C. Coverage C—Personal Property

Coverage C covers the personal property that's owned or used by the insured. It also covers the personal property of resident family members, employees, and on-premises guests.

Note: Personal Property is covered on an ACV basis. It's also covered for the same named perils as in the Broad form (DP 02).

Coverage C includes a provision for coverage if the insured is moving. The provision is called **Automatic Removal**, and it gives the insured 30 days coverage for personal property at the new residence. Any personal property that's lost or damaged during the move isn't covered.

Coverage C also provides **10 %** coverage of Coverage C for personal property located anywhere in the world.

D. Personal Property Exclusions in DP forms

There are certain types of personal property that are exclusions in all **3** DP forms (Basic, Broad, and Special). The following are Personal Property Exclusions:

- Any pets or domestic animals
- Aircraft and parts. This exclusion doesn't apply to model aircraft, because they're not designed to carry people or cargo (duh, right?)
- All boats—except on-premises rowboats and canoes—are excluded
- Motor vehicles that aren't used to maintain the premises or designed for the handicapped (motorized wheelchairs)
- Stamps and tickets
- Credit cards/fund transfer cards
- Currency, coins, metals, and medals
- Personal records (bills, bank notes, manuscripts, passports, etc.)
- Any data, electronically stored or otherwise

Note: The DP forms don't include theft coverage for certain items that are usually targeted by thieves, like jewelry, furs, and firearms. Most insurance companies will provide coverage for those items through endorsements.

E. Coverage D

This coverage protects properties that are being rented out. So, if the insured's rental property is damaged, and the renters can't live there, **Coverage D** will reimburse the insured for the lost rental income.

Coverage D pays the insured the Fair Rental Value for the shortest period of time it takes to repair/replace the damages.

Coverage D is limited to **10 %** of the Coverage A dwelling amount, and covers up to a 4-family unit for rental losses. Coverage D never reimburses for any extra expenses, only lost income.

F. Coverage E—Additional Living Expenses

Coverage E covers additional living expenses. This coverage is available only in the Broad and Special forms, and not the Basic form.

If a covered loss forces the insured to leave the insured residence, Coverage E covers the additional expense of maintaining a normal standard of living.

Coverage E pays for any *necessary* increase in living expenses. Payments end when the property is fixed, or if the insured has permanently relocated and settled someplace else.

Note: Keep in mind that the expenses Coverage E pays have to be over and above the insured's normal living expenses. Coverage E is intended to help the insured maintain his/her family's normal standard of living. Therefore, if the insured decides to rent out the Presidential Suite and order room service three times a day, the insurance company will probably decide this doesn't constitute a necessary expense.

3. Other Coverages

DP forms also provide the following Other Coverages to help eliminate a few gaps:

- **Separate (Other) Structures coverage** specifies that any coverage for damages to separate structures doesn't reduce the amount of **Coverage A** available for damages to the main dwelling due to the same loss. So, if the dwelling and the detached garage are damaged by the same loss, Separate Structures covers the damage without decreasing the available Coverage A limit.

Note: Remember coverage for Other Structures is limited to **10 %** of Coverage A.

- **Power Failure** means the insured isn't covered for an off-premises power failure.

Note: Like the above exclusions, if the off-premises power failure resulted in a direct, covered loss to insured premises, then the resultant loss is covered.

- **Neglect** means the insured isn't covered if he/she didn't use all reasonable means to save and preserve property after a loss.

Putting it into Context:

Lucy came home and saw that a rainstorm had caused a heavy branch to fall on her roof. The branch opened up a hole in the roof, and rain was starting to leak into her home. After she reported the fallen object to her insurance company, Lucy spent the next few days at her brother's house, and left her house as it was. Because Lucy didn't take any steps to protect the interior of her house, any water damage done to the contents won't be covered. Lucy will be reimbursed for the damages done to her roof, but not for any personal property inside the house.

- **War** means the insured isn't covered if their property is damaged as the result of any kind of war, undeclared or otherwise.
- **Nuclear Hazard** means the insured isn't covered against nuclear hazards. The following losses that could result from a nuclear hazard are all EXCLUDED from coverage:
 - o Fire
 - o Smoke
 - o Explosion

- o Genetic mutations resulting in superhuman powers that cause emotional upheaval or any damage to personal property
- **Intentional Loss** means the insured will never be reimbursed for any losses or damages done on purpose.
- **Loss to Lawns, Plants, Shrubs, or Trees (Basic form)** means the Basic DP doesn't cover flora—aren't we ever-so-fancy?

Note: Losses to plants are covered by the Broad and Special forms.

- **Concurrent Causation Exclusions** excludes the following losses from Coverages A and B:
 - o Severe weather that coincides with any general exclusions
 - o Acts or decisions made by the government or a member of an organization.
 - o Sub-par or faulty design, construction, or maintenance

Concurrent clause is a loss where two perils are involved at the same time and one peril is covered, but the other is excluded.

Part B: Personal Liability DP Endorsement

1. Personal Liability

Personal Liability insurance covers the insured if he/she is legally obligated to pay bodily injury or property damages to a third-party.

The law considers it the responsibility of each individual to act in a reasonable and prudent manner in order not to injure another person, or damage another person's property. But it's a fact of life that some people are natural oafs, and everyone has the potential for unintentional oafishness. If someone isn't careful, and their actions result in injuries or damages to another person or their property, then the law could hold that person liable for those damages.

Personal liability is also referred to as **Third-Party Insurance**, since the person injured, or the person whose property is damaged, is not a party to the contract between the insured and the insurance company.

Alert!

The final exam may try to trick you with a question like this:

"Which of the following wouldn't be covered under an insured's Personal Liability?"

- a. A neighbor who hurts themselves on the premises
- b. A friend who hurts themselves on the premises
- c. The insured's son who hurts himself on the premises
- d. A client of the insured, who hurts themselves on the premises

The insured's son wouldn't be covered, because Personal Liability relates to third-parties: it never covers anyone directly connected to the insured, such as spouses, children, or relatives who live in the house.

Personal Liability coverage isn't automatically included in any of the DP forms. The insured can add liability and third-party medical expenses to their DP through endorsement.

The **2** additional liability coverages are:

- 1) **Coverage L—\$100,000** Personal Liability
- 2) **Coverage M--\$1,000** Medical Payments to Others

Note: Coverages L and M are always automatically included in HOPs. More on Homeowners Policies later in the unit.

If the insured chooses to add the Liability Endorsement to their DP, it includes:

A. Coverage L—Personal Liability

Coverage L protects the insured against third-party lawsuits due to third-party damages or injuries from a covered peril. The insurer provides and pays for a legal defense, and pays up to the coverage limit for damages. The coverage limit is usually **\$100,000**.

B. Coverage M—Medical Payments to Others

Coverage M provides coverage for all necessary, third-party medical expenses within **3** years of an accident from a covered peril. The coverage limit is usually **\$1,000**.

Note: Here's an easy way to remember DP Coverages L and M, and we are absolutely sure we're the first ones to ever think of this, ever!

Coverage L stands for *Liability*!

Coverage M stands for *Medical Payments to Others*!

We're giving you pearls here, baby, pearls!

Coverage applies if the insured is liable for bodily injury to:

- Someone who was on covered premises with permission, and they hurt themselves
- Someone who left the covered premises, but ended up injured because of a condition on the covered premises
- Someone who was injured by the actions of the insured
- Someone who was injured by an animal in the insured's care

Putting it into Context:

Under Coverage M, how could someone leave the premises and then end up injured because of a condition on the premises? Well, say a neighbor comes over for a visit, and ends up getting stung by a wasp. You've been ignoring that huge wasps' nest for a while now, because you just didn't want to deal with it. The neighbor leaves, and an hour later has a severe allergic reaction to the sting, and has to be admitted to the hospital. Coverage M would take care of this situation, because the neighbor ended up with injuries that were due to a condition on the premises, even though he/she was off the premises when the injury emerged.

C. Claims Expense

Claims Expense is the insurer's expenses to defend the insured during a lawsuit. If the insured needs to help with the investigation or their defense, they can be compensated for up to **\$50** a day in lost income.

D. First Aid to Others

First Aid to Others covers any expenses for administering first aid to someone else if the expense is a result of a BI covered by the policy.

E. Property Damage of Others / Voluntary Property Damage

If an insured causes damage to someone else's property, the damage is covered up to **\$500** per occurrence. This coverage doesn't require that the claimant prove the insured was negligent.

Part C: Homeowners Insurance (HOP)

1. Homeowners Policy Forms (HOP)

When someone owns their own home, they want to protect that investment, *plus* they face additional risks and exposures due to home ownership.

Homeowners need protection from **3** major risks:

- 1) Damage or destruction to the house
- 2) Damage or destruction to personal property
- 3) Liability (and any lawsuits)

HOPs are designed to protect a person or family against the **3** above risks. Whether an insured owns or rents a home, a HOP provides valuable and necessary protection.

Most insurance companies offer Homeowners Package Policies that provide coverage for all the risks. Besides combining coverages for

the dwelling, personal property, and personal liability, the HOPs also include **fire**, **theft**, and **vandalism**, along with other extended and additional coverages.

HOPs cover any and all common problems associated with owning or renting a home. The HOP is also more complete and convenient than the DP, which is why Homeowners Package Policies are more popular.

These policies can differ state-to-state. As long as you know what state you're in, you can double-check any differences. If you don't know what state you're in, we're worried about you. No more Margaritas for you.

Note: The coverage definitions and policy contract terms are similar between the HOP and the DP.

A. Customer Eligibility

Not only do HOPs offer “one-stop shopping” coverages, the packages are often priced more competitively than the DPs. In order to protect competitive pricing, insurance companies look for clients who are “better-than-average” risks. “Better-than-average” risks are clients who show Pride of Ownership and live in preferred dwellings.

A client must meet the following eligibility guidelines for an HOP:

- The house has to be occupied by the owner with a maximum of **2**-family units (remember the DP allows up to 4-family units)

- The home has to be inspected to make sure heating, plumbing, and electrical systems meet state codes, and are installed properly.
- The owner has to be checked for his/her “loss history”—the number and type of insurance claims he/she has filed in the past.
- Property is inspected for Pride of Ownership—is the house in good condition? Is the house well-constructed? Is the landscape well-kept? Are there any uninsurable risks on the premises?
- The house is a residential property, and is never used for commercial purposes.

Note: An inspection of the home could reveal an unusual hazard that makes the property an undesirable risk. Such hazards could include a vicious dog, an unfenced swimming pool or pond, or broken windowpanes.

Note: As an insurance producer/agent, you’ll be looking for the better-than-average risks”, as opposed to the “I’m-surprised-the-parole-board-let-you-out-early risks.” You’ll thank us later for our golden wisdoms.

2. Homeowners Package Policies

There are 6 versions of HO package policies. All of the policy packages—except the HO 04—apply to owner-occupants, that is, someone who both owns and occupies the dwelling. The HO 04 is the Tenants form, which provides coverage for the personal property of renters.

The differences in the HO policy forms apply only to the property and personal contents coverage: the liability coverage is the same for all the HO forms. All of these HO forms include liability coverage as part of the HO package.

The forms include:

- **Broad Form (HO 02)** provides Broad form (named perils) coverage for both the dwelling and personal contents
- **Special Form (HO 03)** provides Special form coverage (all risk except for the named exclusions) on the dwelling and other structures, and includes Broad form (named peril) coverage on personal property.
- **Tenants Form (HO 04)** provides Broad form (named peril) coverage for tenants and renters. There is no coverage for the dwelling, because the renter doesn't own the dwelling.

Note: The owner of the dwelling should carry a separate DP or a Landlord Package Policy to cover any damages to the structure. That kind of policy wouldn't cover the tenant's personal property, so the tenant would need to carry an HO 04.

- **Comprehensive Form (HO 05)** provides Special form coverage (all risk coverage except for the named exclusions) on the dwelling, personal property, and other structures on the premises.
- **Unit Owners Form (HO 06)** provides Broad form (named peril) coverage for condo owners.

- **Modified Form (HO 08)** provides ACV modified peril coverage for owner occupied dwellings that are older or that are less desirable risks. This is the only coverage in which both the buildings and contents are protected only against basic named perils with the extended coverage perils and V&MM coverage. Again, this form is used a lot with older homes, that are higher insurance risks.

Note: An HO 01 isn't sold in California. So if you see that option on the test, you can scratch it out as a possibility right away.

3. Homeowners Package Coverages

The HOP is divided into **2** parts:

- 1) **Section 1** provides coverage for the dwelling, other structures, and personal property.
- 2) **Section 2** provides Personal Liability coverage and Medical Payments to Others coverage.

Alert!

Section 2 covers the insured's liability for damages or injuries done to a third party. Anyone considered to be an insured under the HOP would be covered by Section 2, which is the insured, the insured's spouse and dependents, and anyone else specifically named in the declarations.

Section 2 doesn't pay for the insured's own injuries or property damage, because it's for third-party expenses. So you may run into a question that asks you who wouldn't be covered under Section 2, with a selection of answers like this:

- A. A neighbor injured on the insured's premises
- B. A friend injured on the insured's premises
- C. The insured's spouse injured on the insured's premises
- D. A neighbor who sustains an injury off the premises that is directly related to a condition on the covered premises.

All of the above people are covered, except the spouse. The spouse doesn't count as a third-party.

Here is a sample Dec-page from an HO:

Section I

Coverage A: Dwelling **\$200,000**

Coverage B: Separate (Other) Structures **\$20,000**
(Usually **10 %** of Coverage A)

Coverage C: Personal Property/Contents **\$100,000**
(Usually **50-55 %** of Coverage A)

Coverage D: Loss of Use **\$10,000**
(Usually **20 %** of Coverage A)

Section II

Coverage E: Personal Liability **\$100,000**

Coverage F: Medical Payments to Others **\$1,000**

Note: Section 1 coverages in the HOP are the same as they are in the DP. Remember:

Coverage A: House

Coverage B: Other buildings

Coverage C: Stuff

Coverage D: Fair rental value and additional living expense rolled into one.

A. Coverage A

In HO 02, 03, 05, and 08, Coverage A applies to:

- The main dwelling
- Structures attached to the dwelling
- Materials and supplies on the premises used to construct, repair, or service the dwelling and nearby structures

In **HO 06 (Condos)**, Coverage A only applies to:

- Alterations, appliances, fixtures, and improvements the insured has made to his/her own unit. For example, if the insured makes improvements to the outside of their unit after a loss, only the insured will be reimbursed for the improvement even though the unit is part of a larger whole. No one else but the insured has a claim on those repairs.
- Fixed property in the unit. For example, the furniture that was present before the insured moved in: cupboards, counters, refrigerator, etc.
- Any property the Condominium Owner's Association requires insurance for.
- Structures on the premises *other* than the unit (i.e. garages, etc.)

Note: The unit or condo owner owns everything inside the bare walls with the exception of some fixed items and electrical wiring. This is referred to as the **Bare Wall Doctrine**. Many times, the HO 06 coverage doesn't adequately cover the condo owner, and they may end up needing to increase their coverage through endorsements. These endorsements can increase the limits and protect the insured on an all-risk basis.

B. Coverage A Exclusions

Coverage A excludes:

- Land
- Commercial structures
- Structures being rented to a non-tenant, unless it's being used as a private garage

C. Coverage B

Coverage B isn't included in HO 04 or HO 06, because tenants and condo owners wouldn't need to worry about appurtenant structures on the premises.

Coverage B applies to:

- Detached garages
- Pools
- Storage sheds
- Fences
- Gazebos
- Wells

Coverage B will usually provide coverage for any structure on the premises that is:

- Separated from the dwelling by a clear space
- Connected to the dwelling by only a fence, utility line, etc.

D. Coverage B Exclusions

Coverage B excludes any structures, which are:

- Commercial or used for any commercial purpose
- Rented to someone who isn't a tenant (unless they're using it as a private garage)

E. Coverage C

Coverage C protects the insured's personal property anywhere in the world.

Note: Under Coverage C, an "insured" is anyone protected by the policy, including: anyone in the household, relatives, or anyone under the insured's care.

The named insured can request that the policy also cover personal property owned by:

- Others, while the property is on covered premises
- A guest or resident employee (servant, nanny) while the property is on covered premises.

F. Coverage C Limits

The limit for Coverage C is **50 %** of the Coverage A limit.

However, personal property in an insured's secondary residence (a weekend house, summer cottage, ect.) is only covered for **10 %** of the Coverage C limit, or **\$1,000**—whichever is greater.

G. Lower Coverage C Limits for Certain Kinds of Property

There are lower coverage limits for the kinds of property or losses that are excluded by DP forms:

Coverage Limits	Personal Property
\$1,500	Electronic apparatus while in/on/away from an auto
\$2,500	Business property on the premises
\$500	Business property off premises
\$200	Money, coins, and other precious metals
\$1,500	Securities, valuable documents, etc.
\$1,500	Watercraft, related watercraft accessories on the premises
\$1,500	Trailers on the premises that aren't used with watercraft
Special Limits Apply to Theft Related Losses	
Coverage Limits	Personal Property
\$1,500	Jewelry, watches, furs, precious and semi-precious stones
\$2,500	Firearms
\$2,500	Valuable silverware, goldware, pewterware, etc.

Note: Special limits pay for the loss of all property in a single category. Specific items can be insured for larger amounts with endorsements or floaters.

H. Coverage C Exclusions

These personal items aren't covered:

- Animals
- Aircraft and parts
- The property of any non-relatives staying on premises
- Rented property off covered premises
- Credit cards or ATM cards (unless they're protected by additional coverages)
- Business or commercial data
- Motor vehicles and any item or electronic equipment inside the vehicle or made for the vehicle
- Any item listed and insured separately in the declarations—this keeps the insured from being paid twice for the same loss

Note: Coverage C does cover vehicles that don't need to be registered such as a motorized wheelchair, a garden tractor, or a riding lawnmower.

I. Coverage D

In the HOP, Coverage D is the DP coverages D and E rolled into one. Therefore, in the HOP, Coverage D provides:

- **Fair Rental Value coverage** reimburses the insured for lost rental income when a covered loss makes the rented premises unfit to live in.

- **Additional Living Expense coverage** reimburses the insured for necessary living expenses after a covered cause of loss makes the premises unsafe to occupy.

Note: If the premises are the insured's principal place of residence, the insured can either choose between Additional Living Expense and Fair Rental Value, or choose to have both coverages. If the insured doesn't live on the premises, the insured can only get Additional Living Expense coverage.

J. Coverage D and an Order of Civil Authority

If a civil authority won't allow the insured to use the residence because of neighboring damage, Additional Living Expenses or Fair Rental Value Loss (Coverage D) is covered for a MAXIMUM of **2** weeks.

Alert!

You're not there yet, but we're going to draw attention to the difference now. In the HOP, if the premises are barred by an order of civil authority, Additional Living Expenses or Fair Rental Loss is covered for a MAXIMUM of **2** weeks. However, in commercial insurance, if there's an order of civil authority, Coverage D covers expenses for a MAXIMUM of **3** weeks. Remember to differentiate the two on the final exam.

Coverage D lasts while the insured either repairs the damaged residence, or moves to another residence—whichever is shorter.

K. Additional Coverages

The following are Additional Coverages that can be added to the HOP:

- **Debris Removal** pays for the removal of:
 - o Debris on the premises
 - o A neighbor's tree or trees that fell as a result of a covered peril and did direct damage to the insured structure
 - o The named insured's tree or trees that fell after or during a windstorm or hailstorm

Note: The only HO form that doesn't cover trees falling due to the weight of ice, snow, or sleet, is the HO 08. This is because the HO 08 is basic coverage.

Note: The 2000 HOP in California now provides up to **\$1,000** to remove a fallen tree. This includes fallen trees blocking access to a driveway that didn't actually cause any damage to the property itself.

- **Reasonable Repairs** covers the cost of protecting damaged property from more damage.
- **Removal** covers property against any direct loss when it's being removed from endangered premises. During the time removal coverage applies, the policy becomes open risk/all risk.
- **Lawn, Trees, Shrubs, and Plants** covers loss to non-commercial trees, plants, and shrubs on covered premises. The limit for any one plant, shrub, or tree is **\$500**—in the HO 08, the limit is reduced to **\$250**. The total limit is **5 %** of the

Coverage A limit in HO 02, 03, 05, and 08, and **10 %** of the Coverage C limit in HO 04 and 06.

- **Fire Department Service Charge** pays up to **\$500** for liability if the fire department is called to save or protect covered property. This is additional insurance with no deductible.
- **Glass Breakage** covers glass breakage on a building, storm door, or storm window. Damage caused by broken glass is also covered.

Note: There's no coverage if the building has been vacant for over **30** consecutive days.

- **Collapse** (in all forms except HO 08) covers loss to covered property from collapse. The collapse has to be caused by Coverage C perils. Some examples of covered causes of collapse would be:
 - o Unknown decay
 - o Unknown insect damage
 - o Rodent damage
 - o Strain from anything inside the structure (people, animals, contents)
 - o Rain collecting on the roof
 - o Defective building design or defective tools
 - o Any broad form peril

Note: Collapse doesn't cover the collapse if it occurred from the natural decomposition of a poorly maintained structure. This could include shrinking, bulging, or settling. Collapse also doesn't cover

damages if there was decay and/or insect damage and the insured knew about it and didn't do anything about it.

- **Credit Card, ATM card, Forgery and Counterfeit Money**

pays up to **\$500** per loss resulting from:

- o Theft/unauthorized use of a credit card
- o Forgery
- o Accepting counterfeit currency

This additional insurance has no deductible. It also includes any necessary legal fees from a lawsuit or investigation.

Note: **Credit Card, ATM card, Forgery and Counterfeit Money** doesn't cover losses that were intentional on the part of the insured, the result of the insured's family borrowing (with permission, hence "borrowing" and not "stealing") credit cards/currency and then losing the credit cards, or the insured's failure to follow the terms of the credit card.

- **Loss Assessment** relates to the Homeowners Association. If a property owned by a collective is damaged by a covered peril, then the Homeowners Association has to complete a loss assessment. The Association charges the members for this assessment. Under the Loss Assessment additional coverage, an insured can receive up to **\$1,000** per loss for his/her share of the loss assessment expenses.

Note: In the 2000 HOP, the deductible now applies to this coverage under Section 1. No matter how many assessments are required for a single occurrence, the insured only has to pay the deductible once.

- **Building Additions** applies if the insured is a tenant who has paid to make improvements to the unit. The insured can use this coverage to insure those additions.
- **Landlords Furnishings** covers the landlord's personal property that's in dwellings rented to others. Typically, this coverage is limited to **\$2,500**.
- **Ordinance or Law** used to be excluded in Homeowners, and was available only through state endorsement. Now this additional coverage is included in all 2000 California HOPs.

Ordinance or law covers:

- o The property value of a house that's torn down in compliance with building code requirements
- o Demolition and debris removal expenses
- o Any expenses to make necessary repairs or additions to comply with building code requirements, except to make a restroom comply with the American Disability Act (**ADA**).

Putting in into Context:

If someone's house is ravaged by a covered cause of loss, they may discover that there are certain modifications that have to be made to comply with building code requirements. In this situation, it could be cheaper to just demolish the house and rebuild it in compliance with the new building code requirements. If the person has Ordinance or Law coverage, those expenses are covered.

- **Grave Markers** now provides up to **\$5,000** for damages to gravestones and mausoleums caused by a covered cause of loss. This is standard in the new 2000 HOP form.

4. HOP Property Endorsements

The following endorsements can be added to an HOP in order to individualize the coverage for the insured:

A. Mobile Home Endorsement

When the Mobile Home Endorsement is added to an HOP, then the Mobile home is the insured dwelling—nothing else changes.

B. Other Structures—Increased Limits Endorsement

The Other Structures—Increased Limits Endorsement increases the standard limit for other structures on the premises. The standard limit is **10 %** of the dwelling amount.

C. Scheduled Personal Property Endorsement (HO 15)

This is the exact same thing as a Personal Articles Floater, or the PAF. The PAF protects personal property on a scheduled basis, anywhere in the world. This can include breakage of glassware caused by an earthquake.

D. Inflation Guard Endorsement

The Inflation Guard Endorsement automatically increases coverage limits by a certain percentage annually to account for economic inflation.

E. Special Personal Property Coverage Form Endorsement

This endorsement is frequently used to protect items that have a higher value, such as furs, jewelry, and precious stones/metals. The Special Personal Property Coverage Form Endorsement

changes the standard coverage for personal property from broad form perils to special form perils.

F. Personal Property—Replacement Cost Endorsement

This endorsement changes Coverage C valuation from ACV to replacement cost.

G. Earthquake Endorsement

This endorsement adds earthquake coverage to the HOP. Earthquakes are usually excluded from the HOP.

Note: The Earthquake Endorsement isn't used that much in California, because it doesn't offer the most extensive coverage. See Other Property Products for more detailed information on Earthquake coverage.

H. Guaranteed Replacement Cost Endorsement

Adding this endorsement means that the insurer will pay the total cost to rebuild a structure, even if the cost to rebuild the structure exceeds the policy limits.

I. Additional Residence Rented to Others

The Additional Residence Rented to Others provides Liability coverage for an insured's additional residence that they are renting to others. The endorsement only covers the property itself.

Note: The Ordinance or Law Coverage Endorsement is no longer an endorsement. It's just automatically included in the 2000 HOP.

J. Workers Compensation—Residence Employees Endorsement

5. HOP Home Business Endorsements

The following **2** coverages are used to cover home businesses:

- 1) **Permitted Incidental Occupancies Endorsement** adds Liability coverage for any business use inside a residence. Otherwise, the areas in a personal residence used for business purposes wouldn't be covered by the HOP.

- 2) **Business Pursuits Endorsements** adds Liability coverage to include the insured's business activities.

Note: The Business Pursuits Endorsement doesn't cover a business that the insured owns, because that would need to be covered under a Commercial coverage.

A. The Earth Movement Exclusion

We're just going to shoehorn this in here for emphasis. Any damages resulting from earth movement is specifically excluded in the HOP. Earthquakes, and the like, are covered by Earthquake insurance. We go into Earthquake insurance in greater detail in Other Property Products. Earth movement includes:

- Earthquake
- Mudflows
- Landslides

- Erosion due to mining/deforestation

Note: If an earthquake or any earth movement directly causes damages that are considered covered perils (fire, explosion, etc.), then the damage is covered under the principle of Proximate Cause/Concurrent Causation.

Part D: Homeowners Liability Insurance—Section 2

1. Section 2

Section 2 in the HOP deals with Liability. Unlike the DP, Liability is automatically included in the HOP. Section 2 of the HOP provides the following 2 coverages:

1) Coverage E—Personal Liability

- o Usually **\$100,000** per occurrence
- o The insured has to be determined negligent

2) Coverage F—Medical Payments to Others

- o Usually **\$1,000** per person
- o The insured doesn't have to be negligent for this coverage to apply

A. Additional Coverages

The following additional coverages are automatically included in the **HOP Section 2**. There is an additional expense for these coverages:

- **Claims Expense** covers the insurer's cost to defend the insured in a lawsuit. The Claims Expense coverage now provides up to **\$250** per day to the insured for any lost income due to the lawsuit and/or investigation.

- **First Aid to Others** covers the expense of administering first aid to others when their injuries were the result of covered causes of loss.
- **Loss Assessment** covers any assessment amount that exceeds the Homeowner's Association Liability limit. This coverage provides up to **\$1,000**.
- **Property Damage of Others** now provides up to **\$1,000** per occurrence in the new 2000 California HOP.

Note: Under the Property Damage of Others, hovercraft loss is excluded. So, all you hovercraft owners out there, go elsewhere for your hovercraft coverage needs.

C. Insured Locations

The following locations are covered by an HOP Section 2:

- The residence
- A new residence
- Second homes
- Vacation homes
- Non-agricultural land
- Land the insured plans to construct something on
- The insured's cemetery plot
- Rented premises

D. Section 2 Endorsements

The following endorsements have a significant impact on Section 2:

- **Workers Compensation Endorsement** is mandatory in California. If a residence employee is injured, and they've

worked a certain number of hours and received a certain amount of income, the insured is considered that person's employer. The insured needs to provide Worker's Compensation benefits to the injured residence employee.

- **Personal Injury Endorsement** expands the definition of BI to include personal injury damages, such as:
 - o Defamation of Character
 - o Libel
 - o Slander
 - o False arrest
 - o Invasion of Privacy
- **Watercraft Endorsement** provides Liability and Medical Payments to Others coverage for scheduled watercraft, including sailboats engaged in a race.

Note: Boat owners may need to look beyond their homeowner's policy to **boat owner's coverage** if their boat is too big or where specialized coverage like extended travel, fuel spills, personal property, replacement cost coverage and more are limited or excluded. In addition, liability under boat owner policies includes operations liability, passenger liability and flotilla liability.

Yacht coverage refers to a more comprehensive policy where hull, trailer, marine liability (protection and indemnity for crewmembers not covered elsewhere) are included.

E. Exclusions

The following exclusions apply to **Section 2**:

- War

- Intentional losses
- Business risks/ventures
- Professional Liability claims
- Uninsured premises that are rented out
- Anything to do with uninsured vehicles: land, sea, or air
- If the Insured gives someone an STD
- Any type of abuse on the part of the insured: sexual, physical, mental
- Anything to do with illegal drugs

2. The California Residential Property Insurance Disclosure Statement

In California, you can't renew a policy for a residential property, unless you're given the California Residential Property Insurance disclosure statement.

The disclosure gives you a basic rundown of California insurance coverage for residential properties. The disclosure is required to include and explain the following points:

- **Guaranteed Replacement Cost Coverage and the Full Building Code Upgrade** pays replacement costs even if they exceed the policy's limit of liability. This includes any expenses resulting from changes to building codes.
- **Guaranteed Replacement Cost Coverage with Limited or No Building Upgrade** pays any replacement costs within the policy's limit of liability, but doesn't pay for any upgrades to meet building code requirements.
- **Extended Replacement Cost Coverage** pays replacement costs up to a certain limit above the policy's limits of liability.

- **Replacement Cost Coverage** pays the replacement costs up to the policy's limit of liability.
- **ACV** pays the actual cash value of the property at the time of loss, up to the policy's limit of liability.
- **Building Code Upgrade Coverage** pays up to the policy's limit of liability in order to modify a dwelling to meet basic building code requirements.

3. Differentiating Between a DP and an HOP

Here are the major differences between DPs and HOPs. This is an overview of everything we've already gone over, but sometimes it's just easier to see a visual representation. Check out our outstanding graph for a better idea:

Outstanding Graph	
Dwelling Policies	Homeowners Policies
Liability available through endorsement	Liability automatically included
Additional Living Expenses and Fair Rental Value is 10 % of Coverage A	Loss of Use limit is 20 % of Coverage A (HO 02, HO 03)
Personal Property Coverage can be added	Personal Property Coverage is automatically included
Theft isn't included in the broad form perils	Theft is one of the broad form perils
10 % of the Coverage C limit is available for personal property off the insured premises	Personal property is covered anywhere in the world

HOMEOWNER'S INSURANCE VALUATION

This section discusses the methods of estimating replacement value and explaining various levels of coverage under a homeowner's insurance policy.

General Concepts

The insurance industry has used Standard Fire Policies for years. California has created their own standard fire policy which embraces equivalent or more favorable coverage. The purpose of standard policy forms is to provide common language that will be similar from state to state. Coverage is typically for loss by fire and lightening on an actual cash value basis. Perils not covered include war, explosion, riot (unless fire ensues), neglect by the insured, theft, vacancy beyond 60 consecutive days, etc.

A ***dwelling policy*** provides coverage for both dwelling and contents on a named perils basis, while a ***homeowners policy*** provides coverage for the dwelling and contents on an all perils basis (a.k.a. all risk), and for the contents on a named perils basis.

Why would a structure be insured under a ***dwelling policy instead of a homeowners policy***? Well, if it was a rental unit on your property, it will be covered by a dwelling policy. Homeowners insurance, on the other hand, is suited for those who own and reside in their own home.

Section PC 5

INLAND MARINE

Objectives

This unit discusses the importance and range of **Inland Marine insurance**. Inland Marine insurance covers valuable items in transit. Your client could need coverage on an expensive camera during a vacation, or he/she could need coverage on an overseas shipment of electronics. Since most other coverages specify that the covered items must remain on covered premises, Inland Marine insurance protects items that don't stay in one place on an open-peril basis.

This unit includes:

- The 2 Kinds of Marine Insurance
- The 6 Categories of Property that Marine Insurance covers
- Ocean Marine Insurance
- Inland Marine Insurance
- Inland Marine Floaters
- Dealers Forms
- Bailees Policies
- Miscellaneous Inland Marine Policies
- Transportation Coverages
- Transportation Coverage Forms

1. The 2 kinds of Marine Insurance

Marine insurance is designed to protect items on the go. There are **2** kinds of Marine insurance:

- 1) Ocean Marine
- 2) Inland Marine

2. The 6 Insurable Categories

There are **6** categories that define the types of property that can be insured by Marine insurance:

- 1) Imports
- 2) Exports
- 3) Means of transportation or communication
- 4) Domestic shipments
- 5) Commercial Property floater risks
- 6) Personal Property floater risks

3. Ocean Marine

Ocean Marine insurance provides coverage for a ship's cargo, and the ship itself, when traveling on the ocean.

A. Protected Losses

There are **4** types of protected losses:

- 1) Hull Insurance** includes coverage for the ship itself—the value of the ship and its equipment.
- 2) Cargo Insurance** protects the value of the goods being shipped, and protects the person shipping the goods for any losses during importation or exportation.
- 3) Loss of Freight Insurance** protects the ship owner for his loss of income if the cargo (including passengers) is lost or not delivered.
- 4) Marine Liability Insurance** protects the ship owner if he/she is determined to be legally responsible for injuries to other people or damages to other people's property.

Note: the insured has to meet the following criteria in order to have their Ocean Marine Insurance apply:

- The vessel has to be seaworthy
- Cargo/freight has to be packed correctly
- The vessel has to follow a planned route and not stray from that route (*Whee! Let's stop off at Bermuda, dudes!*)

B. Coverage and Exclusions

Hull and Cargo insurance is covered on an open risk/open peril/all risk basis, which means all perils are covered unless the policy specifically excludes them.

Some of the common exclusions are:

- War
- Riots
- Rot/Decay
- Wear and tear
- Inherent vice

Putting it into Context:

Inherent vice basically means “it goes with the territory.” So, if a ship is carrying a cargo of perishables, and the ship is delayed, the spoiled perishables aren't covered. That's because if perishables sit around for too long, they spoil—it goes with the territory.

Any Ocean Marine insurance on a named perils basis usually includes:

- **Perils of the sea** such as wind, wave action, sinking, the Kraken, etc.

- **Perils on the sea** such as fire, lightening, jettison, and barratry. Barratry means intentional, illegal acts committed by the captain or the crew.

4. Inland Marine Insurance: Commercial and Personal

We don't spend a lot of time talking about **Inland Marine coverage**, because it isn't used much by the general public. It's extremely important to any commercial businesses, which depend on all types of shipping.

Note: In Inland Marine policies there is a valuation clause, which states that if there is a covered cause of loss, the value of the property is determined at the time of loss.

The property value is determined as the lesser of:

- ACV
- Cost to repair/restore the property
- Cost to replace the property with a functional replacement

A. The 4 Insurance Categories

In Inland Marine insurance, the 4 insurance categories are:

1. Transportation
2. Means of transportation or communication
3. Commercial Property Floater risks
4. Personal Property Floater risks

Here's a more detailed look at each category:

- **Transportation Forms** protect shipments in transit over land, on inland waters (rivers, lakes), along coastlines, or stored in shipments that are about to be transported.
- **Means of Transportation** Forms insure property that provides transportation or communication. This form would cover items such as docks, tunnels, and radio and TV towers.
- **Personal Property Floaters** insure certain classes of personal property anywhere in the world.
- **Commercial Property Floaters** insure business property anywhere in the world.

A. Filed versus Nonfiled Forms

Certain types of Inland Marine Insurance forms are **filed** and certain types are **nonfiled**. The difference between the two forms is the risk involved.

If the risk is normal for a particular property or class, then a filed form is appropriate.

If the risk isn't predictable, because the coverage or situation is so individualized, then a nonfiled form is appropriate.

Check out our rockin' graph for some examples of each:

Rockin' Graph	
Filed Forms Examples	Nonfiled Forms Examples
Accounts Receivable; Signs Coverage	Electronic Data Processing Floaters; Contractors Equipment Floaters

Because there's a Personal Inland Marine and a Commercial Inland Marine, we're going to break this into two sections, just to make it a little easier:

Section 1: Personal

1. Floater Inland Marine Insurance Policies

These policies are used to cover valuable property that moves around a lot (they float, get it?). There are 2 basic types of floaters: **Personal Articles** and **Personal Effects**.

A. Personal Articles Floater (PAF)

The **Personal Articles floater** covers specific personal property that is usually more valuable. Each item is listed, described, and insured separately. In order to obtain a PAF, the insured has to obtain a written appraisal for each item, and submit that appraisal to the insurer.

A **Personal Articles Floater** would be used to insure items such as:

- Cameras
- Musical instruments
- Fine art
- Jewelry
- Stamp or Coin collections
- Tableware
- Golfing equipment

Besides the normal exclusions, fine arts and stamp and coin collections have their own additional exclusions:

Fine Arts coverage *excludes:*

- Damage to the item while it's being stored or repaired
- Accidental damage to any fragile items
- The Velvet Elvis

Stamp and Coin Coverage *excludes:*

- Any damages to the item while it's being worked on
- Any damages due to changes in climate, temperature, humidity, etc.
- Your 12-year old using your rare 1881 edition quarter in a gumball machine

Note: Loss Settlement for fine art is insured on an **agreed value basis**. Therefore, the insured could claim that their autographed "Dogs Playing Go Fish" is worth \$50,000, but the value was already negotiated before the painting was insured. Nice try, sneaky.

Loss Valuation for all other property is the lesser of:

- ACV
- Repair costs
- The cost to replace the item with a similar item
- A scheduled amount

Note: The PAF offers the exact same coverage as the Scheduled Personal Property Endorsement, which can be added to an HOP.

B. Personal Property Floater

The Personal Property Floater policy provides open risk/all risk, national or international coverage for property on an unscheduled basis. The Personal Property Floater doesn't require an appraisal to determine coverage limits.

Note: A Personal Property Floater is similar to the HO 15 Endorsement (Scheduled Personal Property Coverage Endorsement)

The **Personal Property Floater** insures such items as:

- Cameras
- Jewelry
- Furs
- Musical Instruments
- Etc.

Alert!

Remember that the PAF is scheduled and the Personal Property Floater is unscheduled. That's definitely on the California State Insurance Exam.

Section 2: Commercial

1. Commercial Inland Marine Insurance

Commercial Inland Marine coverage consists of:

- Common policy declarations
- Common policy conditions
- Commercial Inland Marine Coverage Part:
 - o Commercial Inland Marine Declarations
 - o Commercial Inland Marine Conditions

- o One or more Commercial Inland Marine coverage forms
- o Any Endorsements the insured needs

A. The 4 Inland Marine Coverage Forms

- 1) **Business Floaters**
- 2) **Dealers Forms**
- 3) **Bailees Policies**
- 4) **Miscellaneous forms**

Here's a closer look at those 4 forms:

A. Business floaters

Business Floaters cover mobile personal property off the premises. This includes:

- **Commercial Articles Coverage** covers commercial items that are separately listed, described, and insured.
- **Contractor's Equipment Floaters** cover any equipment or machinery used by building contractors.

Note: Each item in the **Contractors Equipment floater** is listed, described, and insured separately. Anything that can be put into categories can be covered on a blanket basis (i.e. a toolset is insured for \$5,000, but the tools aren't individually insured). Equipment can be covered on a scheduled basis depending on when it's being used or it's not being used.

- **Installation Floaters** cover property being installed in newly built buildings. The coverage lasts until construction is complete. The **Installation Floater** can insure an owner, contractor, or installer.

B. Dealers Forms

Dealers Forms insure business stock and merchandise on or off the premises. **Dealers Forms** also insures customer's private property in the custody of dealers.

The **Dealers Forms** include:

- **Equipment Dealers Coverage** covers the inventory of businesses that sell or rent contractor or agricultural equipment. This coverage would also cover the customer's personal property in the dealer's custody for servicing.
- **Jewelers Block** covers the inventory of retail jewelers. This coverage also protects the personal property of customers, and any jewelers that work for the insured.
- **Camera / Musical Instruments Dealers Coverage** covers dealers who sell cameras and musical instruments. Don't you dare get that wrong on the final exam.
- **Furriers Block** covers retail fur dealers.

C. Bailees Policies

Bailees policies cover bailees, which is a person temporarily in charge of other people's property for the purposes of servicing or repair. A television repairman would be an example of a bailee.

The **Bailees Customer policy** covers the bailee for any loss or damage to a customer's property. Even if the bailee isn't at fault, the **Bailees Customer policy** still covers the damage. Coverage is on a named perils basis.

2. Miscellaneous Inland Marine Policies

Miscellaneous Inland Marine policies insure other kinds of property, such as:

- **Accounts Receivable Coverage** protects the insured's financial records. Loss of financial records could make it difficult for the insured to collect payments due from customers. This coverage also covers collection expense, which would mean the insured had to hire a collection agency to recover a payment.
- **Valuable Papers and Records Coverage** covers the cost of valuable records or documents.
- **Electronic Data Processing (EDP)** covers any loss of data, or the insured's liability for the loss of data that belongs to someone else.

Note: Electronic Data Processing policies cover computer hardware and software. Obviously, you can cover computer hardware and software under a Commercial Property policy, but depending on your client's level of EDP loss exposure, it might be more beneficial for them to purchase an EDP. Here are some of the benefits to choosing an EDP:

- EDPs cover property that moves around, so any computer equipment that's mobile or used away from covered premises would be covered.
- EDPs include coverages that are excluded from Commercial coverage, such as covering expenses to replace destroyed data.
- EDPs are less expensive

- **Contractors Equipment**
- **Signs Forms** insure signs on the premises or while in transit.

Note: **Signs Form coverage** is on a scheduled basis and each sign is separately listed, described, and insured.

A. More Coverage Forms

Here are some of the various coverage forms you may bump into with Inland Marine:

- **Commercial Articles Coverage Form**, which insures such items as:
 - o Equipment for films/movies, etc.
 - o Musical instruments
- **Commercial Fine Arts Coverage Form**, which insures such items as:
 - o Paintings
 - o Sculptures
- **Contractor's Equipment Form**, which covers a contractor's tools at different job sites and in storage.
- **Equipment Dealers Coverage Form**, which insures such items as:
 - o Tractors
 - o Graders
- **Film Coverage Form**, which insures such items as:
 - o Motion pictures
 - o Soundtracks
 - o Videos
- **Floor Plan Merchandise**
- **Jewelers Block Coverage Form**
 - o This form includes coverage for money in a safe
- **Mail Coverage Form**, which insures such items as:

- o Bonds
 - o Stock certificates
 - o Securities
- **Physicians and Surgeons Equipment Coverage Form**, which insures such items as:
 - o Medical Equipment
 - o Dental Equipment
- **Theatrical Property Coverage Form**, which insures such items as:
 - o Sets
 - o Props
 - o Costumes
 - o Scenery

3. Transportation Coverages

Transportation coverages cover the domestic shipments of shipping firms and independent truckers. Shipping firms are also known as **common carriers**, and independent truckers are also known as **contract carriers**.

Note: A negligent contract carrier would be liable for all losses to cargo.

When a common carrier receives the shipment, they issue a receipt called a **bill of lading**. Once the company issues the **bill of lading**, they are legally obligated to the owner for the goods. The common carrier is always legally liable for loss or damage to any goods it transports.

The **bill of lading** includes:

- The names of the shipper and the consignee
- The point of origin and destination
- The number of packages
- Description of the freight
- Weight/volume of the freight

Note: A bill of lading actually limits a common carrier's liability on a particular shipment, which could result in the carrier being underinsured. See **Motor Truck Cargo Liability—Owners form** below, just because we're too lazy to repeat ourselves.

A. Motor Truck Cargo Forms

Motor Truck Cargo forms are used to insure property in transit. Such forms include:

- **Motor Truck Cargo Policy—Trucker's form** insures contract carriers against any loss or damage to their cargo.
- **Motor Truck Cargo Policy—Shipper's form** insures cargo being transported by common carriers.
- **Motor Truck Cargo Liability—Owners form** insures company property that's lost or damaged while it's being transported by company trucks.

Putting it into Context:

Silverlines Co. transports tractor parts to several large tractor dealers in the Midwest. The company doesn't pay a contract to transport the tractor parts, because now the company is big enough to transport the equipment themselves. If a *Silverlines Co.* shipment is lost or damaged while being transported by a *Silverlines Co.* truck, the

company is protected under the **Motor Truck Cargo Liability—Owner's Form**.

Someone transporting their goods may also want his/her own property coverage on specific shipments for the following reasons:

- The goods could be transferred from one carrier to another, and then if a loss occurs, it could create some doubt as to which carrier is liable.
- The bill of lading could limit the carrier's liability, rendering the shipment underinsured.
- The carrier might not have appropriate insurance, or could be underinsured for a loss.

Transportation Coverage forms cover the owners of goods being transported using any means of transportation. **The Transportation forms** include:

- **Annual Transit Coverage** insures all shipments from their origin to their destination during the entire year. This is usually provided on a named perils basis.
- **Trip Transit Coverage** insures a specific shipment for a specific trip.

Section PC 6

OTHER PROPERTY PRODUCTS

Objectives

You may have noticed in the previous chapters that there were some reoccurring exceptions to the policies. You may have wondered what someone does for insurance protection if they live on a fault-line or in a flood zone. This unit covers the other types of coverage that can be included or added.

This unit includes:

- Earthquake Insurance
- Flood Insurance
- Pleasure Boat Coverage
- Commercial Ocean Marine
- Umbrella/Excess Liability
- The California FAIR Plan
- New Developments

Part A: Catastrophic Coverages

1. Earthquake Insurance

Dwelling and Homeowners policies specifically exclude Earthquake coverage, including earth movement. Earthquake coverage is obtained through endorsement or as a separate policy.

California Insurers must offer earthquake insurance when writing new business on dwellings with up to four units.

Because earthquakes are such a significant risk exposure in California, a lot of private insurers were either not offering the coverage, or offering very limited coverage. The **California Earthquake Authority (CEA)** was established as a privately funded, publicly controlled risk pool in order to make this coverage available for everyone.

Note: Few places in the US are safe from the dangers of earthquakes. In fact, during the last 100 years, earthquakes have occurred in 39 US states and have caused some damage in all 50 states.

Between 1975 and 1995 there were only **4** states that did not have any earthquakes:

- 1) Florida
- 2) Iowa
- 3) North Dakota
- 4) Wisconsin

A. Defining an Earthquake

We know you know what an earthquake is—we still need to define it, so no whining.

An earthquake is a sudden, rapid shaking of the earth caused by the breaking and shifting of rock beneath the Earth's surface.

There are **3** factors that determine the earthquake risk of a property:

- 1) **Location**, or the risk taken when the home is selected.
- 2) **Hazards**, or the surrounding natural phenomena that could worsen an earthquake and can't be lessened through human intervention.
- 3) **Vulnerability**, or the risk factors that could lead to damages in following earthquakes.

B. CEA Policy Provisions

CEA Policies contain the following provisions:

- Dwelling coverage with a deductible that's **15 %** of the dwelling limit
- **\$5,000** personal property coverage
- **\$1,500** for Additional Living Expense coverage
- No coverage for pools, fences, landscaping, driveways, and other structures

Note: There's an optional coverage that allows the insured to purchase **\$10,000** for any building code upgrades.

Note: CEA only deals with residential Earthquake insurance.

C. Advantages and Disadvantages

There are advantages and disadvantages to using the Earthquake endorsement with an HOP.

The **advantages** are:

- Deductibles might be lower

- Earthquake peril coverage is added to each separate coverage
- Extended Replacement Cost, Personal Property Replacement Cost, and Ordinance and Law endorsements apply to earthquake-related claims

The **Disadvantages** are:

- The deductible, which is **15 %** of the dwelling amount, applies to each separate coverage—this means an insured could end up paying more than one deductible depending on the amount of damage after an earthquake
- The deductible applies one time on separate policies
- Coverage is typically pricier than a separate policy

Single limit vs multiple limit? Some stand alone earthquake policies have a single limit of coverage, that is, dwelling, other structure, content and loss of use losses would be lumped together into one single limit. Reimbursement, after the deductible, would be made based on a single amount. Homeowner policies with earthquake endorsements are more likely to follow a multiple limit approach where a formula is applied: a dollar amount for the dwelling; 10% of the dwelling amount to other structures; 50% for contents and \$25,000 for loss of use. Add the applicable amounts, less the deductible, to calculate the claim total.

2. Commercial Property Earthquake Coverage

The **Commercial Property Causes of Loss—Earthquake form** adds coverage for earthquake and volcanic eruption to selected property coverage forms, such as:

- All types of **Commercial Property Business forms**. There is a per occurrence deductible that's the percentage of each item.

Note: In Commercial insurance, an occurrence includes all earthquake shocks or volcanic eruptions that occur within a **168**-hour period.

- **Business Income and Extra Expense Coverage forms.**

Note: This doesn't provide coverage for any losses to buildings over **4** stories high during the first **168** hours after an earthquake-related or volcanic eruption-related loss.

- **Commercial Property Coverage Forms**

A. Other Earthquake Coverage Exclusions

- Fire
- Explosions that aren't part of a volcanic eruption
- Collapsed mines
- Tidal wave, tsunami, flood
- Mudslides or mudflow

3. The Businessowners Earthquake Endorsement

The **Businessowners Earthquake endorsement** adds the same coverage as the **Commercial Property form** mentioned above, but without the exclusions. There's an easy one for you.

Part B: Flood Insurance

1. Flood Insurance

A **flood** is defined as a normally dry area that is temporarily submerged under water. This might be an overflow of a river or a tidal wave, a mudslide, or any other unusual accumulation of water.

A lot of people don't realize that neither the Dwelling nor the Homeowners policies provide any coverage for flood damage. Even if they do know they aren't covered for flood insurance, a lot of people still choose not to carry the coverage. They think flood damage could never happen to them.

However, as Hurricane Katrina has just proven, major floods do happen and more often than most people imagine. In fact, according to national statistics, more than **90 %** of all natural disasters involve flooding.

A. Flood Coverage

Flood coverage is very important for anyone who lives in areas prone to flooding. These areas are called "flood plains," or "flood zones," and are usually located near rivers or along coastlines.

In addition, homeowners can be required to carry flood coverage by mortgage lenders if their home is located on one of these flood plains, and they are getting a mortgage that's insured, guaranteed, or owned by a federal agency.

Such mortgages include those that are:

- Insured by the Federal Housing Administration
- Guaranteed by the Department of Veterans Affairs
- Made by a federally insured bank or thrift

- Purchased by Freddie Mac or Fannie Mae

Flood coverage is available for residential and commercial properties, including manufactured homes, condos, and contents of a regular unit.

B. What is Covered

The Flood policy typically includes, but isn't limited to, coverage for:

- Loss of insured property, building and/or contents (with exceptions), from flood, mudslide and flood-related erosion.
- Losses from abnormal tidal action
- The cost of removing debris after a flood-related loss

C. Flood Policy Exclusions

The Flood policy typically excludes the following:

- Damages from normal soil erosion caused by a nearby body of water
- Sewage backup
- Any damages caused by conditions within the insured's control
- Additional living expense and rental value

D. Peril Exclusions

Flood coverage doesn't apply to any resultant flood losses caused by:

- War
- Nuclear reaction

- Operation of building codes
- Neglect
- Fire, windstorm, or explosion
- Erosion, earthquake, landslide, or any other earth movement except a flood-related mudslide.

2. National Flood Insurance Program

NOTE: In order to sell flood insurance through the National Flood Insurance Program, FEMA requires California agents to take a special 3-hour Flood Training Course.

Flood insurance is can be supplied by the federally sponsored and subsidized **National Flood Insurance Program (NFIP)**. The **NFIP** is administered by the Federal Emergency Management Agency (FEMA) branch, which is responsible for setting Flood insurance rates, coverage limits, and eligibility requirements.

Even though Flood insurance is a federal government program, NFIP policies can be sold through insurance companies and any licensed agent or broker. This is known as the **Write-Your-Own-Program**, which started in 1983. The idea behind the **Write-Your-Own-Program** is that private insurance companies sell federal Flood insurance under their company name and collect premiums. The company keeps a percentage of the payments for operating expenses and invests the rest for any future claims. If losses are higher than the company's income permits, the government pays the difference.

Insurance producers can't give someone a Flood insurance binder. Typically, there's a **30**-day waiting period for Flood insurance. This prevents people from waiting until they hear a hurricane or a tsunami has been predicted, before stampeding for Flood insurance.

One exception to the waiting period is when a new home is purchased, at the time of title transfer, Flood coverage can become effective immediately if it's one of the conditions of the loan.

3. The 2 Types of Flood Coverage

There are **2** basic types of flood insurance available to the public. The amount of Flood coverage depends on certain phases. Communities will be placed in different phases, which allows for more or less Flood insurance:

1) Emergency Program

When a community first applies to the NFIP for Flood insurance, they're placed in the **emergency program** until the federal government determines the flood rate. Only limited Flood coverage can be purchased to cover buildings and contents during this phase:

Emergency Program Coverages		
Property Types	Building	Contents
Single Family Residence	\$35,000	\$10,000
Other Residential Structures	\$100,000	\$10,000
Non-residential Structures	\$100,000	\$100,000

Note: **\$1,000** standard deductible applies to each building and contents, per each loss.

2) Regular Program

Once the rates are determined—assuming there's no imminent flood danger—the community is put in the **regular program**, which then offers higher limits of coverage:

Regular Program		
Property Types	Building	Contents
Single Family Residence	\$250,000	\$100,000
Other Residential	\$250,000	\$100,000
Small Business	\$500,000	\$500,000
Other Non-residential Structures	\$500,000	\$500,000

A. Eligibility

Both residential and non-residential buildings are covered against a flood peril if the building:

- Is in an eligible community
- Has at least two rigid walls and a roof
- Is anchored to prevent potential shifting during a flood
- Is mostly above ground

The policy covers losses to the building and the cost of debris removal caused by a flood or flood-related mudslides. The insured has to request a policy that covers personal contents.

When a flood is threatening personal property, the policy covers the reasonable expense of moving insured contents to safety and/or temporary storage for up to **45** days.

Part C: Pleasure Boat Coverage

1. Personal Watercraft

The HOP offers an optional Watercraft endorsement, which offers a very limited amount of Liability and Medical Payments to Others. In order to get coverage for Physical Damage or Medical Payments, the insured would need to purchase a Boatowners policy.

A. Boatowners Policies

Boatowners policies offer the following coverages:

- Physical Damage to the boat, motor, and trailer
- Liability
- Medical Payments

Note: Boatowners Liability coverage includes Operations Liability, Passenger Liability, and Flotilla Liability. Flotilla Liability is coverage for accidents involving more than one vessel.

Section 1 provides property coverage for the boat (usually on an ACV basis) with optional replacement coverage. Coverage includes:

- **Coverage A** for the boat and permanently attached items
- **Coverage B** for the outboard motors and startup equipment
- **Coverage C** for trailers used to transport the boat
- **Coverage D** for miscellaneous equipment used in operating the boat

Additional coverages include:

- **Reasonable repairs** covers the cost of keeping the property from becoming even more damaged.
- **Recovery** covers the cost of recovering a boat that's lost or that sinks.
- **Automatic coverage** replaces the boat, motor, or trailer listed in the declarations. If the insured just bought the boat or related equipment, the new items are covered if the insurer is notified within **45** days. This may result in additional premiums.

Coverage is on an open perils basis and *excludes*:

- War
- Nuclear hazard
- Wear and tear, including gradual deterioration
- Mechanical breakdown or faulty manufacturing
- Mysterious disappearance
- Damage while the watercraft is being repaired/serviced
- Damage while the watercraft is carrying passengers or cargo for payment
- Loss to covered property that's been rented out to someone else
- Damage to covered property, except sailboats, involved in a race or speed test

Section 2 provides liability coverage for bodily injury or damage to personal property while:

- The named insured is operating any boat

- Others are operating the insured boat with permission

It includes coverage for:

- **Watercraft Liability** coverage for expenses that arise out of any lawsuit the insurer defends, bond premiums, expenses from the insurer's requests, and any interest on judgments
- **Medical payments** for accidents that happen in, upon, or getting into or out of covered watercraft
- **Uninsured boaters**, usually for **\$10,000**, for accidents with uninsured watercraft

Liability coverage usually doesn't apply to a boat that's:

- Rented out
- Racing
- Carrying people or stuff for a fee
- Being transported by vehicle over land
- Operated by Sonny Crocket

Note: Most policies limit coverage to losses that happen in specific navigational zones.

2. Yacht Insurance

Yacht insurance covers yachts, sailboats, inboard pleasure craft, and catamarans, usually for the term of **1** year and on an agreed value basis.

A. Hull coverage

Hull coverage covers damage to the yacht on either a named peril basis or open peril basis.

Hull coverage *excludes*:

- Unexplained disappearance of any equipment besides the boat or motor
- Damages while the boat is being transported over land
- Any wages
- Losses resulting from capture or seizure
- Loss to spars, sails, and rigging on sailboats during a race

B. Protection and Indemnity Coverage

Protection and Indemnity coverage covers bodily injury, property damage, and medical payment insurance.

C. Yacht Insurance Provisions

The following provisions might be included in the policy:

- **Lay-up Warranty** comes into play when the yacht isn't being used during the winter.
- **Omnibus clause** extends coverage to any non-employees using the yacht with the insured's permission.
- **Navigational limits** confines coverage to specific geographical areas.

Part D: Commercial Ocean Marine

Fun Factoids:

Did you know that one of the most successful private insurance companies actually started in a London coffee house in the 1690s? A group of businessmen put up fliers to attract merchants and ship owners. The merchants and ship owners met with the businessmen and agreed to pay a certain premium in exchange for the

businessmen's assurance that the ships and cargo would be insured for perilous overseas journeys. This small group of independent insurance agents is known today as **Lloyds of London**.

1. Commercial Ocean Marine

There's no standard Marine insurance form. However, Marine insurance generally covers the:

- Hull
- Cargo
- Freight
- Protection and indemnity

A. Hull Insurance

Hull insurance insures the ship owner against direct loss or damage to the ship, its machinery, and equipment. Hull doesn't cover cargo or baggage.

Hull insurance can include a **Collision clause / Running Down clause** to cover liability for damages to another ship or another ship's cargo.

Hull insurance **excludes**:

- Any other types of property
- Any deaths

Note: The insurance can be written to cover one or several watercraft.

B. Cargo Insurance

Cargo insurance insures the owners of goods/cargo against loss or damages to cargo while it's being transported on water.

Note: If the Cargo insurance includes a warehouse-to-warehouse clause, then the goods/cargo are covered from the time it leaves the original warehouse until it reaches its intended destination.

Cargo insurance can be written on either a **single trip basis** or an **open cargo basis**. If the insured chooses open cargo, then insurance will cover all reported shipments within a specific period.

C. Freight Insurance

Freight insurance insures the owner of a ship or the owner of cargo for any lost income resulting from lost shipping charges (freight) if the trip is interrupted, or the cargo is lost or damaged.

D. Protection and Indemnity Insurance

Protection and Indemnity Insurance is liability insurance written separately or with other coverages. It covers a ship owner against liability for:

- Injury or death to the crew, passengers, visitors, or harbor workers

Why is Protection & Indemnity Insurance required? Simply put, legislation, like those detailed below, exposes boat owner /employer's to added liability which can only be satisfied through additional P&I coverage. In some cases, there are stiff penalties and consequences for failure to obtain this additional coverage.

Under **the Jones Act** a seaman has remedy against his employer if his injury was caused by employer negligence. Workers comp policies typically exclude coverage for work aboard vessels.

Under the **USL&H Act**, an employer's liability can include employee injuries on navigable waters as well as adjoining piers, docks, marine railways or any loading / unloading area.

Under the **Defense Base Act** requires workers compensation coverage for employees working on a military base outside the U.S. or employees working on U.S. sponsored public works projects outside the U.S.

- Loss or damages to cargo due to negligence
- Types of property damaged by the ship that aren't covered by the **Collision clause / Running Down clause**

Note: in the event of a total loss, Marine policies reimburse for the face value of the policy.

E. Averages and the Sue and Labor Clause

Partial losses are called **Averages**:

- **General Average** means part of the ship or cargo is thrown overboard to salvage remaining cargo. In such cases, the losses must be shared by all the owners whose property was saved by the sacrifice. This includes the owners of the ship and cargo, plus anyone with a vested interest in the freight.
- **Particular Average** means an accidental, partial loss of cargo. No one decided to sacrifice the cargo; it was just accidental damage. In this case, everyone pays for their own loss.
- **The Sue and Labor Clause** is a biggie in Marine insurance policies. The clause states that if a loss occurs,

the insured has to do everything possible to preserve the rest of the goods. Even if the insured doesn't manage to save the endangered goods, the insured will still be reimbursed for the expenses of doing everything possible to save and preserve the goods.

Note: If the insured fails to do everything possible to save and preserve the goods, then he/she has violated a condition of their policy. This could mean that the insured has to pay for their own salvage, legal fees, etc. If the insurer does agree to reimburse the insured, the limitations on incurred expenses will be a great deal stricter.

Part E: Umbrella and Excess Liability

1. Umbrella Policy

An **Umbrella policy** is a separate policy that provides extra liability protection in addition to the protection the insured already has on his/her autos, homeowners, or other products requiring liability.

Most umbrella policies provide excess protection in the following **2** ways:

- 1) By adding excess liability coverage over and above the limits that are already in the underlying policies. Umbrellas are usually written for additional liability protection of **\$1 million** and up.

For example, the underlying auto policy might have the liability limits of 250/500/100. The Umbrella policy then adds

the additional liability coverage of \$1 million, making the *total* liability coverage \$1.5 million.

- 2) By expanding the liability coverage to cover specific exclusions in the underlying policy.

For example, most homeowner policies exclude coverage from damages due to libel (a written attack), slander (a verbal attack), or defamation of character (a campaign to willfully damage a person's reputation). The Umbrella policy can provide the missing protection.

A. Commercial Umbrella Policies

A **Commercial Umbrella policy** is a separate policy that extends liability coverage over and above Commercial policy limits.

Agent World: There is ***no standard commercial umbrella policy*** although there is an ISO Form. Most insurers, have developed their own form with unique coverage.

A **Commercial Umbrella policy** can be written for \$1 million per occurrence with a \$2 million general aggregate limit. Each insurance company determines how much liability coverage the underlying policies should have, i.e., an underlying policy with specific limits is required to be maintained to qualify for a commercial umbrella policy.

The **Commercial Umbrella policy** extends liability coverage protection for:

- CGL
- Commercial Automobile Liability
- Businessowners
- Garage Liability
- Employers Liability Exposures

Putting it into Context:

Gina runs a child daycare center out of her home. One day, a 3-year old grabbed a heated curling iron lying on the bathroom counter. The resulting third degree burns on the child's hand left permanent and possibly disabling scars. The child's family decided to sue Gina. Gina's \$1 million CGL policy would not cover the damages awarded. But, here \$3 million Commercial Umbrella policy kicked in to pay the balance.

Self-Inured Retention

B. Personal Umbrella Liability Policy

A **Personal Umbrella Liability** policy adds excess liability coverage for personal liability exposure due to any of the following:

- Owning or maintaining a home
- Owning or maintaining a personal auto
- Participation in sports or other non-professional activities
- Damages from the indirect acts of others in the insured's custody, such as children and pets
- Owning or maintaining boats, recreational vehicles, or other personal motorized vehicles

C. Blanket Limits

An Umbrella policy that provides all existing policies an additional total liability limit is referred to as a **Blanket limit**. A minimum Blanket limit is usually \$1 million.

Existing policies cover claims up to a certain limit, or the underlying liability limit. Afterwards, the additional liability coverage policy pays the remainder of the claim up to the Blanket limit.

2. Umbrella Policy Coverages

An Umbrella policy adds coverage for some of the types of losses excluded by primary policies.

For example, coverage for personal injury (e.g., libel and slander) can be added to an HOP.

Putting it into Context:

Hanna was involved in a multi-car pileup that was determined to be her fault. She was liable for \$800,000 in damages and medical expenses. Her auto policy covered \$300,000 of the liability, and her \$1 million Personal Umbrella policy covered the remaining \$500,000. If she didn't have the Umbrella policy, she would have been responsible for \$500,000 out of pocket.

A. Primary Liability Requirements

The insured has to carry primary Liability coverage before they can purchase an Umbrella policy. The minimum limits can differ, but typically they are:

- \$500,000 Auto Liability
- \$300,000 Personal Liability

B. Standard Umbrella Deductibles / Self Insured Retention

The Umbrella policy can include deductibles or self-insured retention for losses excluded by the primary policy. The difference is that a **deductible** is paid to the insurance company when a **self-insured retention** is paid directly to the claimant.

This is usually in the amount of:

- **\$25,000** and up for a Commercial Umbrella policy
- **\$250--\$1,000** for a Personal Umbrella policy

3. Excess Liability vs. Umbrella Policies

The **difference between an Umbrella and Excess Liability Policy** is that the Excess Policy ONLY adds additional liability protection to the limit of the underlying policy without expanding other coverage. For example, if someone has fire insurance and they think they need Excess coverage, they can extend their fire coverage ONLY. If a loss results from another peril, the excess fire liability does nothing.

F. The California FAIR Plan

FAIR stands for Fair Access to Insurance Requirements. Most states have their own FAIR Plan, which acts as a safety net for people who may otherwise have trouble getting insurance.

If someone needs insurance for an insurable property and they've been denied normal insurance coverage, they then become eligible for the FAIR Plan. The fair plan serves **two primary areas**: Brush hazard zones and inner-city areas.

All insurance producers in California have to participate in the **California Fair Plan Association (CFPA)**. The Fair Plan is important because:

- It keeps Property insurance stable
- It guarantees that Property insurance is available for anyone who needs it
- It guarantees that insurers always provide insurance for insurable properties

Insurable property that isn't insured under the normal insurance market has to be insured through the FAIR Plan. If the property is physically insurable, coverage can't be denied, even if the property has been previously declined because of its location or any environmental hazards.

Putting it into Context

Sal's dream of owning a hotel finally came true. After purchasing the Home Sweet Home Inn for next to nothing, he contacted his insurance agent to set up a policy. His agent told him that he qualified for the FAIR Plan because the gas station next to Sal's property had caused extensive pollution in the area. The pollution was out of Sal's control and he was legally bound to insure his property, so the insurance company was obligated to write him a policy.

FAIR Plan properties may be higher insurance risks, but insurers equitably distribute these risks.

A. Qualifying for the FAIR Plan

In order to obtain insurance through the FAIR Plan, the applicant has to have:

- 1) Physically insurable property
- 2) Made attempts to get insurance through normal insurance markets
- 3) Been categorized as a high risk by the normal insurance market

If all **3** conditions apply, then the applicant qualifies for the FAIR Plan.

B. Basic Property Insurance

Basic Property insurance falls under the FAIR Plan umbrella covering:

- Fire and Lightning
- Windstorm
- Riot and civil commotion
- Explosion
- Vehicles
- Smoke
- Hail
- Aircraft
- Vandalism

Both personal and commercial risks can be covered in the Plan.

However, farm and autos are ineligible. Any licensed agent or broker may submit risks to the FAIR plan.

Important: The FAIR Plan covers only “well-maintained” properties. A property with faulty wiring could not be covered.

G. New Developments

Agents should be reminded that there are ALWAYS new developments in Commercial Lines legislation and laws. Recently, for example, the industry has responded with products and coverage in the following areas:

Cyberspace liability insurance: Covers internet and computer-related losses caused to other parties

Identity Theft and Restoration: Provides consumers with the services of a fraud specialist to assist and guide in the process of restoring and protecting stolen identity (some homeowner's policies include this coverage).

Intellectual Property Insurance: To protect against the threat of a competitor suing for infringement on ideas or intellectual property.

Summary

If you combine Other Property coverages with Personal and Commercial lines, you'll be providing the most extensive coverage for your clients. Even if your clients are worried about certain exceptions, you can put their fears to rest with your knowledge of all the available options.

Section PC 7

PERSONAL AUTO

Objectives

It's likely that most of your clients will own and/or drive an auto. Therefore, it's important that you know the different components of Personal Auto Insurance, including covered autos, and the duties the insured has to perform in the event of an auto accident.

This unit includes:

- The Components of the Personal Auto Policy
- Auto Policy Definitions
- Personal Auto Policy Coverages
- A Closer Look at the 4 Parts
- Uninsured/Underinsured Motorist
- Auto Assigned Risk Plan
- The California FAIR Plan
- Financial Responsibility Law

1. The Personal Auto Policy

This section gives you an overview of a Personal Auto Policy. In California, the Personal Auto policy format is:

- Declarations
- Definitions
- Part A—Liability (mandatory)
- Part B—Medical Payments (includes coverage for the insured)
- Part C—Uninsured Motorist
- Part D—Property Damage to Insured's Auto/Physical Damage
- Part E—Duties After an Accident or Loss

- Part F—General Provisions

Note: You might see the term Personal Auto Policy shortened to PAP. We have our own personal aversion to that acronym, so we'll just stick with Personal Auto Policy.

Rates and premiums for Personal Auto policies are determined by:

- 1) The insured's driving safety record
- 2) The number of miles the insured drives annually
- 3) The number of years driving experience the insured has

Auto Policy or ISO Policy? ISO (Insurance Services Office) develops standard policy forms for personal and commercial auto insurers. Because these forms are widespread and well known, agents need to know how their company's policy differs from the an ISO standardized policy.

A. Policy Definition of a Personal Insured Auto

The **Auto Policy** insures personal autos that are:

- Not used as commercial autos for business reasons
- Owned or leased for a minimum of **6** months at a time by a person, or spouse living in the same household

Note: If one of the spouses leaves the household, they're still covered:

- For up to **90** days
- Until they get new coverage
- Until the policy expires

In other words, within limits, any person qualifies as an insured while using a covered auto.

Newly Acquired Auto?

- A. A newly acquired auto will have the broadest coverage provided for any vehicle shown in the Declarations of an existing policy (except collision coverage for damage to your auto).
- B. Where existing collision coverage is listed, it will begin for the newly acquired auto on the date the insured becomes the owner with notification of 14 days.
- C. If the insured does not have collision coverage on at least one auto listed in the Declarations page, collision coverage on a newly acquired auto begins on the date the insured becomes the owner, but the insured must request it within 4 days and a \$500 deductible applies.
- D. If a newly acquired auto is **in addition** to any vehicle shown in the Declarations, the insured must notify the insurer within 14 days.

B. Coverage Territory

The Auto Policy covers accidents that happen during the policy period within:

- The US
- US Territories (this mostly applies to Puerto Rico)
- Canada

Note: An insurer can cancel a Personal Auto policy for the following reasons:

- Nonpayment of premium
- Suspended/revoked license
- Illegal activities
- Misrepresentations regarding the drivers' record or history

If any of the above reasons apply, the insurer can cancel the Auto policy if they notify the insured within **20** days of the cancellation date.

If the insurer chooses nonrenewal of policy, they have to let the insured know within **30** days.

2. The **4 Basic Components of an Auto Policy**

Every Auto Policy has **4** basic components to the contract. We'll discuss each component separately.

- 1) **D**eclarations
- 2) **I**nsuring Agreement
- 3) **C**onditions
- 4) **E**xclusions

Note: Remember the acronym DICE? The **4** parts of the auto contract are exactly the same. Easy one, right? Take 'em as they come.

Primary, excess and special physical damage: Auto insurance coverage follows the ownership of the vehicle first and the driver second. So, if you are an authorized driver of your car and you get in an accident, your insurance is "primary". If someone else was driving your car with your permission, your coverage would still be "primary", the driver's insurance company, however, might be called upon to cover any "excess" or secondary coverage (damages beyond your limits). Certain types of vehicles, like RV's, snowmobiles, etc may be eligible for ***special physical damage coverage***.

A. Declarations

This section of the Auto Policy contract is also referred to as the Face sheet or the Dec-page. This section includes the following information:

- Names of all insured drivers, and the names of the producer and insurer
- Lists all the covered autos
- Policy number
- Policy period
- States when and where coverage applies
- Notes which coverage limits the insured has chosen to carry
- Specifies deductibles, endorsements, and premium amount

Note: We've mentioned this a couple of times, but just to reiterate—more than one party can have an insurable interest in property. In the case of autos, a lot of people borrow money to finance purchasing a new or used auto. The person or entity that loans the money has an insurable interest in the insured auto. Since insurable interest has to exist at the time of loss, if the financed car was totaled, it affects both the insured and the person/entity who provided the loan. Someone who provides a loan is referred to as a leinholder, and since they have an insurable interest in the auto, they're also listed in the Declarations.

Note: Insurance policies renew or expire at **12:01 a.m.** If an insured gets a notice that their policy will cancel for nonpayment on May 5th, and they bring in the money to pay that morning at 10:00 a.m., they've actually been without coverage since 12:01 a.m.

B. Insuring Agreement

This section of the Auto Policy states which losses are covered, the property that's covered, and which perils are insured against (i.e. theft, collision, fire, etc.)

An example of an Insuring Agreement might state as follows:

We agree with you, in return for your premium payment, to insure you subject to all the terms of this policy. We will insure you for the coverages and the limits of liability shown in the Declarations of this policy.

Note: In the above example, “you” and “your” refers to the named insured.

The Insuring Agreement states that as long as the insured pays his/her premiums and doesn't let the policy expire, the insurer will pay for any losses covered by that policy.

C. Conditions

This part of the Auto Policy outlines the duties and responsibilities of both the insured and the insurer.

The **Conditions** section includes (but isn't limited to):

- **Policy Period and Territory** meaning where the coverage applies and for how long.
- **Changes** means that any changes an insurance company makes to an Auto Policy have to be made through endorsements. A new Declarations page and/or policy will then be issued.
- **Legal Action Against Us** details the procedure the insured has to follow if they want to sue the insurer.

- **Transfer of Your Interest** explains what has to happen if the insured wants to transfer their rights and/or interests in the event of their death.
- **Our Right to Recover Payment** means that after paying damages to an insured, an insurance company will try to recover money from the at-fault party. (Subrogation)
- **Two or More Cars Insured** refers to anti-stacking.

Putting it into Context:

Say you have two cars: a really nice one, and an old beater. You've underinsured the old beater, because—well, it's an old beater. The really nice car has plenty of insurance. One day you're out tooling around in the old beater, when you accidentally run a stop sign and cause an auto accident. Even if you have enough insurance on the really good car, you weren't in the really good car—so if you're underinsured in the old beater, you're underinsured—end of story. You can't combine the insurance you have on both cars to cover the accident you had in the beater, because this would be stacking. The insurance follows the car not the person.

- **Bankruptcy** means that if the insured goes bankrupt during a period when the insured was liable for an auto accident, the insurer isn't relieved of any financial obligations under the policy.
- **Termination or Reduction of Coverage** describes what will happen if a policy is terminated, cancelled, or nonrenewed. If an insured is notified that their policy will terminate on May 5th, they need to be aware that the actual termination occurs at **12:01 a.m.** on May 5th.

Note: Time changes don't apply to automobile policies. So, if someone buys their policy on June 1st on the East Coast, and on June 1st the following year, their on the West Coast, the policy expires at June 1st 12:01 a.m. West Coast time.

D. Exclusions

The **Exclusions** describes property, perils, persons or situations that aren't covered by the Auto Policy.

Specific Exclusions in the Auto Policy could vary depending on the type of coverage and the situations the contract is designed to cover.

Some Auto Policies list separate Exclusions under each of the following coverages:

- **Liability**
- **Uninsured / Underinsured Motorist**
- **Personal Injury Protection (PIP)**
- **Damage to the Insured's Car**

E. Additional Auto Policy Sections

The Auto Policy has several more sections in addition to the 4 basic components. They include:

- **Auto Policy Coverages**
 - o Liability Coverage
 - o Personal Injury Protection Coverage (PIP)
 - o Uninsured/Underinsured Motorist
 - o Coverage for Damage to the Insured's Car

- **Definitions**
- **What to do in Case of an Accident**
- **No Coverage in Mexico**

Note: The **4** Auto Policy Coverages listed above will be covered in more detail later in the unit.

3. Auto Policy Definitions

The Definitions section of the Auto Policy contract defines certain key terms used in the policy. These definitions help clarify the intent of various coverages and conditions.

There's a section at the beginning of the contract listing general definitions that apply to the entire contract. In addition, each coverage section (i.e. Liability, PIP, etc.) might include definitions that are specific to that coverage.

Probably the most important definition to fully grasp is the legal definition of the **Named Insured**.

A. Named Insureds

The **Named Insureds** on an auto policy can include:

- The primary insured, any family members, and any relatives living in the same house. Anyone who is going to be using the covered auto needs to be listed as additional drivers on the Declarations page.

Note: There is a family Auto Policy provision called the Omnibus Clause, which allows the parents, in-laws, brothers and sisters (etc.) of the primary insured to be listed in the Declarations.

- Any person using the insured's covered auto, unless he/she doesn't have the insured's permission—like car-jackers, just to toss out an example.
- Other persons occupying the insured's car such as passengers
- Anyone acting on the Named Insured's behalf.
- Any individual or organization is covered for liability due to the insured's acts.

Putting it into Context:

If the insured uses an insured auto for a church or school function, and the insured is in an accident, the church or school would be covered for liability under the insured's policy.

Note: Most insurance companies will also defend any claim or lawsuit asking for those damages. But remember, an insurance company won't defend any lawsuit or make additional payments once the Limit of Liability has been exhausted. So, depending on the situation, the minimum amount of Liability coverage in California (**15 / 30 / 5**) wouldn't go very far.

B. Who isn't a Named Insured?

An insured person can never mean:

- The USA or any of its government agencies

- Any employees of the US government using a personal auto in the course of their job
- Anyone using the car who isn't quite sure if they have permission or not

Note: This is called Grand Theft Auto, and it's frowned upon in all 50 states. Golden wisdom #302.

C. Accident or Occurrence

An **Accident** or **Occurrence** is defined as an event that results in an insured loss. Coverage on an Occurrence basis differs from coverage on an Accident basis in that:

- **Occurrence** means gradual or accumulative damage that can't be exactly placed in time or place. This is more along the lines of "wear and tear."
- **Accident** refers to instantaneous damage, unintentional, and identifiable as to time and place.

D. Legally Liable

This means responsibility is imposed by the law, rather than by a contract.

E. Bodily Injury

This refers to harm to the body, sickness, disease, or death of any person

F. Property Damage

This refers to physical injury to or destruction of tangible property, including loss of its use. In English: when stuff gets busted up, that's property damage.

4. Auto Policy Coverages

The Auto Policy coverages can be divided into **2** parts:

- 1) **Part 1**—Liability and Medical Expenses
- 2) **Part 2**—Physical damages to the insured auto

A. Part 1

Part 1 consists of:

- **Liability and Supplementary Payments**
- **Medical Payments and PIP**
- **Uninsured / Underinsured Motorists**

B. Part 2

Part 2 consists of:

- **Automobile Damage—Collision and Comprehensive / Other than Collision**

5. A Closer Look at the **4 Coverages**

Here's a little summary of each of the coverages mentioned above:

A. Liability and Supplementary Payments

Liability and Supplementary Payments means the insurance company will pay for any third-party injuries or property damage if the named insured is legally liable after an auto accident.

Supplementary Payments include expenses due to defending a Named Insured during an auto-accident related lawsuit. These *Supplementary Payments* include:

- Any expenses for settling a claim or defending a lawsuit
- Interest on a judgment, as long as it doesn't exceed the Limit of Liability coverage
- Any lost wages or salary up to **\$50** per day, if the insurer requests that the insured attends hearings or trials
- Premiums on Appeal Bonds
- Up to **\$250** for Bail Bonds

Note: The insurance company doesn't have to defend a suit or settle a claim once the Limit of Liability is exhausted, or if the injuries or damages aren't covered by the policy.

The following **Exclusions** apply to Liability:

- Intentional injury or property damage
- Bodily injuries or damages if the insured auto was being used to carry people for a fee (**for hire**)

Note: This doesn't include people using their car for carpools or "share-the-expense car pools". This exclusion only refers to people who are charging their passengers.

- If the Limits of Liability have been exhausted
- If the covered auto is being used without permission
- The insured's personal property or property in the custody of the insured that's damaged while it's in the car

- Any of the insured's employees who are injured on the job (this exclusion usually doesn't apply to domestic employees)
- Any vehicles used in the course of business

Note: That last Exclusion doesn't apply to private passenger autos, pickups, vans, or trailers. Basically that Exclusion is set up to keep people from using commercial vehicles as personal autos.

Putting it into Context:

If the insured owns a flower shop and uses their industrial commercial van to make deliveries, the van would be excluded under the Personal Auto Policy. But if the insured uses their personal auto to visit a client, then coverage still applies. The insured would need a Commercial Auto Policy to cover the business auto.

- Bodily injuries or property damage that's covered by a Nuclear Liability Policy

Note: Okay, here's the skinny on the above Exclusion, which we know sounds pretty extreme. First of all, it's obvious that Exclusion doesn't apply to your average motorist. The reason why this Exclusion is even listed is because a nuclear energy incident is considered a **Catastrophic Event**. The Personal Auto Policy isn't designed to handle Catastrophic Events.

- For damages done by or to off-road vehicles with four wheels, or for any vehicles with less than 4 wheels

- For race cars or autos used in any race (street race, drag race, etc.)

Minimum Limit of Liability refers to the minimum amount of liability required by state law in order to drive an auto. There usually isn't a maximum limit of liability—different insurance companies are willing to insure drivers for different amounts.

The minimum limit of liability in California is referred to as Split-limit coverage, and it's expressed as three numbers separated by slashes—**15 / 30 / 5**:

- **15** means the insured won't get more than **\$15,000** for bodily injuries for any one person involved in the accident.

Putting it into Context:

If there are two people in an accident, and their medical expenses are \$10,000 and \$5,000, they are both fully covered because neither one exceeds the Bodily Injury Liability of \$15,000.

- **30** means that **\$30,000** is the most the policy will pay for the bodily injuries of everyone involved in the accident.

Putting it into Context:

If there are three people in an accident, and their expenses are \$20,000, \$21,000, and \$10,000 respectively, none of them have exceeded the Bodily Injury Liability limit, but it exceeds the total Bodily Injury Liability limit. Everyone could receive up to \$15,000 for their injuries, until the expenses reach \$30,000.

- **5** means a maximum of **\$5,000** will be paid for all damages to all property involved in any one accident. This could mean the insured only has \$10,000 to pay for a number of autos damaged in a multi-car accident if the insured is at fault.

Note: Since it's hard to buy one new car for \$5,000—let alone pay for multiple cars—and a few nights in the hospital for one person can cost up to \$30,000, in our opinion, carrying the minimum requirements isn't the safest idea.

B. Medical Payments/PIP Coverage

Medical Payments Coverage is optional coverage in some states. This is sometimes referred to as **PIP** or **Med-pay**.

Medical Payments/PIP coverage covers the reasonable medical expenses for anyone traveling in a covered auto. Such expenses could include:

- Emergency room visits
- Ambulance fees
- Hospital expenses
- Etc.

In the very worst-case scenario, Medical Payments/PIP also covers funeral expenses.

Medical Payments/PIP could be offered in increments of \$1,000 up to \$100,000. Whatever the amount, everyone riding in the

covered auto has that total amount of medical coverage, no matter if there is one person in the car, or six people in the car.

Alert!

With Medical Payments/PIP, the Limit of Liability applies per person. Therefore, if the limit of liability is \$100,000, that means it's \$100,000 per person, not for everyone involved in the accident. Example: "Frank has \$50,000 in PIP coverage. He and his three friends are in an auto accident, and each of their medical bills amounts to \$50,000. How much will Frank's PIP cover?"

- A. \$50,000 only
- B. Frank's injuries only
- C. Everyone's injuries are covered
- D. Frank's injuries are covered first and then whatever is leftover is divided among the other friends

The answer is C. They want to lull you into a Limit of Liability stupor, so remember, in Medical Payments/PIP, it's per person, *not* per occurrence.

Medical Payments/PIP is considered **No-Fault coverage**. This means it doesn't matter whose fault the accident was, everyone's covered in the insured auto. This allows the injured people to have their medical expenses taken care of immediately, because the insurance company doesn't have to wait to determine fault.

Medical Payments/PIP coverage only applies to the insured's and the insured's passengers' personal medical or funeral expenses, never third-party expenses.

In California, Medical Payments/PIP covers any related expenses that happen within **3** years of the date of the accident (some states only allow 1 year).

Medical Payments/PIP covers:

- The insured or family members driving a car designed for public roads. In simpler terms, the family in the family car—not the family in the dune buggy.
- The insured or family members if they're hit by a car while their walking or riding a bicycle.
- Any passengers in the car.

Medical Payments/PIP excludes:

- Vehicles with less than four wheels.
- Vehicles used on private lands/roads (golf cart, maintenance truck, etc.).
- Any vehicle used/designed for racing.
- A vehicle that's used without the owner's permission.
- A business vehicle, or a vehicle being used for business purposes.
- If the primary coverage is Workers Compensation.
- If the insured is driving a car other than the covered car (hopefully the other car has its own PIP in this situation).

- During war or a nuclear hazard, but at that point, if you're worrying about your PIP coverage, you've lost sight of the big picture.

Note: Since PIP coverage is optional in a lot of states, producers don't always encourage their auto insureds to carry that particular coverage. Most insureds will have health insurance plans to pay for any automobile accident-related injuries. Bear in mind that oftentimes, the insured's passengers might not have a health plan, or they have a very insubstantial one. In our opinion, every insured should include PIP as part of their Auto Policy.

C. Uninsured/Underinsured Motorists (UM/UIM)

UM/UIM coverage is extremely important. Most people feel that if they get in an accident, it won't be their fault, so there's really no reason to carry high Limits of Liability. If it's not their fault, the other motorist has to pay, right?

Not necessarily. If your client is in an accident with an uninsured or underinsured motorist, they could find themselves with hundreds of thousands of dollars in medical expenses and property damage. If the other motorist isn't insured/is underinsured, and they don't have other assets, there's really no way for your client to recover payment without UM/UIM coverage.

An **Uninsured Motor Vehicle** is a vehicle that:

- Doesn't carry Bodily Injury or Property Damage Liability

- Has an insurance policy on the car, but their insurance company denies them coverage
- Has a driver who declares bankruptcy within **2** years of the accident
- Is involved in a Hit-and-Run or a Phantom Vehicle

What's the Difference?

You're driving along when a pick-up truck runs a stop sign, and smashes into your car. The pick-up truck quickly drives off before you can get a good look at the driver. You've just been the victim of a hit-and-run.

You're driving along when a pick-up truck runs a stop sign. You see the truck in time to avoid being hit, but when you take evasive action, you end up hitting a parked car. The pick-up truck quickly drives off before you can get a good look at the driver. You've just been the victim of a phantom vehicle.

A hit-and-run directly causes the accident, and then leaves the scene. A phantom vehicle indirectly causes the accident, and then leaves the scene.

An Underinsured Motor vehicle means the person has insurance, but it's not enough to cover all the expenses their liable for after an accident.

With some insurance companies, UM/UIM is written for the same amount as the Limit of Liability. So, if your client has \$50,000 for Bodily Injury, then they also have \$50,000 in UM/UIM.

Here's where it gets trickier: a lot of times, UM/UIM only pays the excess in liability limits.

Putting it into Context:

Megan is sitting at a red light, when she's rear-ended by another driver. Megan ends up with \$100,000 in medical expenses. The other driver carries 25/50/10 of Bodily Injury Liability, and Megan also carries only 25/50/10 for Bodily Injury Liability coverage and UM/UIM coverage. Because Megan's coverage isn't higher than the driver's, there is no excess coverage, and Megan's UM/UIM coverage won't pay anything over and above what the other driver's policy pays on the claim. Therefore, Megan can only collect \$25,000 from the other driver, but that leaves her with \$75,000 in medical expenses.

If your client asks you why they should carry higher limits of liability when they don't have a lot of assets to protect, tell them that the higher the limit of liability, the higher the limit of UM/UIM coverage. And UM/UIM protects everyone's number one asset: their own health and the health of their family.

Putting it into Context:

Megan is sitting at a red light, when she's rear-ended by another driver. Megan has \$100,000 in medical expenses, but she also carries 100/300 coverage in Liability and UM/UIM coverage. Even though the motorist who hit her only as 25/50 coverage for Bodily Injury Liability, Megan's UM/UIM coverage pays the excess. Therefore, Megan can collect \$25,000 from the other driver, and then her insurance will pay an additional \$75,000. Megan's medical expenses are fully covered.

UM is included in all Personal Auto Policies, unless the insured signs a **waiver** rejecting the coverage. The minimum BI limits offered have to mirror the minimum liability limits per person (**\$15,000**) and per occurrence (**\$30,000**).

Who is insured under UM / UIM: Uninsured and underinsured motorist coverage provides coverage for you and all members of your family who reside in your household, passengers, or people driving your car with your permission. A typical limit might read \$100,000 per person / \$300,000 aggregate. So, if the driver of the other car who caused an accident has only \$30,000 per person / \$60,000 aggregate of coverage, you could stand to collect \$70,000 per person from your own UM / UIM policy up to a maximum of \$240,000.

There is also a coverage called **Uninsured Motorist Property Damage (UM/PD)**. **UM/PD** pays for damages to your vehicle, whereas general UM/UIM only pays for medical expenses. The only property damage limit available for UM coverage is **\$3500**.

6. Automobile Damage—Collision and Comprehensive / Other than Collision Coverages

IMPORTANT:

It is unlawful for any insurance agent or broker, or any insurance solicitor employed thereby, to receive any financial benefit from an automobile repair facility or any other form of direct or indirect consideration from any person for referring insureds to that person or that person's designee for vehicle repairs covered under the

automobile comprehensive coverage, property damage coverage, or automobile collision coverage, of an insurance policy issued through the insurance agent or broker or by an insurer represented by the insurance agent.

You may be thinking to yourself, hey, what the heck happened to **D. Automobile Damage—Collision and Comprehensive / Other than Collision Coverage**? Well, this part of the Auto Policy is huge, and we couldn't think of another way of organizing it that wouldn't end with us jumping out the nearest window.

Therefore, we're giving it its own section, but remember that it's the fourth coverage, right? Right.

The insured can pick Collision and/or Comprehensive/Other than Collision coverage for each vehicle. Unlike the limits of liability coverage, each auto doesn't have to carry the same physical damage coverage. One auto can carry both Collision and Comprehensive, and a second auto might only carry Comprehensive.

A. Collision Coverage

Collision Coverage insures a vehicle for damages due to the following situations:

- The car hits another car
- The car hits a solid object
- The car flips over
- The car hits a pedestrian

Note: In most states, hitting a pedestrian with a vehicle is considered a collision.

B. Comprehensive / Other than Collision Coverage

Anything else that causes damage to the auto is covered under **Comprehensive / Other than Collision coverage**. This coverage insures against direct and accidental loss caused by something other than collision (get it?).

Comprehensive covers more common perils that damage autos, such as:

- Wind
- Hail
- Thrown or falling objects

Note: If you come around a corner and hit a huge boulder on the road, the auto damage is covered by Collision (hitting a solid object). However, if the huge boulder was still rolling down the hillside and hits your car as you come around the corner, the auto damage is covered under Comprehensive (thrown or falling objects).

- Explosion
- Earthquake
- Water or flood

Note: Water or Flood coverage doesn't cover you if you deliberately drive your car into the ocean. However, you're covered if your car

floats away because you forgot the tide was coming in. It's a Herculean effort to keep from making sarcastic comments.

- Riot or civil Unrest
- Glass breakage
- Damage from striking an animal or bird

Comprehensive basically covers:

- Any covered, accident-related damage done to an owned, or non-owned auto, and its equipment

Note: A non-owned vehicle is an auto the insured has either borrowed or provided by their work/job. A non-owned vehicle could also apply to rentals that the insured rents on short vacation, or autos the insured needs while their primary insured vehicle is being repaired/replaced due to breakdown, repair, servicing, loss, or destruction.

- Additional transportation expenses while the named insured is replacing or repairing a damaged auto

Comprehensive / Other than Collision doesn't cover losses due to:

- Deterioration including wear and tear
- Freezing
- Mechanical or electrical breakdown
- Road damage to tires
- Nuclear fallout
- Any kind of war or insurrection

Other Than Collision coverage is property insurance coverage.

Collision and Comprehensive Coverage will cover losses to auto electrical equipment:

- That is part of the vehicle's operations or monitors the vehicle's operations
- If it shares the same unit housing sound reproducing equipment and is permanently installed in an opening for the radio

Collision and Comprehensive Coverage will not cover losses to:

- Car stereos or equipment unless it's factory installed and listed in the Declarations
- Equipment used with car stereos, such as MP3 players
- Electronic equipment that sends or receives any kind of signal (laptops, cell phones, etc.)
- Customizing
- Radar detectors
- Cars involved in racing
- An auto that's wrecked or confiscated because the insured was doing something illegal
- Losses to a car that the insured doesn't own—unless the insured was using the car as a substitute while their primary vehicle was being repaired/replaced
- A camper or trailer that isn't listed in the Declarations

Note: All of the normal Exclusions apply to Comprehensive/Other than Collision (cars used in a race, cars carrying people for a fee, etc.). The

one Exclusion you should remember is that campers or trailers are excluded if they aren't listed in the Declarations. However, if the trailer is being towed behind an insured vehicle, liability coverage does apply. We've seen that question on the final exam!

Personal effects like computers, sports gear, etc that are transported in a vehicle are not covered by a PAP.

C. Covered Autos under Collision / Comprehensive

The following are all covered autos under Collision/Comprehensive coverage:

- Any vehicle listed in the Declarations
- Any trailer the named insured owns that's being towed behind a covered vehicle
- Any vehicle the named insured borrows because their normal vehicle isn't working (rentals, etc.)
- A vehicle the named insured purchases to replace a currently insured vehicle

Note: If the insured buys an auto to replace their current insured auto, the replacement auto is automatically covered for **14** days from the day it's purchased, for the exact same coverages in the Declarations. In fact, if the insured has more than one auto insured, with different coverages on each, the replacement auto is automatically covered with the very best coverage the insured has on any of the cars.

- Any additional vehicles the insured purchases

Alert!

Here's some numbers to remember:

Again, if the insured buys an additional vehicle, that vehicle is automatically covered for **14** days—just like with a replacement vehicle. If the insured has at least one car covered for Physical Damage coverage, it doesn't matter if the new car is a replacement or an additional vehicle. The insured has full coverage, after deductibles, as long as they request changes or additions to the current coverage within **14** days.

Now, if the insured doesn't have Physical Damage coverage (only Liability) on any covered vehicle, the insured has to report the new car to the producer and request that Physical Damage be added to the coverage within **4** days.

If the insured doesn't request Physical Damage within **4** days, there's a chance they're tooling around without Comprehensive or Collision coverage. If the insured gets in an accident within those **4** days, a **\$500** deductible applies.

Note: We all know how much a car depreciates once we plunk ourselves into the driver's seat and drive it off the lot. In fact, the amount paid for the car at the time of sale won't be the car's actual cash value five minutes later, when you wave goodbye and drive off.

If your car is totaled or damaged, you're still responsible for paying the remainder of the loan or lease. **Gap insurance** pays the difference between the amount the insurer pays for the totaled car, and the amount the person still owes on the car.

D. Standard Exclusions

The following Exclusions apply to covered autos:

- There's no coverage if the accident was intentional
- There's no coverage for commercial vehicles
- There's no coverage for vehicles used without permission
- There's no coverage for vehicles with fewer than **4** wheels (motorcycles, etc)
- There's no coverage for vehicles used in a race
- There's no coverage for vehicles that are used on a regular basis by the insured, that aren't listed in the Auto Policy

Putting it into Context:

Millicent lets her niece, Emily, borrow her extra car to drive regularly to and from school. If Emily has an accident, Emily's Dad's Auto Policy doesn't cover the damages to Millicent's car, nor is there any Liability coverage because the car was furnished for regular use. The insurance follows the car, not the person—so Millicent needs to have primo coverage.

- The insured can't collect more than one payment for the same loss under Liability, PIP, or UM/UIM
- If someone is driving a borrowed car, their personal insurance isn't the primary insurance, because the insurance follows the car not the person

Putting it into Context:

Here's the significance of insurance following the car and not the person. Most people probably assume that if they're carrying really good insurance, they're fine no matter what car they're driving. Not

so. If you borrow your friend's car, and you have really high limits of Liability, but your friend is underinsured, if you're in an accident, it's your friend's insurance that applies to the accident. Insurance follows the car not the person.

E. Transportation Expenses Coverage Under Collision / Comprehensive

If an insured is involved in a collision, or their car isn't drivable because of a comprehensive loss, Transportation Expenses coverage reimburses the insured for a rental, taxi, carpool, or other temporary transportation.

The Auto Policy provides a limited amount of coverage of **\$20** per day up to a maximum of **\$600**.

Note: The limits of this coverage vary from state to state, and most companies give the insured the option of choosing more coverage.

Transportation Expenses coverage can also be referred to as **Loss of Use** or **Rental Reimbursement coverage**. This coverage is added to the Auto Policy via endorsement. Before this coverage is applicable, the insured has to have filed a Collision or Comprehensive claim.

Transportation Expenses coverage also applies if:

- The rental or substitute vehicle is stolen. Coverage starts **48** hours after the car is stolen and stops as soon as the car is found or replaced.

- Any other losses to a substitute vehicle beginning **24** hours after the named insured stops using the car and ends after a reasonable period of repairs/servicing/replacement.

F. Motorcycles

Motorcycles are typically NOT covered by Personal Auto Policies and generally cannot be added as an endorsement. They must be insured on their own and insurance IS REQUIRED by the State of California . . . 15/30/5 . . . a minimum of \$15,000 liability per person, \$30,000 aggregate and \$5,000 property damage. Carrying the minimum, however, may not sufficiently protect your estate, i.e., the decision to increase coverage limits are the same one would make for an automobile, although some motorcycle insurers place limitations on the amount of medical payments and uninsured motorist coverage. If there is a loan on the motorcycle, the lender may also require comprehensive and collision coverage, as well. If the owner does not have health insurance, medical coverage is also desirable. Collision, comprehensive and medical are likely to cost more for motorcycles since the rider and vehicle are more likely to be hurt and damaged in any accident.

G. Recreational Vehicle Coverage

RV's can be insured on their own or added as an endorsement to most Personal Auto (PAP) policies. Unlike a car, however, there are additional things to consider on an RV like coverage for fixtures, furnishings and appliances. Additional coverage for these items may be available or a special may be required. And, the type of coverage varies by the type of RV . . . motorhomes are motorized vehicles while fifth wheels and travel trailers are not. There may also be time

restrictions on parking and traveling. If the RV is a primary residence then homeowner's type coverage is necessary. ATV's and personal water crafts vehicles (PWC) can be covered by homeowner's insurance. However, coverage can be limited and even non-existent in the case of ATV's ridden off the owner's property. Special coverage is desirable, especially when vehicles are licensed as street legal.

H. Provisions

There are several other Provisions relating to settling claims with the insurance company for autos damaged due to Collision or Comprehensive losses:

- Claims are settled on a lesser of:
 - o ACV
 - o Repair expenses
 - o Replacing the car with a similar car
- **Payment of Loss** means the insurance company can choose to pay the covered loss by repairing/replacing the car, or, if the car is stolen and then recovered, the insured can have it repaired through their insurance policy (Comprehensive coverage).
- **Other Sources of Recovery** means if there's more than one insurance policy insuring the same car, each insurer pays a pro-rata share in that loss.

Note: In the case of a non-owned vehicle, the insured's coverage would be considered in excess of any other insurance on the same vehicle. Since the insurance follows the car, the insurance on the car is considered Primary and always pays for damages first.

- **Appraisal** means the insured and the insurance company can't agree on the value of the loss, and they'll each choose an appraiser to determine independent values.
- **No Benefit to Bailee** means the insurance policy on the car won't benefit anyone else.

Putting it into Context:

If the insured has their car in a garage for repair, and the garage is destroyed in a fire, the garage isn't covered by the insured's Auto Policy. The garage was acting as "bailee" and the insured and their insurance company will be able to recover damages for the car from the garage's Commercial policy.

I. Duties in the Event of a Loss

The Duties in the Event of a Loss provision in the Auto Policy requires that the insurer be immediately notified of an accident. The insurer needs to know how, when, and where, plus the names and addresses of all injured parties and witnesses.

Anyone seeking compensation has to:

- Cooperate with the insurer during the investigation/settlement/trial
- Send the insurer any relevant legal documents
- Get a physical examination if the insurer requests it
- Give the insurer access to medical records or relevant background information
- Submit a Proof of Loss

If the person makes a claim under Damage to Your Auto coverage, they're required to:

- Take reasonable steps after the loss to prevent further loss
- Immediately notify the police if the car is stolen
- Allow the insurer to examine damaged or wrecked property before the property is repaired or abandoned

J. No-Fault Plans

Pure No-Fault Plans aren't used. If two drivers are in an accident, Modified No-Fault Plans allow the two separate policies to take care of a percentage of the loss.

No-Fault Liability coverage would provide payment up to a certain limit. So, if the insured's No-Fault Liability limit is \$15,000, the insurance would pay the first \$15,000 in expenses. Afterwards, any remaining expenses would be taken out of the at-fault driver's insurance.

Some states have No-Fault Plans, and some don't. California doesn't have a No-Fault Plan. If the insured lives in a state that requires No-Fault coverage, then the Personal Auto policy provides the minimum required benefits.

7. Selected Endorsements

The following endorsements are used to modify a Personal Auto policy:

- **Miscellaneous Type Vehicle Endorsement** allows the policy to cover vehicles with less than 4 wheels, and/or less

than **10,000** pounds like motorcycles, dune buggies, golf carts, small mobile homes, etc.

- **Limited Mexico Coverage Endorsement** provides limited excess coverage for autos taken across the Mexico border. Significant limitations apply. For example, the accident must occur within 25 miles of the U.S. border and the duration of the trip must be 10 days or less.
- **Trust Endorsement** specifies that a private passenger auto, pickup or van is deemed to be owned by a person if title is transferred to a Trust. This is handy since a lot of people keep assets in family trusts.
- **Joint Ownership Endorsement** makes coverage available for vehicles which are owned by individuals other than a husband and wife who reside in the same household and for related individuals who live in different households.
- **Auto Loan / Lease Endorsement (GAP Coverage)** pays any amount unpaid due on a lease or loan for the loss of the covered vehicle.
- **Named Nonowner Coverage** gives someone coverage who doesn't own a car, but borrows or rents cars.
- **Extended Nonowner Coverage for Named Individual Endorsement** removes the exclusions for driving nonowned autos that are furnished or available for regular use. This endorsement also removes the business use exclusion that applies to nonowned trucks and vans.
- **Additional Transportation Expenses** increases the usual transportation limits of \$20 per day up to a maximum of \$600, to **\$30** per day up to a maximum of **\$900**.
- **Customizing Equipment Coverage** pays for direct and accidental loss to custom furnishings, special carpeting, special paint or graphics beyond the \$500 coverage typically provided in standard policies.
- **Towing and Labor Coverage** covers the cost and labor associated with towing a damaged car.

8. The Good Driver Discount

You're rewarded for being a good driver. If you qualify for the Good Driver Discount, you're given a **20 %** discount. You can qualify for the Good Driver Discount if you meet the following requirements:

- You've been licensed to drive a car in California for at least **3** years
- During the last **3** years you haven't:
 - o Had more than one violation point
 - o Had any driving-related felonies or misdemeanors
 - o Was the at-fault driver in an accident that resulted in bodily injuries or someone's death

9. California Auto Assigned Risk Plan (CAARP)

It's difficult for insureds who are higher risks to obtain auto insurance. The **California Auto Assigned Risk Plan** was set up to give everyone the chance to get Auto insurance. Coverage is available for both personal and commercial autos to California residents; non-residents who own a vehicle registered in California and members of the military stationed in California.

CAARP provides the following minimum / required limits:

\$15,000 / \$30,000 for bodily injury and uninsured motorist

\$5,000 property damage

\$1,000 medical payments

Without the plan, there's the danger of a higher percentage of people driving without insurance. The problem is that a large percentage of people drive, and those people are all required to carry insurance. If their insurance is revoked, and they can't get insurance, they could resort to driving without insurance—and that's dangerous for everybody.

Any agent or broker can place business with CAARP, however coverage can ONLY be bound by CAARP.

The **Auto Assigned Risk Plan** means that all auto insurance companies in the state have agreed to share the poor risks. Those risks are referred to as Assigned Risks. This ensures that everyone has the opportunity to get Auto insurance, which gives poor risks a chance to improve their driving history.

A. Non-Standard Physical Damage Coverage

If an insured is a higher risk due to their driving record, age, etc., they would obtain **Non-standard Physical Damage coverage**. This happens when an insured purchases Liability through CAARP, but they still need physical damage coverage. The coverage usually requires higher deductibles, and has stricter limitations about who can drive the car and what kinds of coverages are available.

10. Low Cost Auto Insurance

In 1999, two bills were put through the California Legislature to deal with the problem of uninsured drivers in the state. Most uninsured drivers don't purchase liability insurance because of the cost. These two bills combined because the **California Low Cost Automobile Insurance Pilot Program**, and the law was passed in October of that year.

In order to qualify for the program, the person has to be a good driver (licensed in California for 3 years, no driving-related felonies,

or misdemeanors, and no more than one violation point). Also, the total family income can't exceed **250 %** of the federal poverty level:

- **\$25,525** for one person
- **\$34,255** for two people
- **\$51,625** for a family of four
- **\$86,425** for eight or more

In January 1, 2006, the program changed to allow:

- The value cap on an insured's vehicle to increase from \$12,000 to **\$20,000**
- Up to **2** low cost auto policies per person for households with more than one generation (older and younger).

Note: All California Counties are now eligible. Premium payments vary by County and age ranging from \$200 to under \$400 per year per vehicle.

A. Liability Limits

The limits of Liability in the low cost program are:

- **\$10,000** for BI or death
- **\$20,000** total for BI's per accident
- **\$3,000** for property damage per accident

B. Cancellations and Nonrenewal

Someone's eligibility for the plan is determined the first year by CAARP. After that, it's up to their insurance carrier to determine ongoing eligibility.

Someone can be refused a renewal if:

- There is a substantial increase in loss exposure or hazards
- The person no longer meets the program's eligibility requirements
- Someone buys additional liability outside the program, which isn't allowed (someone can buy additional non-liability outside the program)
- A qualified household needs more than 2 policies (only two low cost policies are allowed per household)

11. Financial Responsibility Law

Most states require drivers to prove that they can pay for liable bodily injury or property damage in the event of an auto accident. The driver satisfies this requirement by buying Auto insurance for at least the minimum liability required by state law.

California requires that all licensed drivers with a registered auto carry a minimum of **15 / 30 / 5**:

- **\$15,000** per person for bodily injury
- **\$30,000** maximum for bodily injury for all persons involved in the accident
- **\$5,000** for property damage

California also requires licensed drivers to carry the same limits (**\$15,000 / \$30,000**) for bodily injury damages caused by uninsured and underinsured drivers.

Note: If the car is regularly driven in more than one state, the driver's insurance has to meet the financial responsibility requirements in each of those states.

Proof of financial responsibility has to be carried in the vehicle.

This proof can be:

- A valid Liability insurance policy (**15/30/5**)
- Documentation if someone is self-insured
- A bond of at least **\$60,000**
- Cash or securities deposit of at least **\$60,000**

California insurance companies issue Certificates of Insurance to prove the insureds met their financial responsibility. The

Certificate of Insurance includes:

- The policy number
- The covered auto(s)
- The effective date
- The expiration date

If the insured lies to a police officer or falsifies their financial responsibility, the insured can be convicted of a **Class B misdemeanor**. Here are a few examples of this sort of falsification:

- Forging signatures
- Forging the actual financial responsibility document
- Intentionally giving false information
- Denying the insured has coverage

2. Required Coverages

If you're driving in California, a valid driver's license and valid insurance is mandatory. If you violate this law, you could be required to prove financial responsibility for **3** years—**3** years all at once. So, if a cop pulls you over, you have to prove that you can pay for any auto accident related expenses that happen in the next **3** years.

Anyone who drives the car has to have a valid insurance card. If a police officer asks to see the insurance card, and the driver doesn't have it, the driver is committing a Class B traffic violation. This violation usually results in a fine, but it can also mean the insured has their car towed and they have to hoof it or take a cab.

California law requires that all accidents be reported immediately. Within **72** hours of an auto accident, the driver has to:

- Report the accident to the DMV
- Provide a copy of their insurance card that verifies the driver's liability insurance
- Depending on the situation, the driver may also have to file a report with the city

If the person who owned the car wasn't in the car accident and learned about the accident after the fact, they also have to file an accident report with the DMV.

Note: If someone fails to report an accident to the DMV, or they file a false accident report, they'll be charged with a Class B misdemeanor.

12. Cancellation of A California Personal Auto Policy

Regardless of what is said in a policy, the Amendatory California Endorsement provides a uniform method to handle policy cancellations:

1. Insured's may cancel by returning the policy or giving written notice of the effective date to cease coverage.
2. Insurance companies may cancel a policy by giving written notice showing the cancellation date, the reason for cancellation. If the policy has been in effect for **60 days or less**, an insurer may cancel for any reason with at least **10 days notice**. If **older than 60 days**, a policy may be cancelled with at least **30 days notice** for non payment of premium, violation of a law, discovery of fraud, discovery of willful or gross negligence, failure of the insured to exercise reasonable loss control in the event of an accident, a determination by the insurance commissioner that continuation of this policy would threaten the financial solvency of the insurance company or a material change in the insured's activities.

13. New Developments

In April 2006, a change was suggested for the Auto insurance industry that complied with the promises of Proposition 103 in 1988—namely that Auto insurance prices would be based more on someone's driving record than where they live.

The new regulations are looking for a comfortable middle ground between insureds, who want to be judged by their driving records, and insurance companies, who need to determine

premium rates based on any loss exposure (including where someone lives).

Additional Standards Applicable To Automobile Insurance

1. If an insurer is responsible to a third party it is unlawful to recommend the claimant make a claim under his own policy.
2. No shall require or suggest that an automobile be repaired at a specific repair shop unless a referral is requested. Nor, require a claimant to travel an unreasonable distance to have his vehicle inspected, repairs estimated or actual repairs conducted.
3. No insurer shall require the use of non-original parts for automobile repairs unless they are like kind. Nor shall the insurer require a claimant to provide his own parts.
4. If the claimant uses his own repair shop, the insurer cannot limit or discount the reasonable cost of repair.

Repair Shop Recommendation: An insurer can recommend a specific repair shop to repair a claimants automobile as long as the following written notice is provided within 5 days of the recommendation:

"WE ARE PROHIBITED BY LAW FROM REQUIRING THAT REPAIRS BE DONE AT A SPECIFIC AUTOMOTIVE REPAIR DEALER. YOU ARE ENTITLED TO SELECT THE AUTO BODY REPAIR SHOP TO REPAIR DAMAGE COVERED BY US. WE HAVE RECOMMENDED AN AUTOMOTIVE REPAIR DEALER THAT WILL REPAIR YOUR DAMAGED VEHICLE. IF YOU AGREE TO USE OUR RECOMMENDED AUTOMOTIVE REPAIR DEALER, WE WILL CAUSE THE DAMAGED VEHICLE TO BE RESTORED TO ITS CONDITION PRIOR TO THE LOSS AT NO ADDITIONAL COST TO YOU OTHER THAN AS STATED IN THE INSURANCE POLICY OR AS OTHERWISE ALLOWED BY LAW. IF YOU EXPERIENCE A PROBLEM WITH THE REPAIR OF YOUR VEHICLE, PLEASE CONTACT US IMMEDIATELY FOR ASSISTANCE."

Fair Credit Reporting Act

Your clients must be informed if information in their credit report or other records, such as a Motor Vehicle Reporting detailing driving history, is used to deny an application for insurance.

Summary

Each part of the Personal Auto Policy has different variations for complete and individual coverage. You have to make sure your clients don't end up falling into the category of underinsured motorist.

Section PC 8

COMMERCIAL COVERAGES

Objectives

This unit delves into the different kinds of commercial coverage. There are a variety of policy forms and coverages that can be combined to maximize a business owner's protection. Pay close attention to the types of businesses that are eligible and ineligible for commercial coverage. Those are just the kind of sneaky questions that will show up on the final test.

This unit includes:

- Commercial Property Insurance
- Commercial Package Policy (CPP)
- Business Owners Policy (BOP)
- Business Owners Liability Form
- Selected Endorsements
- Farm Insurance
- Flood Insurance

Part A: Commercial Property Insurance

1. Commercial Property

Commercial Property Insurance is necessary for business property and business personal property.

Note: Commercial policies use the following definitions:

"You" means named insured

"Your" refers to only the named insured shown in the declaration

"We", "us" and "our" refer to the insurer providing insurance

2. Commercial Property Modular Forms

There are **14** forms you can use to maximize the business owner's coverage:

- 1) Builders Risk Coverage
- 2) Extra Expense Coverage
- 3) Business Income Coverage with Extra Expense
- 4) Business Income Coverage without Extra Expense
- 5) Leasehold Interest Coverage
- 6) Legal Liability Coverage
- 7) Glass Coverage
- 8) Condominium Association Coverage
- 9) Condominium Unit Owners Coverage
- 10) Mortgage Holders Errors and Omissions Coverage
- 11) Tobacco Sales Warehouse Coverage
- 12) Standard Property Policy
- 13) Building and Personal Property Coverage
- 14) Value Reporting Endorsement

The Standard Property Policy form and the Building and Personal Property Coverage form are used the most frequently, so we'll summate the first **11** and then go into more detail on the last **3**.

Here's a closer look at the first **11** coverage forms:

Note: Prior to 9/11, **terrorism coverage** was routinely included in commercial insurance policies. Today, most insurers have either drastically raised their premiums or excluded terrorism coverage entirely, BOTH in existing and new policies. The Terrorism Risk Insurance Act of 2002 provides for a sharing of losses between insurers and the federal government.

A. Builders Risk Coverage

This form protects property that's under construction. Either the owner or the contractor can be covered by this form.

Coverage applies to the following, as long as they are on the premises or within **100** feet of the premises:

- Foundations
- Temporary structures
- Building materials and supplies

- Fixtures
- Machinery or equipment

Alert!

The coinsurance requirement for Builders forms is **100 %** of the completed value of the property. The insured can't ever purchase less insurance than the property's estimated completed worth.

The Builders Risk Coverage Form terminates as soon as:

- The building is finished or the builder's interest ends
- The builder abandons the property
- **60** days after the building is considered occupied
- **90** days after construction
- The policy expires or is canceled

B. Extra Expense Coverage

Some insureds can't afford to shut down their business. They can get coverage by adding **Extra Expenses Coverage** to their **Business Income Coverage Forms**. The Extra Expenses Coverage keeps the insured's business in production while the business is being repaired or replaced. For example, if a public utilities station, a newspaper, or a dairy were to shut down, it could create a lot of difficulties for the customers. It also could result in the business never being able to recover.

This type of risk requires the Extra Expenses Coverage Form.

Note: Extra Expenses Coverage usually does not cover lost income. This type of coverage is specifically designed to reimburse the insured for the cost of keeping the business running.

There are limits placed on this coverage depending on how long it takes the business to recover. These limits are stated in the Declarations as **40 %**, **80 %**, or **100 %**. To make this a little clearer:

- 30 days or less: **40 %** of the full amount of insurance is paid
- 31-60 days: **80 %** of the full amount of insurance is paid
- Over 60 days: **100 %** of the full amount of insurance is paid

So say the insured has Extra Expenses Coverage of \$100,000:

- 30 days or less: **40 %** of the full amount is paid. Therefore the insured is entitled to \$40,000
- 31 to 60 days: **80 %** of the full amount is paid. Therefore the insured is entitled to \$80,000
- Over 60 days: **100 %** of the full amount is paid. Therefore the insured is entitled to \$100,000

C. Business Income Coverage with Extra Expense

Business Income refers to earnings and cost. The **Business Income with Extra Expense Coverage Form** covers the extra expense of keeping the business up and running **ONLY after a direct physical loss. There needs to be a complete suspension of operation for the Business Income to be triggered.**

Note: The Business Income Declaration shows which causes of loss are covered.

In addition to the **Business Income Forms**, the insured can choose extra coverages:

- **Extended Business Income Coverage** covers lost income up to **30** days after repairs.
- **Order of Civil Authority Coverage** covers the business owner's losses if an order of civil authority forbids entry to the business. This coverage can last up to **3** weeks.

Putting it Into Context:

A major fire hit Bertrand's area, causing extensive damage to the entire City Center. Bertrand was forced to shut down his Custom Jewelry store during the fire, and after the fire was put out, the city declared the entire area unsafe. Because Bertrand is covered under Order of Civil Authority Coverage, he can be reimbursed for financial losses for up to three weeks.

D. Business Income Coverage without Extra Expense

The **Business Income Coverage Form** covers the insured business for lost income during the Period of Restoration. The period of restoration starts from the time of loss until the property can be repaired or replaced.

There are Optional Coverages that can be added to the Business Income Forms:

- **Agreed Value** covers the business owner for the value of his business. A new form must be completed annually.
- **Extended Period of Indemnity** covers a business owner's income over the initial **30** days of coverage.
- **Maximum Period of Indemnity** covers a business owner's income for up to **120** days after a loss.
- **Monthly Limit of Indemnity** reimburses a business owner monthly for a specific amount following a loss.

Note: Business Income and Extra Expense coverages are considered **Time Element Consequential Loss Coverage**. Within this type of coverage, the amount of loss is connected to the amount of time it will take to restore/repair the business.

Non-Time Element Consequential Loss Coverage also has to do with direct loss, but it covers profits. For example, if a business owner's inventory is valued at \$40,000, and they were scheduled to sell that inventory for profit of \$80,000, Non-Time Element Consequential Loss coverage would reimburse them the \$40,000 in profit that was lost.

E. Leasehold Interest Coverage

This coverage applies to insureds who are leasing spaces for their commercial business. If an insured is forced to relocate, this coverage pays any difference between the old rent and the new rent for the period of the insured's contract.

Putting it into Context:

Say an insured is renting a space for \$2,000 a month for 90 months, and they've been renting the space for 40 months. If that space is destroyed by a covered cause of loss, and the insured is forced to

relocate, the new rent could be substantially higher. If the new rent is \$3,000 a month, then Leasehold Interest coverage would pay the difference for the rest of the insured's contract. Therefore, the insurance would pay the extra \$1,000 for the next 50 months

F. Legal Liability Coverage

Legal Liability pays for third-party damages, either direct or indirect. This also applies to third-party property that's in the insured's control or custody.

G. Glass Coverage

This coverage expands the type of glass coverage offered by the Commercial Property policy. The Commercial Property policy does cover glass under the Special Causes of Loss form, but it excludes vandalism, theft, or accident perils. The Glass Coverage form offers more complete coverage for glass.

Coverage is limited to:

- **\$100** per pane/plate
- **\$500** per occurrence

The covered perils are:

- Glass breakage
- Chemical damage

Note: There are no limits placed on claims due to glass breakage or chemical damage.

The additional coverages are:

- Frames
- Temporary Plates
- Debris Removal

- Removal of Obstruction

The excluded perils are:

- Fire
- Nuclear Hazard
- Anything to do with war

H. Condominium Association Coverage

This coverage covers everyone who lives in the condominium units. All the unit owners belong to the association, and pay a monthly rate in order to handle any future claims.

Coverage applies to:

- The building and facilities
- Halls
- Stairways
- Grounds
- Permanent fixtures

I. Condominium Unit Owners Coverage

This coverage form insures the condo owner's business personal property, and applies to:

- Business personal property
- Permanent fixtures
- Any improvements the condo owner has paid for

J. Mortgage Holders Errors and Omissions Coverage

This coverage protects against any losses from a mortgage holder's mistake. There are **4** different coverages available under this form:

- 1) Coverage A—Mortgage Holders Interest
- 2) Coverage B—Property Owned or Held in Trust
- 3) Coverage C—Mortgage Holders Liability
- 4) Coverage D—Real Estate Tax Liability

K. Tobacco Sales Warehouse Coverage

This coverage form protects tobacco products and materials being stored at a warehouse. This coverage applies if the tobacco actually belongs to someone else, but it's in the custody of the insured.

3. The Standard Property Policy and the Building and Personal Property Coverage form

The Standard Property Policy form and the Building and Personal Property Coverage form get their own section, because they're used the most frequently.

A. The Standard Property Policy

The Standard Property policy is a basic version of the Commercial Building and Personal Property form. An insured might not be able to get approval for more extensive coverage due to risk exposure or loss history, and so they'd purchase a Standard Property policy.

Perils covered by the Standard Property policy are:

- Fire
- Lightening
- Explosion

There are very limited optional peril coverages that can be added to the Standard Property policy, but only using Basic form perils.

The following endorsements wouldn't apply to the Standard Property policy:

- Replacement
- Agreed Value
- Inflation Guard

B. Commercial Building and Personal Property Form

Commercial Building and Personal Property Insurance

covers the premises and the business owner's personal property. The personal property of others is covered if that property is in the insured's custody.

Building Coverage insures the described building and other structures on the premises, as well as the following:

- Additions or alterations to the premises
- Indoor and outdoor fixtures
- Fixed machinery and equipment
- Outdoor furniture
- Personal property used to repair or protect the premises

Business Personal Property includes any of the following, as long as the items are within **100** feet of the building:

- Furniture, fixtures and betterments
- Inventory
- Leased property
- Machinery and equipment
- Personal property used for the business

If someone's personal property is damaged on the premises, the commercial owner's insurance pays to replace or repair the property. The following items are excluded from coverage:

- Non-commercial animals
- Antennas and satellite dishes
- Any kind of major mode of transportation: planes, boats, and automobiles.
- Contraband

- Outdoor fences
- Land and water
- Money
- Outdoor plants of any kind
- Detached signs

Note: “Contraband” is a term for illegal items. Cocaine would be an example of contraband, so no matter how much that drug-lord client is willing to pay for premiums, we do not insure his/her shipment of cocaine. We’ll let you break the bad news.

The **Commercial Business and Property Form** offers the following Additional Coverages:

- **Debris Removal** pays up to **25 %** of the amount paid for losses to property, minus the deductible. If the insured wants Debris Removal, the insured must report the claim within **180** days of the loss.
- **Preservation of Property** pays for property that needs to be removed from an insured location to prevent further damage to that property. This coverage also pays for the property to be temporarily stored at another location. Coverage only applies after **30** days.
- **Fire Department Service Charge** pays up to **\$1,000** for charges related to a service provided by the fire department, as long as that service had something to do with a covered cause of loss.
- **Pollutant Clean-up and Removal** pays up to **\$10,000** to remove or clean up pollutants on the premises. All expenses have to be reported in **180** days.

Most of these **Coverage Extensions** can be added without the insured needing to pay a higher premium, because the coverages are considered “incidental.”

Note: There is only one Coverage Extension that results in a higher premium, and that’s **Newly Acquired or Constructed Property**.

The following Coverage Extensions are only available if the insured has met their **80 %** coinsurance requirement:

- **Accounts Receivable** reimburses the business for financial losses if a business can't collect payments from customers due to damaged data or lost information. **Accounts Receivable** pays up to **\$10,000** for incidents occurring on insured premises and **\$5,000** for incidents occurring off insured premises.
- **Business Personal Property Off Premises** insures valuable business personal property that is frequently away from insured premises. Business Personal Property Off Premises pays up to **\$10,000** for business property, *not* including money or valuable papers.
- **Newly Acquired or Constructed Property** pays up to **\$250,000** for the insured's new property or constructed property. This includes **\$100,000** coverage per any additional buildings.
- **Outdoor Property** pays up to **\$1,000** (only **\$250** for any one tree, shrub, or plant) for loss of declared outdoor property.
- **Personal Effects and Property of Others** pays up to **\$2,500** for personal property belonging to the insured or their associates.
- **Valuable Papers and Records** pays up to **\$2,500** to replace lost and damaged information.

C. Value Reporting Endorsement Form

This form provides coverage for a business whose inventory has fluctuating values during the year. The amount of insurance is adjusted monthly, quarterly, or annual to reflect the changing monetary value of the inventory. The ability to adjust coverage helps solve the problem of overinsurance as well as underinsurance.

Know This: The Value Reporting Endorsement may be used to modify insurance provided by the ***Building and Personal Property Coverage Form***. If required reports of value are not provided to the insurer the most that will be paid in event of loss is **75 %**.

4. General Commercial Property Conditions

There are **9** general Commercial property **conditions** you should memorize for the final exam. For the most part, you'll run into a variation of these conditions in Commercial lines:

- 1) **Concealment and Fraud** applies only to property coverage and states that if the insured intentionally concealed something material or committed fraud, their coverage would be revoked.
- 2) **Control of Property** means that if someone else committed a negligent act that damaged the insured's property, coverage still applies. Basically, this condition recognizes that the insured doesn't always have control of their property, and mishaps can happen involving other people or situations.
- 3) **Duplicate Coverage** means that if there is a loss, and there are two or more coverages in the insured's policy that apply to that loss, the insurance company will only pay the amount of the loss. Therefore, if the loss is \$10,000, and it's covered under two different coverages, the insured won't receive \$20,000.
- 4) **Legal Action** means the insured can sue the insurer within **2** years of the date of the loss if the insured followed all of the conditions of their policy.
- 5) **Liberalization Clause** means that any policy changes that benefit the insured and don't require a higher premium apply immediately to the policy without the need for endorsements or writing an entirely new policy. The changes have to be made during the policy period or within **45** days of the policy's effective date.
- 6) **No Benefit to Bailee** means no one else can benefit from insurance other than the insured. This applies if someone leaves their property with a bailee for maintenance or repairs. If the property is damaged, the bailee isn't covered by the insurance, and they'll need to pay for the damages themselves.
- 7) **Other Insurance** means if the insured has two policies covering the same peril, the companies will each pay a percentage of any losses. The insured can't collect the full amount of the loss twice. Usually, in the event of a loss, if the coverages offer the same limits of liability, the insurers will split the expenses 50/50.
- 8) **Policy Period and Coverage Territory** means that coverage only applies during the policy's effective date and within the coverage territory (which includes the US, Canada, US territories, and Puerto Rico).
- 9) **Transfer of Rights of Recovery (Subrogation)** means that the insured can't collect insurance and then go after

an at-fault party for damages. They've transferred the right of recovery to the insurance company.

A. Loss Conditions

In the event of a loss, the insured has to follow the conditions of their policy for coverage to apply.

- The **Duties in the Event of Loss** condition states that the insured must perform a list of duties after a loss:
 - o Immediately notify the police if anything is stolen or any law was broken.
 - o Notify the insurer of the loss, including the how, what, where, when, and why.
 - o Protect property from further loss.
 - o Prepare a written inventory of lost property.
 - o Keep records of all expenses relating to the loss.
 - o Give the insurer access to any necessary records and information.
 - o Allow the insurer to inspect the damaged property.
 - o Submit the Proof of Loss within **60** days

Remember that the insurer must always inspect damaged property before that property is repaired, replaced, or thrown out. This keeps the insured from collecting more money than they should. Under no circumstances is the insured allowed to report on damages, appraise damages, or settle the value of damaged property: that is *always* determined by the insurer.

- The **Loss Payment condition** states that the insurance company has to reach a settlement decision and inform the insured of the decision within **30** days.
- The **Valuation condition** details how the settlement will be paid.
- The **Tenancy of Vacancy definition** states that a building is considered vacant if **70 %** or more of the **total square footage** in the building isn't being used. If the building has been vacant for more than **60** consecutive days, certain perils won't be covered, for example:
 - o Vandalism
 - o Theft/attempted theft

- o Glass breakage
- o Leaky sprinklers
- o Water damage

Any other covered perils would be covered, but with an automatic **15 %** reduction in coverage.

Vacancy Permit Endorsement? Consent from a fire underwriter for an insured to maintain coverage on a building that has been vacant or unoccupied beyond the limitation period specified in a policy. Of course, vacancies of any building occur at the peril of vandalism, theft, leaks and glass breakage. On the other hand, an insurer who issues a vacancy permit endorsement may waive the vacancy condition above.

B. Mortgage Holder's Rights

If a mortgagor has a vested financial interest in a property, they can collect the insurance if that property is damaged and the primary insured hasn't been keeping up their end of the bargain. Usually, this happens when an insured stops making premium payments. If the mortgagor pays all missed/late premiums, and files a Proof of Loss within **60** days (when the insured fails to do so), even though the insured can't collect, the mortgagor can collect.

5. Causes of Loss Forms

There are **3** Causes of Loss Forms:

- 1) Basic
- 2) Broad
- 3) Special

Note: Most exclusions are included in the Cause of Loss Form(s).
 Note: Other coverages may not be covered under all three forms.
 Note: Windstorm is a covered peril under the Basic, Broad and Special Cause of Loss Form

Causes of Loss Forms		
Basic	<i>Includes</i>	Excludes
	Fire, lightning, explosion, windstorm, hail, smoke, aircraft, vehicles, riot or civil commotion, vandalism, leaky	Law, governmental action, earthquake, nuclear hazard, power failure, war or military action, artificially generated

sprinklers, sinkhole collapse, volcanic action		electricity, damaged water pipes, steam discharge, mechanical breakdown
Broad	Includes	Excludes
All perils in basic coverage, falling objects, weight of snow ice or sleet, accidental water discharge, glass breakage, and collapse		Neon tubing, leakage of water or steam for longer than 14 days
Special	Includes	Excludes
Open peril coverage		Wear and tear, rust, deterioration, smog, pollutants, settling, cracking, insect or animal damage, mechanical breakdown, explosion, criminal acts, fraud, loss from failure to act, collapse, faulty planning or design

6. Selected Endorsements

There are **3** endorsements that are automatically excluded, unless the insured adds them via endorsement:

- 1) Ordinance or Law Coverage
- 2) Earth Movement
- 3) Water

Here's a closer look at those **3**:

A. Ordinance or Law Coverage

This endorsement adds coverage to a commercial property policy to protect against any future changes in ordinance or law. If a new law required renovations, repairs, or upgrades, this endorsement would help cover those costs.

In 1992, the **Americans with Disabilities Act (ADA)** took effect, which has had an enormous impact on public spaces. If a commercial structure was built before the ADA, it's technically exempt. However, as soon as that structure needs to be rebuilt/repaired, it will need to go through the necessary modifications to meet state requirements. Adding the Ordinance or Law Coverage would pay for these modifications.

B. Earth Movement

There's no coverage for earth movement-related losses, such as:

- Earthquake
- Volcanic earth tremors
- Landslide

The insured would need to add a Commercial Property Earthquake Endorsement to obtain coverage. However, in Commercial lines, every earthquake/tremor that happens in a 168-hour period is considered 1 occurrence.

Putting it into Context:

If an earthquake hits on Sunday, there could be serious aftershocks for the next few days. Basically, for the next **168**-hours (**7** days), any aftershock or even another earthquake counts as 1 occurrence. Therefore, a business couldn't report more than 1 claim during the next **7** days, no matter how many earthquakes/aftershocks occurred.

Alert!

In Personal lines, any earthquake damages within a **72**-hour period are considered **1** occurrence.

In Commercial lines, any earthquake damages within a **168**-hour period are considered **1** occurrence.

That has enormous final exam potential, so memorize that factoid.

C. Water

There's no coverage for:

- Flood
- Tidal wave
- Mudslide
- Sewage/drain backup
- Etc.

The final exam loves to ask about the sewage backup exclusion. Not only did we answer several practice questions quizzing us about whether or not sewage backup was covered, but we also bumped into that question on the licensure exam. Someone can buy Flood insurance, depending on their location, but even then, Flood insurance wouldn't cover sewage/drain backup.

7. More Selected Endorsements

We wanted to draw special attention to the above three exclusions, because they're very common and significant. Meaning, they could really affect someone's Commercial coverage, *and* the final exam will probably ask oodles of questions about them.

However, here are some other endorsements that are also important to know:

A. Peak Season

This endorsement increases insurance limits on personal property during "peak season," which might have an increase in loss exposures.

B. Value Reporting Form

This endorsement covers the types of businesses that have stock/inventories with increasing/decreasing values. The business can cover these fluctuations in value by adjusting the reporting period. This keeps the business owner from paying way too much for insurance, or for paying too little and ending up underinsured for a covered cause of loss.

The insurance is based on the reported inventory. The policy limit is based on the highest projected value during the policy period, and the final premium is based on the insured's actual

coverage during the policy period. A **Value Reporting Form** is used to modify insurance.

If the insured doesn't report their values on time, they could end up being penalized if they do suffer a loss. They have to report their values within 30 days of the reporting period. The reporting period can be weekly, monthly, quarterly, or annually.

If the insured doesn't report their values on time, and they suffer a covered cause of loss, the most the insurance company will pay is **75 %** of coverage.

C. Business Income from Dependent Properties

This endorsement protects businesses that are dependent on other businesses in order to operate. This endorsement covers the following losses of income:

- **Contributing Location** protects an insured if they depend solely on another company for inventory or materials. If that business is affected by a covered cause of loss, the insured can also claim a financial loss.
- **Recipient Location** protects an insured if they depend solely on one company for business. If that business is affected by a covered cause of loss, the insured can also claim a financial loss.
- **Manufacturing Location** protects an insured if they depend solely on one company for transportation or shipment of products. If that business is affected by a covered cause of loss, the insured can also claim a financial loss.
- **Leader Location** protects an insured if they depend heavily on another company to attract customers. If that company is affected by a covered cause of loss, the insured can also claim a financial loss.

D. Blanket Insurance Endorsement

Blanket insurance is a single dollar amount insurance limit that applies to all insured property, or more than one property, or personal property located at more than one property. This contrasts with **Schedule Insurance** where a list or schedule of buildings and contents with specific amounts of insurance

applied to each. **Agreed Value** is when the underwriter agrees with the insured to the amount of insurance and co-insurance.

So, if an insured owns two buildings with a Blanket limit of \$600,000, that limit applies to an occurrence that happens at either building. This gives an insured the flexibility of applying a larger limit to covered losses.

Part B: Commercial Package Policy

1. Commercial Package Policy (CPP)

The **Commercial Package Policy** provides coverage to profit and nonprofit organizations, including schools, retailers, and apartment building owners. This policy is—as we call it in the insurance biz—an “all that and a bag of chips policy”: the policy is simple and easy to understand, it covers almost all commercial risks, and it provides almost any commercial insurance someone would need. This policy sells itself, people, so hurry up and get licensed.

Note: **Ocean Marine** and **Aviation Insurance** are not included in the **CPP**.

A Commercial Package Policy (CPP) consists of:

A. Common Policy Declarations

You will find the following in the **Common Policy Declarations**:

- Name and address of the named insured
- Policy period
- Premium payments
- Description of the covered business
- A list of coverage parts

B. Common Policy Conditions

The **Common Policy Conditions** apply to all the coverage parts in the **CPP**. These include:

- **Changes** in the insured’s policy can *only* be made by the insurer with the insured’s consent.

- **Examination of your books and records** means the insurer has the right audit the insured's books and records relating to the policy. The audit can take place anytime and up to **3** years after the policy period. This can happen if the audit relates to an investigation or legality.
- **Inspections and surveys** means the insured or service contracted by the insured can inspect and survey the covered property at any time. If the inspection is going to mean a change in premium rates, the insured will receive a report on the recommended changes.

Note: **Inspections and surveys** condition is only used to establish the property's insurability. The inspection isn't related to health or safety regulations.

- **Premiums** means the insured is responsible for premium payments.
- **Transfer of your rights and duties under this policy** usually applies to an insured who dies. Basically the insured's rights and duties transfer to whomever is representing the insured's estate.
- **Cancellation** means either the insured or the insurer can cancel a policy. Cancellation procedures may vary from state to state.

C. Endorsements

Attached documents that change the insurance policy are called **Endorsements**. Endorsements might be added by the insurance company or be required by law.

Interline Endorsements can also be included in the Common Policy Conditions. These endorsements modify two or more lines of insurance. Some endorsements are mandatory, and some are optional.

D. Two or more coverage parts

These provide the actual insurance coverage. A **Coverage Part** consists of:

- Declarations for that specific part.
- Conditions for that specific part.
- Coverage forms.

- Endorsements relating to that specific part.

The insured can select one or more coverage parts, including:

- Boiler and Machinery Coverage
- Commercial Auto Coverage
- Commercial Crime Coverage
- Commercial General Liability Coverage
- Commercial Inland Marine Coverage
- Commercial Property Coverage
- Employment Practices Liability Coverage
- Farm Coverage
- Professional Liability Coverage

Note: A **Mono-line Policy** refers to only one selected coverage part. A **Multi-line Policy** refers to more than one selected coverage part.

NOTE: **General Liability** refers to liability resulting from injury or property damage for the insured's premises, operations, products or completed operations.

2. Boiler and Machinery (Equipment Breakdown) Coverage

In this section we will deal with Boiler and Machinery Coverage aka equipment breakdown coverage. It's important to note the following about **boiler and machinery coverage**:

- Businesses depend on the **Boiler and Machinery Coverage Form** to protect against mechanical breakdowns. This coverage is generally not available under other insurance policies, and it protects against catastrophes such as damage from an exploding steam boiler, or expensive mechanical failures.
- **Boiler and Machinery Coverage** covers the premises and property in the insured's custody.
- When damaged property is repaired or replaced within **18** months after an accident, the settlement is based on the cost to directly replace the damaged property. After **18** months, the settlement is the less expensive of the ACV or projected repair costs.

Why Buy Boiler & Machinery Insurance? Typical commercial property insurance excludes breakdown of machinery and steam explosions or if covered pays only AFTER an accident. The premium for boiler and machinery insurance includes an inspection charge to help avoid explosions. Thus, it is proactive.

Note: Just to reiterate: an **Accident** is defined as the sudden and accidental loss of an object or a part of the object. It **does not** include:

- Wear and tear
 - Leaks
 - Breakdown of a vacuum tube or brush, electronic computer or data processing equipment, or a structure or foundation supporting an object or its parts
 - Malfunctioning safety or protective devices
- **Selected Object Definitions Form** lists the insured items and property in the **Declarations**. The **Declarations** has to include at least one of the following object definitions forms:
 - o Pressure and Refrigeration objects
 - o Mechanical objects
 - o Turbine objects
 - o Comprehensive coverage (including all insurable boiler and machinery objects but *excluding* production machinery)
 - o Comprehensive coverage (including all insurable boiler and machinery objects and *including* production machinery)

Boiler and Machinery Coverage	
Includes:	Excludes:
Within the policy limit, \$25,000 for: • Expediting expenses • Water damage	Accidents: • To electronic equipment • To objects being tested • Caused by a windstorm,

• Ammonia contamination • Hazardous substances damage, contamination or pollution	• hail, or freezing • Caused by lightning, weight of snow (ice or sleet also), vehicles, aircraft, sinkhole collapse, smoke, sprinkler leakage
Automatic coverage for accidents that occur at a newly acquired site (for up to 90 days)	Earthquake or flood
	Ordinance or law
Defense (cost of defending or settling a claim for liability of damage to the property of others located on the insured's premises)	War, military action, or nuclear hazard
	Lack of utility services
	Indirect losses
Supplementary payments for defensive purposes	Fire or damage resulting from efforts to extinguish a fire, explosion

- A smaller business can use the **Small Business Boiler and Machinery Form (Basic or Broad)**. The Small Business Boiler and Machinery Form covers milder boiler and machinery problems. Coverage is **80 %** of replacement cost.
- **Business interruption and extra expense** is also included with a limit of **25 %** of the property damage limit. The object definitions are automatically in this form, so you won't need an object definitions form.

Remember: Business interruption coverage insurance compensates you for lost income if your company has to vacate premises due to a disaster. **Extra Expense insurance** reimburses your company for money spent, above normal operating expenses, to avoid having to shut down during the restoration period after a disaster. In some cases, extra expense insurance alone may provide sufficient coverage without the need for business interruption coverage.

- There are **2** Small Business Boiler and Machinery Forms:
 - 1) The **Basic Form** protects against direct loss, business interruption, and extra expenses due to mechanical failure. Coverage for heating/cooling equipment is optional.

- 2) The **Broad Form** covers a larger range of businesses and items.

A. Equipment Breakdown Form

The **Equipment Breakdown Form** protects against boiler and machinery breakdown.

Covered equipment includes:

- Internal pressure or vacuum equipment.
- Mechanical or electrical equipment.
- Communications and computer equipment.

Note: A **Breakdown** is defined as an equipment failure. If the equipment is functioning, but not functioning well or correctly, it's not considered a breakdown.

The form covers:

- A breakdown that causes direct damage to the insured's property or any property in the custody of the insured
- New property
- Any loss from new ordinances or laws at the time of or after the breakdown
- Any loss of business income and the extra expense of keeping the business running for a maximum of **5** days
- Any loss of business income and the extra expense of keeping the business running, if the breakdown causes problems with the utilities
- If the breakdown causes refrigeration or storage facilities to lose power, and products or materials are ruined or spoiled as a result
- The expense of making temporary repairs as quickly as possible

Coverage also includes **\$25,000** for each of the following:

- Reimbursing expenses faster
- Water damage
- Ammonia contamination
- Dangerous substance contamination

The **Equipment Breakdown Form** excludes:

- Fire or explosion
- Water, even if it was used to put out a fire
- Ordinance or law
- Any kind of war
- Nuclear hazard
- Earthquake
- Interrupted utility services
- Wear and tear
- Accidents to electronic equipment
- Damage to equipment undergoing testing
- Breakdowns caused by windstorm, hail, or freezing
- Breakdowns caused by lightning, vehicles, aircraft, sinkhole collapse, smoke, riot, civil commotion or vandalism; weight of snow, ice, or sleet
- A negligent insured
- Indirect losses

B. Selected Endorsements

The following **selected endorsements** can be added to the equipment breakdown protection coverage available under boiler and machinery:

- **Actual Cash Value**
This endorsement replaces the property damage valuation condition in the breakdown coverage form. This endorsement stipulates that any property damaged by a breakdown will be repaired/replaced based on the lesser of:
 - o Cost to repair/replace the property with similar property (quality, etc.)
 - o ACV of the damaged property

Part C: BOP & Business Owners Liability Form

1. Business Owners Policy (BOP)

The **Business Owners Policy (BOP)** is a commercial package policy that provides property and liability insurance to certain types of small businesses. While the Commercial Package Policy (CPP) allows the insured to pick and choose coverages, the Business Owners Policy (BOP) is a pre-packaged, mandatory group of coverages.

Major differences between the **BOP** and **Commercial Property Policies** include:

- BOP's loss of earnings is limited to 12 months. CPP's can be longer.
- BOP's eligible buildings are insured on a replacement cost basis.
- BOP's have a standard deductible of \$250

Otherwise, coverage and exclusions are similar to that provided by coverages A, B, C of the CGL form.

Eligibility for BOP is stricter than the CPP. The BOP has rules about the size and type of eligible businesses. An ideal BOP business is smaller, not part of a chain, and has predictable coverage needs.

You'll need to remember the specific kinds of businesses that are eligible and ineligible. Remember: the ideal BOP business is smaller, not part of a chain, and has predictable coverage needs.

A. Eligible Buildings

Eligible buildings for the BOP are:

- **Apartment Buildings**
- **Office Buildings** that are occupied principally for office purposes. These buildings can be no more than six stories high and **100,000** sq. ft. The building can use space for non-commercial purposes (such as living quarters), but the non-commercial space *can't* exceed **25,000** total sq. ft.
- **Other Buildings** used for commercial purposes, but the buildings can't exceed **25,000** total sq. ft.

B. Ineligible Businesses

The following businesses are ineligible for the BOP:

Ineligible Businesses	
Auto repair or service stations	Household personal property
Auto, motor home, mobile home, and motorcycle dealers	Insureds whose business operations involve one or more locations that are used for manufacturing, processing, or servicing, except for eligible processing or service businesses
Banks, building and loan assoc., savings and loan assoc., credit unions, stock brokers, and similar financial institutions	One or two-family dwellings
Bars, grills, and most restaurants	Parking lots or garages
Buildings occupied wholly or partially for manufacturing or processing unless the occupancy is an eligible processing business	Places of amusement, such as theaters and arcades
Condominium assoc. other than office or residential	Wholesalers that are ineligible wholesale businesses

C. Eligible Restaurants

Some fast food restaurants and smaller restaurants are eligible for the **BOP**. The smaller restaurant has to be considered “a limited-cooking restaurant.” This means the food is prepared using non-exhaust producing equipment, such as: microwave ovens, electric warmers, household type ranges or ovens, and toasters.

Note: Fast food restaurants are ineligible if they use open-broiling and solid fuel, like charcoal or hardwood. Fast food restaurants are allowed to seat a maximum of **150** people.

Here are some other **eligibility requirements** of fast food and small restaurants:

- No more than **7,500** sq. ft. of floor area
- Maximum seating capacity of **75**

- Liquor can't be sold, and beer and wine sales can't exceed more than **25 %** of overall sales
- Catering services can't exceed **10 %** of total sales
- Businesses that seasonally close for **30** consecutive days are automatically ineligible

Eligible Restaurants	
Cafés	Drugstores
Cafeteria style buffets	Hot dog or hamburger stands
Coffee shops	Ice cream/yogurt shops
Concession stands	Oriental or ethnic restaurants
Delicatessens/sandwich shops	Pizza shops
Doughnut shops	Salad bars
Drive-ins	Take-out only restaurants

Note: Some convenience food/gasoline stores are also eligible. The business can't include any other service besides gas (e.g. repairs or a café) and gas sales can't be more than **50 %** of total sales.

The following kinds of contractors are eligible for a **BOP**:

Eligible Contractors	
Appliances and accessories	Masonry
Carpentry	Metal ceiling or wall installation
Carpet and furniture cleaning	Metal door, window, or assembled millwork installation
Concrete construction	Painting
Decorative or artistic metal erection	Paper hanging
Driveway, parking area, or sidewalk paving	Plastering or stucco work
Electrical work inside buildings	Plumbing (not industrial)
Fencing	Refrigeration systems
Floor covering installation	Roofing
Furniture or fixtures installation	Septic tank cleaning
Glass and glazing	Siding installation
Heating and/or air conditioning systems	Sign painting
Interior decorating	Tile or stone work (interior)

Landscape gardening	Window cleaning (three or fewer stories high)
Lawn sprinkler installation	

The following factors make a contractor ***ineligible for coverage***:

Ineligibility Factors for Contractors	
Annual payroll over \$300,000	Repair, installation, or service of boilers, burglar alarm systems, automatic fire extinguishing systems, elevators, escalators, or computers
Annual sales over \$3 million	Repairing or painting ships
Demolition, blasting, wrecking, high pressure boiler, or liquid petroleum gas work	Sales, service, or installation of automatic opening door or garage doors
General contracting	Sales unrelated to installation, service, or repair exceed 25% of annual sales
Hazardous material or pollution abatement operations, such as asbestos, lead and radon	Shop only carpentry or sheet metal work
Heavy construction, such as building bridges, installing, or rigging cranes, pipeline construction, and sandblasting	Subcontracted work exceed 10% of sales
Installation work	Tree service or removal
Installing or dealing in hot tubs, swimming pools, or wood/coal stoves	Use cranes in business operations
Lawn chemical spraying, except for landscape gardeners in compliance with applicable law	Waterproofing
Manufacture or sale of products under the contractor's name	Work at height over three stories
Rent or lease equipment to others	

-

D. BOP Coverage Forms

The **BOP** consists of the following coverage forms:

- Business Owners Declarations
- Business Owners Common Policy Conditions Form
- One of two available Business Owners Property Forms
- Business Owners Liability Form

The **Business Owners Common Policy Conditions Form** contains the following conditions:

- Cancellation
- Changes
- Concealment, misrepresentation, or fraud
- Examination of records
- Inspections and surveys
- Insurance under two or more coverages
- Other insurance
- Liberalization
- Premiums
- Transfer of rights of recovery against others to the insurance company
- Transfer of rights and duties under the policy

E. Additional BOP Coverages

The following is a list of additional **BOP Coverages**:

- **Debris Removal** pays up to **25 %** of the amount paid for losses of property to remove debris.
- **Preservation of Property** pays for property that needs to be removed from an insured location to prevent further damage to that property. This coverage also pays for the property to be temporarily stored at another location. Coverage only applies after **30 days**.
- **Fire Department Service Charge** pays up to **\$1,000** for charges related to a service provided by the fire department, as long as that service had something to do with a covered cause of loss.

- **Pollutant Clean-up and Removal** pays up to **\$10,000** to remove or clean up pollutants on the premises. All expenses have to be reported in **180 days**.

The **BOP** also covers:

- **Increased Cost of Construction** pays up to **\$10,000** per building.
- **Electronic Media** pays a maximum of **\$2,500** per loss.
- **Collapse**
- **Water Damage** covers the cost to remove the damaged sections, repair the damage, and replace any destroyed items.
- **Expense to Temporarily Replace Glass**
- **Money Orders and Counterfeit Currency** pays up to **\$1,000** per loss.
- **Forgery and Alteration** pays up to **\$2,500** per loss.
- **Business Income** pays normal expenses up to **60** days after the loss. Other losses are covered up to **12** consecutive months during the restoration period. Extended Business Income is included for up to **30** days.

Note: The “restoration period” almost always begins **72** hours after a loss occurs.

- **Extra Expense** covers any extra expense for up to **12** months after the date of the loss and doesn’t have any limits of insurance.
- **Civil Authority** lasts for up to **3** consecutive weeks, which starts **72** hours after a civil authority closes the premises.
- **Business Income from Dependent Properties** pays up to **\$5,000** if the insured suffers loss of income because a customer or supplier has suffered a covered cause of loss.
- **Fire Extinguisher Systems Recharge Expense** pays up to **\$5,000** to renew or recharge the systems, and for any damages caused by a discharged or leaking extinguisher.

F. Coverage Extensions

Coverage Extensions extend the coverage and come with their own limits:

- **Newly Acquired or Constructed Property** pays up to **\$250,000** for damages to new buildings on or off premises. Newly Acquired or Constructed Property also covers business personal property in/at new buildings on or off premises.

Note: Newly Acquired or Constructed Property coverage lasts until the earliest of any of the following:

- The policy expires
- **30** days after the new acquisition
- New values are reported to the insurer

- **Business Personal Property off Premises** pays up to **\$5,000** for damage to Business Personal Property while it's being moved, or while it's being stored off premises. This excludes money or valuable papers.
- **Outdoor Property** pays a maximum of **\$2,500** for damages to outdoor property, however it does not pay more than **\$500** per damaged item (plants included). Covered causes of loss are fire, lightning, riot or civil commotion, or aircraft.
- **Personal Effects** pays a maximum of **\$2,500** for damages to business personal property owned by the named insured and others connected to the business. This does not apply to items used for the business or any loss due to theft.
- **Valuable Papers and Records** pays up to **\$10,000** per occurrence on premises and **\$5,000** off premises to research, replace, or restore lost and damaged records.
- **Accounts Receivable** pays up to **\$10,000** per occurrence on premises and **\$5,000** off-premises for any loss of money due to damaged or lost accounts receivable records.

G. Limits

Here are some important **limits** to the insurance:

- There is a sub-limit of **\$1,000** for any losses to attached outdoor signs, unless the insured wants optional sign coverage.

- **Coverage Extensions and Additional Coverages** (fire department service charge and pollution clean-up and removal) limits are in addition to normal policy limits.
- A **Building Limit** protects against inflation by automatically increasing building coverage by the annual percentage listed in the declarations. The limit is pro-rated and based on the number of days from the start of the policy year.
- A **Building Personal Property Limit** automatically increases the business personal property limit by **25 %** to account for stock fluctuation.

Note: While Business Owner Policies include more types of coverage than CGL policies, the fixed, ***lower limits of liability in a BOP*** plan can be insufficient. Larger businesses, or those with special needs should consider added liability insurance as a separate policy to their BOP, or purchase a CGL plan.

H. Deductibles

There is no deductible for coverages for:

- Business income
- Extra expense
- Civil authority
- Fire department service charges
- Fire extinguisher system recharge expense

Note: For all other property coverage the deductible is standard—usually **\$250**. The insured can opt to pay higher deductibles to lower their premiums for building and personal property.

I. Loss Valuation

Losses are settled by:

1. **Replacement cost** (subject to **80 %** coinsurance)
 - Buildings
 - Business personal property
 - Tenant's improvements

- Coverage for glass

2. Actual Cash value

- Secondhand merchandise that is for sale or being stored
- Property of others
- Household contents
- Manuscripts
- Art, antiques, or rare objects
- Valuable papers and records at the cost of blank materials and labor
- Money at face value and securities at their value the day the loss occurred
- Accounts receivable

J. Optional Property Coverages

The following **Optional Property Coverages** can be added by Endorsement with an additional premium:

- **Outdoor Signs** is open peril coverage for all outdoor signs owned by or in the custody of the insured.
- **Employee Dishonesty** covers loss or damage to business personal property by employees. The coverage lasts for up to **1 year** after the damage is discovered, even if the policy has expired. **Employee Dishonesty** doesn't cover loss or damages from the insured's business misconduct. Needless to say, ENRON will have a heck of a time collecting insurance from Employee Dishonesty. Coverage is on a blanket basis.
- **Mechanical Breakdown** covers direct damage to covered property resulting from accidental breakdowns.
- **Money and Securities** covers theft, disappearance, or destruction of money and securities in any context.

2. Selected Endorsements

The following endorsements can be added to a BOP for broader coverage:

A. Hired Auto and Non-Owned Auto Liability

This endorsement can be added for an additional premium, and can include either:

- **Hired Auto Liability**, which adds hired auto liability coverage for third party bodily injury or property damage resulting from the insured's use of a hired/borrowed/leased auto.
- **Non-Owned Auto Liability**, which adds liability coverage to the insured arising out of the insured's use of a non-owned auto.

Part D: Farm Insurance

1. Farm Insurance

Farmers need their own unique insurance because their business and their home are often at the same location. They need insurance that will cover them both personally and commercially.

The Farm Coverage Part can be written as a mono-line policy or included in the CPP.

Alert!

You may find that question on the final exam: What kind of commercial policy can you add a Farm Coverage Part to? Remember it's the CPP.

The Farm Coverage Part includes several **Farm Property Coverage forms** to cover the farmer's personal and business property. This also includes a **Farm Liability Coverage form** to protect the farmer against personal or professional liability.

A. Farm Property Coverage Forms

Farm Property Coverage forms cover physical losses to different kinds of property. The insured can choose between **3** forms:

1. Farm Dwellings, Appurtenant Structures, and Household personal Property Form

Farm Dwellings, Appurtenant Structures, and Household Personal Property Form is similar to Section 1 of the HOP. The form consists of **Coverages A-D**:

- o **Coverage A** covers the dwellings
- o **Coverage B** covers appurtenant structures
- o **Coverage C** covers personal property
- o **Coverage D** covers loss of use

2. Farm Personal Property Coverage Form

This form covers farm property, either scheduled or unscheduled. The form consists of **Coverages E-G**:

- o **Coverage E** covers scheduled personal property. Examples of property that can be covered under Coverage E are grain, livestock, machinery, and vehicles used on the farm.
- o **Coverage F** covers unscheduled personal property on and off premises on a blanket basis.
- o **Coverage G/Barns, Outbuildings, and Other Farm Structures Coverage Form** covers silos, barns, fences, and other farm buildings/structures that aren't dwellings.

3. Farm Liability Coverage Form

This form covers any liability resulting from farming operations or activities. The form consists of **Coverages H-J**:

- o **Coverage H** covers bodily injury and property damage liability
- o **Coverage I** covers personal and advertising injury liability
- o **Coverage J** covers medical payments

2. The Main causes of Loss Forms in Farm Insurance

Like in other lines of insurance, Farm insurance has **3** main causes of loss forms: Basic, Broad, and Special.

A. The Basic Form

In Farm Insurance, the Basic form covers:

- Fire
- Lightning
- Windstorm/hail
- Riot/civil commotion
- Explosion
- Aircraft
- Earthquake loss to livestock
- Flood loss to livestock
- Vehicles
- Smoke
- Vandalism
- Theft
- Volcanic activity
- Sinkhole collapse

B. The Broad Form

In Farm insurance, the Broad form covers:

- Electrocution of covered livestock
- Wild animal attacks on covered livestock
- Drowning of covered livestock
- Loading or unloading accidents
- Accidentally shooting covered livestock

C. The Special Form

In Farm insurance, the Special form covers:

- All perils except those specifically excluded in the policy

D. Special Form Exclusions

Here are a few Special form exclusions:

- Pollutants/contaminants

- Criminal/dishonest acts
- Unauthorized transfers of property
- Voluntary transfers of property
- Failure to preserve/save property from loss or further damages

3. Specialized Coverage Farm Insurance Forms

If a farmer wants to insure certain items/properties separately, he/she can choose their own Specialized Coverage form, such as:

A. Mobile Agricultural Machinery and Equipment Coverage form

This form covers mobile agricultural machinery and equipment separately.

B. Livestock Coverage Form

This form covers livestock separately.

4. Farm Liability Coverage Forms

This form provides **Coverages H-J**:

- **Coverage H** provides bodily injury and property damage liability
- **Coverage I** provides personal and advertising injury liability
- **Coverage J** provides third-party medical payments

A. Farm Liability Exclusions

The following are generally excluded from Farm Liability coverage:

- Farm employee injuries
- Aircraft spraying
- Pollutants
- Motor vehicles that aren't described in the policy
- Poor performance
- The insured's own goods/products

5. Federal Government Crop Insurance

Crop insurance protects against losses to growing crops. Crop insurance is necessary because most Property policies exclude crop damage. How Crop insurance works, is it covers the amount lost, or the **reduced yield**. So, if 80% of a harvest was saleable, Crop insurance would cover the 20% that wasn't saleable.

The Federal Government is involved in crop insurance through the sale of FCIC (Federal Crop Insurance Corporation) (sold through special agents) as well as a reinsurer of policies issued by the private sector.

Note: Crop insurance usually only covers the harvest, and not the plants. So, if an apple farmer had Crop insurance, the insurance would cover the apples, not the apple trees.

PART E: COMMERCIAL FLOOD INSURANCE

Flood insurance for commercial businesses is available through the National Flood Insurance Program (NFIP), an agency of the federal government administered by FEMA. Any licensed agent or broker may submit business to the NFIP after taking a special 3-Hour Training Course. There is no binding authority and there is a waiting period of 30 days before coverage becomes effective.

A **flood is defined** by the NFIP as an excess of water on land that is normally dry.

Commercial flood policies cover the following perils:

- Mudslides
- Inland or tide water overflows

Exclusions to commercial NFIP policies include:

- Business income and extra expense
- Landscaping and fencing
- Accounts and cash
- Aircraft
- Mold

Excess Flood Insurance may be available under a separate policy if the amount of the primary **flood** insurance is not enough to cover the value of your property.

Section PC 9

COMMERCIAL GENERAL

LIABILITY &

PROFESSIONAL LIABILITY

Objectives

This unit discusses the utmost importance of Commercial General Liability (CGL) and Professional Liability. Nowadays, lawsuits are extremely common, and it's important to know what types of insurance the business owner can choose to protect themselves against potential litigation.

This unit includes:

- Commercial General Liability (CGL)
- Professional Liability

Part A: Commercial General Liability

1. Commercial General Liability: What is CGL?

CGL is designed to protect business owners against lawsuits. The **CGL** covers businesses from such hazards as:

- Third-party lawsuits due to any bodily injuries suffered on covered premises
- Third-party lawsuits due to any bodily injuries during business operations
- Third-party lawsuits due to slander or libel

The **CGL** can be written separately or included in the Commercial Package Policy (CPP). The **CGL** includes:

- Common Policy Declarations
- Common Policy Conditions
- CGL Declarations
- CGL Coverage Form
- Any necessary Endorsements

The **CGL Declaration Page** lists **six different Limits of Insurance**. Payment of damages on one limit will also affect another limit.

Aggregate Limits: The most an insurer will pay during the policy period

Products-Completed Limit: Injury and property damage that occur away from the insured's premises from the insured's products or completed work.

Personal and Advertising Injury Limits: : For offenses arising out of the business of the insured. Personal injury might be wrongly detaining a customer for shoplifting or expelling a customer from premises wrongfully, wrongful entry, copyright infringement, stealing ideas. Advertising injury might apply to defamation, false statements, intrusion of privacy, public disclosure of private facts, misappropriation of a person's likeness or name.

Each Occurrence limit: The most an insurer will pay for the sum of ALL damages

Premises Damage Limit: Pays for damages by fire to premises rented to the insured.

Medical Expense Limits: Pays reasonable medical expenses for bodily injury caused by an accident without regard to fault.

Here is how these limits might appear in a policy:

ABC Company Limits of Insurance	
\$2,000,000	General Aggregate Limit (Other Than Products-Completed Operations)
\$2,000,000	Products-Completed Operations Aggregate Limit
\$1,000,000	Personal and Advertising Injury Limit—Any One Person or Organization

\$1,000,000	each occurrence limit
\$50,000	Coverage for damage to premises rented to you Limit—Any One Premises
\$5,000	Medical Expense—Any One Person

A. Basic Hazards & Terms

Basic Liability Hazards include:

- **Who is an “insured”?** An insured, under most CGL policies, means any person qualifying as an Insured under “Who Is Insured” in the Declaration Page, e.g., a director of the company is an Insured while acting within the proper scope of their official duties and powers with the company.
- **Premises and Operations Hazard** covers on-premises accidents and damage to someone else’s personal property.
- **Productions and Completed Operations** covers bodily injury and property damage caused by commercial goods off the premises. This doesn’t cover the actual damage to the product.
- **Completed Operations Coverage** covers completed products. Damages or injuries are covered if the person was using the product the way it’s supposed to be used. Under this coverage, damages to the actual product are only covered if a contractor was installing it.
- **Covered Territory** might be defined in the policy as the USA, its territories and possessions, or product coverage worldwide, etc
- **Automobile and mobile equipment.** Very tricky. For example, a truck with a drill mounted on the back might be considered mobile equipment until it is moved. Then it needs to be on the business auto policy. Vehicles that need to be licensed to operate may not be mobile equipment and need to come under your auto policy as well.
- **Leased employee.** Definitions may vary. Some policies say an “employee” includes a “leased worker” but not a temporary worker (someone furnished to meet seasonal or short-term work).
- **Employee.** Whether employees of a company are covered under a CGL policy depends on the relationship to the employer, state law and the policy language.

Putting it into Context:

A contractor was in the process of installing an air conditioning unit into a home. During the installation, the unit caught fire and caused a great deal of damage to the living room. Because the contractor was in the process of installing the unit, **Premises and Operations Coverage** covers the damage. If the contractor had finished the installation, **Completed Operations Coverage** would cover the damages. Since a contractor was completing the work, the damaged air conditioning unit would also be covered.

- **Damages from Work Done by an Independent Contractor** covers any damages from work done by an independent contractor...allow myself to introduce...myself...
- **Contractual Liability** means the insured accepts liability from another party via contract.

Putting it into Context:

The Great Western Railroad Company has tracks that run through a small portion of Emma's property. Great Western wants Emma to assume the liability if anyone is injured on the tracks. If Emma agrees and a child is hurt on the tracks, Emma's insurance would have to pay under the **Contractual Liability clause**.

B. Hold Harmless Provision

Most of the time, businesses don't want to assume someone else's liability (really no one does now that we think about it—we sure as heck wouldn't).

The way around contractual liability is called a **Hold Harmless provision**, which is an agreement between the insured and the other party, stating that the insured can't be held liable. The **Hold Harmless provision** can be added to the CGL, though an **insured contract** may also be required.

Which brings us to...

C. Insured Contracts

An insured contract is an agreement pertaining to the covered business. This can include a number of types of businesses, but there are specific kinds of insured contracts that cover particular situations, such as:

- **Agreements to Insure a City or Town** is an insured contract that is usually required by the government.
- **Commercial Contracts** means the insured assumes liability for third-party bodily injuries and property damage.

Note: **Commercial Contracts** excludes architects, engineers, and medical and fire personnel. Like everything else, this could end up on the test. We've seen a couple questions relating to **Commercial Contract** exclusions.

- **Easement Agreements** means the leaseholder assumes liability, not the real estate owner.

Note: **Easement Agreements** excludes construction, demolition, and railroads.

- **Easement or License Agreements of Private Railroad Crossings** is essentially the same as a normal Easement Agreement—the leaseholder of the private railroad crossings assumes the liability, not the real estate owner.
- **Elevator Maintenance Agreements** states that the owner is responsible for any bodily injuries or damages due to a malfunctioning elevator.
- **Commercial Premises Lease** is the agreement between the landlord and the tenant.
- **Sidetrack Agreements** refer to the responsibility a business owner accepts from the use of railroad sidetracks. A “sidetrack” is a railroad track that runs alongside commercial properties.

2. SECTION I -- CGL Coverage Forms

There are **4** possible CGL Coverage forms, including:

- 1) **Coverage A:** Bodily injury and property damage liability
- 2) **Coverage B:** Personal injury and advertising injury
- 3) **Coverage C:** Medical payments
- 4) **Coverage D:** Supplementary payments A and B

A. Coverage A Insuring Agreement: Bodily Injury and Property Damage Liability

Coverage A covers bodily injury and damages that occur while the insured is conducting his/her business. This coverage applies whether the injuries happened on or off insured premises.

Coverage A exclusions:

- The use of any kind of vehicle (land, sea, air, space, mammalian, reptilian), unless specifically noted in the policy
- Contractual liability unless it's an insured contract
- Any recall of goods, work, or electronic data
- Damages to the insured's goods, work, or electronic data
- Injuries that are covered by Workers Compensation
- Intentional injury
- Contractual liability
- Pollution liability

Note: Workers compensation is considered a primary coverage, that is, it takes precedent over other coverages. You'll find that people who are primarily covered by Workers Compensation are often excluded from other coverages.

- Liquor liability, except for Host Liquor liability
- Personal and advertising injury
- Pollution
- War

B. Coverage B Insuring Agreement: Personal Injury and Advertising Injury

Coverage B applies when the insured suffers a personal and/or advertising injury through his/her business. We put together a rather nifty graph to explain the differences between a personal injury and an advertising injury.

Nifty Graph

Personal Injuries include:	Advertising Injuries Include:
False arrest, detention, imprisonment, or malicious prosecution	Stealing (“borrowing”) someone else’s advertising ideas
Wrongful entry or eviction of someone on the insured’s premises	Violating a copyright or an advertising slogan
Oral or written material that’s slanderous, or says nasty things about another person’s goods or services	
Violating another’s right of privacy	

The following are **Personal and Advertising Injury** exclusions:

- The insured intentionally violating someone else’s rights
- Any contractual liability
- Intentional injuries caused by the insured’s advertising, broadcasting, publishing, and webcasting
- Injury due to:
 - o The insured’s criminal acts
 - o Any violations of contract
 - o If the insured’s goods, products, or advertised services aren’t up to snuff
 - o If the advertised price is wrong
- If the insured intentionally gave false information either in writing or orally

C. Coverage C Insuring Agreement: Medical Payments

Coverage C covers any medical expenses for bodily injuries occurring on the premises, no matter who is at fault. All claims have to happen within coverage territory (US, US territories, Canada), and filed within **1** year of the actual injury date. Under Coverage C the insured can have a particular doctor examine the injured person. Coverage C covers the following necessary expenses:

- Ambulance fees, hospital fees, and funeral services
- Medical, surgical, and dental services
- First aid

Coverage C excludes:

- The named insured
- Servants or hired hands
- Renters
- Anyone covered primarily by Workers Compensation or disability benefits
- Injuries during athletic training or events

D. Coverage D: Supplementary Payments A and B

The insurer has to pay **supplementary payments** if a claim or lawsuit is made against the insured. Supplementary payments are in addition to normal payments, and don't affect policy coverage. The insurer has the right to investigate, defend, or settle any claims.

Coverage D includes:

- All reasonable expenses

- Lost income up to **\$100** per day
- Bail bonds (up to **\$250**) or any other necessary bonds
- Any interest before and after a judgment

CGL Exclusions: The CGL Policy is the “**first line of defense**” against many common claims, but, it does not cover certain losses, like professional liability, are not covered by CGL because the loss is not a bodily injury, property damage or advertising injury. Following are occupations and special forms commonly **not insured** by CGL; therefore requiring separate policy coverage . . .

Professional Liability – Protects accountants, attorneys, insurance agents, etc from professional judgments, recommendations and advice. Not covered by CGL Policies because CGLs do not cover **financial losses** for claims outside of bodily injury, property damage, personal injury and advertising.

Liquor Liability – Businesses selling/serving/distributing liquor need a special policy. An endorsement called Host Liquor Liability may be available for business who hold open houses or parties where liquor is served.

Workers Compensation – Policies for injuries suffered by employees.

Pollution – Claims from toxic damage to an insured’s premises or property

Automobile – Business autos are covered by separate Business Auto coverage.

Care, Custody and Control – Refers to damage of property temporarily in control of an insured.

3. Occurrence Forms versus Claims Made Forms

CGL can be written using **2** kinds of forms:

- 1) **Occurrence Forms** focuses on whether or not the injury occurred during the policy period no matter when the claim was filed.
- 2) **Claims Made Forms** focus on claims made during the policy period only.

Putting it into Context:

Sid was severely injured when the tire on his new motorcycle suddenly fell off. Eighteen months after the accident, he finally filed a claim against the manufacturer. Fortunately for the manufacturer, they had CGL coverage under the Occurrence Form at the time of the injury, even though the policy had expired at the time of the claim.

Back in the day, most policies were written on an Occurrence form basis. What necessitated the development of the Claims Made forms was the spike in occupational diseases, that didn't emerge until decades after the exposure.

From 1900-1980, safety procedures were pretty rudimentary and people didn't know how toxic certain chemicals or substances were. People routinely worked with asbestos, lead-based paint, and a variety of substances we now know to be highly toxic/carcinogenic.

The thing about occupational diseases was they could remain dormant for several decades. Insurance companies suddenly found themselves paying huge sums of money for asbestos-related illnesses that dated back 30 or 40 years.

The Occurrence form offered the client a lot of protection, but actually made the insurance companies much more vulnerable. Insurance companies base their policies and rates on complex calculations regarding potential risk and risk classifications. It became obvious that Occurrence forms had the potential to cripple their system of analysis, which would drive insurance rates up for everyone.

Insurance companies didn't waver from honoring their commitment to the victims of industrial carcinogens and asbestos, but it was clear the insurance companies needed more protection. The Claims Made form was born.

Note: Claims Made form coverage differs between Coverages A-C. Coverage A and Coverage B covers a claim made during the policy period or an **Extended Reporting Period (ERPs)**, but doesn't cover any occurrences before the retroactive date. If a person files both Coverage A and B claims, the date of the first claim is documented. Coverage C covers an injury that occurred during the policy period, regardless of when the claim is filed.

Note: **Retroactive date** is defined as the earliest date coverage is provided by a Claims Made form. Usually, the retroactive date is the effective date of the first year the policy form was given to the insured.

4. Extra Protection Through ERPs

Extended Reporting Periods (ERPs or Tails) protect the insured against gaps in coverage. Businesses have **Tail coverage** for any and all future claims.

ERPs differ from the retroactive date, because ERPs not only provide coverage during the policy period, but they cover any future claims as well.

Putting it into Context:

Margaret's washer manufacturing business closed its doors after 23 years. She purchased **Tail coverage** in case a claim was brought against her in the future, due to any defects in the washers she manufactured in the past.

A. The Types of ERPs

ERPs include the following:

- **Basic Extended Reporting Period (Basic Tail)** covers injuries that occur during the policy period and automatically applies to all ERPs. This includes:
 - o **Mini-tail** (60 day Basic Tail) covers claims no more than **60** days after the policy expires.
 - o **Midi-tail** (5 year Basic Tail) covers claims within 5 years that occurred within **60** days after the policy expired.
- **Supplemental Extended Reporting Period** (Maxi-tail) covers unlimited claims that occurred within the **60**-day period after the policy expired. Supplemental ERPs can be added via endorsement.

5. Who is a CGL insured?

The following people/entities are considered to be the insured in CGLs:

- Any person(s) who own a commercial business
- Someone using the insured's vehicle (such as the company car)
- Employees on the job
- Company lawyers
- Real estate managers

- Any new organizations for up to **90** days

6. Limits

Limits refer to the maximum a policy will pay per occurrence or policy year. No matter how many payments were made the previous year, the limit starts over again during the next policy year.

Here are some standard CGL limits:

A. Each Occurrence Limit

This is the maximum paid for bodily injury, medical expenses, and property damage under Coverages A and C.

B. Damage to Premises You Rent Limit

This is the maximum Coverage A will pay for fire damage to a rental property the insured is occupying.

C. Medical Expense Limit

This is the maximum paid for injuries under Coverage C.

D. General Aggregate Limit

This is the maximum paid for Coverages A-C per year.

E. Personal and Advertising Injury Limit

This is the maximum paid for Coverage B injuries. Even if the General Aggregate limit hasn't been exhausted, after this limit is exhausted, payments stop.

F. Products-Completed Operations Aggregate Limit

This is the maximum paid for injuries or damages from defective products. This limit is found under Coverage A.

7. Conditions

The insurer and insured are obligated to follow certain rules and accomplish certain duties. These are policy conditions that apply to any future CGL clients.

A. Bankruptcy Condition

This means that even a bankrupt insurer has to defend any lawsuits or pay any claims.

B. Insured's Duties in the Event of Occurrence, Claim, or Suit Condition

This means that if the insurer knows there are possible claims or lawsuits in the insured's future, the insurer has to let the insured know as soon as possible. Afterwards the insured's duties are:

- Cooperate with the insurer regarding any claim or lawsuit
- Authorize the insurer to collect any necessary information
- Immediately send the insurer any/all legal documents

C. Legal Action Against Us Condition

This means the insured isn't allowed to sue their insurer while their insurer is providing coverage.

D. Other Insurance Condition

This means if the insured has CGL and other relevant insurance coverage, both policies will help cover the loss either by using Contribution by Limits or Contribution by Equal Shares.

Note: Contribution by Limits means the insurers cover the loss until applicable policy limits are exhausted. Contribution by Equal Shares means the insurers cover the loss equally.

E. Premium Audit Condition

This means the insurer determines and adjusts the premiums. The insured keeps necessary documents to help the insurer determine the premium amount at the end of a policy cycle.

F. Representations Condition

This means the insured agrees to all the information in the policy's declarations.

G. Separation of Insured / Severability Condition

This means that no matter how many names appear on the policy, the insurance company treats them as one insured.

Note: If there's a claim, the individuals named on the policy are treated separately.

H. Transfer of Rights of Recovery Against Others to Us (Subrogation) Condition

This means the insurance company has the right to collect from the responsible party after paying any claims.

I. When We Do Not Renew Condition

This means that if the insurer won't renew the policy, the insurer has to notify the insured within **30** days of the expiration date.

J. Your Right to Claim and Occurrence Information Condition

This means the insured has the right to receive information regarding occurrences or claims made against the insured for the past **3** years. The insured has to request this information within **60** days of the expiration date, or **30** days before terminating the policy. Afterwards, the insurer will provide the requested information within **45** days.

The claim history includes:

- Records of each occurrence
- Summaries of payments made and amounts reserved under the General Aggregate limits and Products-Completed Operations Aggregate limits

8. Owners and Contractors Protective Liability

The **Owners and Contractors Protective Liability Policy** protects business owners against any injuries or damage caused by hired contractors. Coverage is on an Occurrence basis.

Part B: Professional Liability Insurance

1. What is Special Liability / Professional Liability Insurance?

Special Liability/Professional Liability insurance provides coverage for liability that arises from the insured's, or employees of the insured, malpractice and errors.

Professional Liability Insurance is extremely important: it pays any expenses the insured is liable to pay as a result of failing to provide professional services.

Note: CGL policies provide coverage for premises and operations, and specifically excludes professional liability which is coverage for claims based on **professional services fault**. CGL covers losses from bodily injury, property damage, personal injury, or advertising injury that occur from a company's ordinary activities.

Note: Professional liability coverage defenses differ from CGL defenses in that they are centered around claims against a company's "**professional acts**" through its directors, officers, past or future employees, affiliated companies (names) and even independent contractors under certain situations acting in their capacity . Ordinary acts by employees are excluded, as are acts of intentional dishonesty, fraud or those having criminal or malicious intent. Employment practice liabilities (wrongful termination, harassment, discrimination, etc) are also excluded as are fiduciary liabilities.

A. Errors and Omissions

Professionals could be liable for damages resulting from the failure to do a service, or a failure to do the service correctly.

Professionals such as accountants, architects, insurance and real estate agents, attorneys, and consultants use a form of Professional Liability insurance called **Errors and Omissions insurance**. This coverage protects them if they're responsible for any mistakes, or the mistakes of their employees.

B. Malpractice Insurance

Medical professionals such as physicians, nurses, dentists, physical therapists, and veterinarians carry a Professional Liability called Malpractice insurance.

C. Directors and Officers (D&O)

Directors and Officers liability (D&O) Insurance protects the directors and officers of a company in case they're sued by shareholders, creditors, competitors, and/or stockholders.

Know that there are 3 common D&O insuring agreements:

Insuring Agreement A: Directors and Officers Individual Coverage

Insuring Agreement B: Company Indemnification Coverage

Insuring Agreement C: Company Securities Claim liability

The **D&O** policy provides coverage for claims made against an ***insured while acting as a director or officer***. This coverage has protection for:

- Misrepresentation
- Violation of trust
- Other negligent acts
- Omissions or acts of negligence
- Acts outside their authority
- Failure to perform their duties
- Misstatements
- Wrongful trading
- Reimbursement for expenses as a result of a liability lawsuit filed against them

Exclusions to coverage include:

- Fraud
- Willful violation of the law
- Improper personal profit
- Bodily injury and property damage losses
- Disputes with other directors
- Prior litigation
-

Employment Practices Liability (discrimination, sexual harassment, etc) is a special area of insurance that may require a separate policy or a special endorsement. As an agent advising your client you need to know who is not covered and what losses are excluded. Coverage in this area might involve:

- Claims for monetary relief, e.g., pay each employee \$1,000 or non-monetary relief, e.g., mandatory sexual harassment training; OR the claim may lead to administrative / regulatory investigation by the Equal Employment Opportunity Commission, etc.
- Claims where an employee secures a pre- or post-judgment interest (pre= interest from the time it is owed; post=interest from the point the judgment is awarded) punitive or exemplary damages (above and beyond actual damages meant to reform or deter future violations); multiplied damages (normal damages times two or three) up to the limit of liability.
- Claims involving wrongful acts, including death, discrimination, harassment, wrongful demotion, failure to hire or promote, hostile work environment, wrongful termination or retaliation.
- Claims where bodily injury exclusion includes a carve-out for emotional distress, defamation, invasion of privacy or humiliation, i.e., while bodily injury may be excluded from the claim, the insurer may pay (carve-out) payment for certain issues.
- Understand that there is NO exclusion for fraudulent or intentional acts.

D. Fiduciary Liability

This type of liability covers fiduciaries—individuals in charge of trust funds or in a position of power over someone else's finances/investments—against breaches of fiduciary duties, such as:

- Misleading statements
- Misstatements
- Errors and Omissions

E. Liquor Liability

This type of liability covers insureds that supply, sell, or provide alcohol. If an inebriated person leaves the premises and causes bodily injuries or damages, the company that provided the

alcohol could be held liable. **Liquor liability** protects restaurant owners/bar owners/etc. against this possibility.

F. Employment Practices Liability

This is a relatively new type of Professional Liability. It protects the business against the actions of the employees.

Putting it into Context:

Someone at June's company keeps leaving pornographic material on her desk and on her coworker's desks. At first she dismissed it, but now it's becoming impossible to ignore. She and her coworkers decide to band together and sue the company for creating a hostile work environment. If the company has **Employment Practices liability**, they are covered for the actions of whoever is responsible for the harassment.

2. Other Professional Liability Policies

In addition to the coverages above, Other Professional Liability policies might include the following:

- **Hospital Liability policy**
- **Druggists Liability policy**
- **Completed Operations Insurance policy**

Putting it into Context:

If a plumber is negligent while working in someone's home, and after he/she leaves the water heater explodes as a result, any injuries are covered if the plumber has **Completed Operations Liability insurance**.

Professional Liability Triggers

The ***occurrence policy coverage trigger*** is tied to the date of the event or accident giving rise to the claim. The actual claim may arise years after the policy expired.

The ***claims-made policy coverage trigger*** is the date the insured first became aware and notified the insurer of a potential claim. The claim must be made during the policy period, it must be ***reported*** to the insurer during the policy period, it must have happened after a prior acts or retroactive date and insured must state he had no knowledge of the claim on the date the policy was purchased. Normal policies require reporting during the policy period. ***Reporting extensions*** can be granted or endorsed.

Summary

Those in the professional world need coverage that's specific to their needs. This could include CGL to protect their premises, and Professional Liability insurance to protect against any litigation arising from errors. Basically, there's a coverage designed for any possible professional in any possible situation to afford complete protection.

Section PC 10

BONDING & CRIME

Objectives

Many business pursuits wouldn't be possible without the use of Bonds. We'll explain how bonding works to guarantee that a professional obligation is completed, and the insurance company's role in the process. You'll also learn vital crime definitions and the necessary coverages that go along with crime insurance.

This unit includes:

- General Definitions
- Surety Bonds
- Crime Insurance
- Loss Sustained versus Discovery Forms

1. General Definitions

You probably know all these definitions, but we need to stress the importance of wording in insurance or legal definitions.

These definitions are formulated very carefully to prevent misinterpretation or abuse of the system—even if some of them seem a little obvious.

A. Burglary

This means illegally removing property after forcefully obtaining entry to the premises.

B. Robbery

This means illegally removing property from another person by threatening and/or using force or violence.

C. Theft

This is a general term for stealing.

Alert!

We've pointed this out before, but just one more time—

Burglary is a person breaking in and stealing from a location.

Robbery is a person stealing from another person using threats or force.

D. Coverage Trigger

This refers to the event that causes the need for coverage, therefore, whatever “triggers” the need for coverage. In Crime insurance, the **2** main coverage forms depend on the trigger.

The **2** main coverage forms are:

- 1) **Discovery Forms** compensate businesses for any loss discovered during the policy period, no matter when the loss actually occurred (this is akin to Occurrence forms).
- 2) **Loss Sustained Forms** only compensate businesses for losses that occurred during the policy period (this is akin to Claims Made forms).

Part A: Bonding

1. Bonding

Bonding is a special type of protection in which the **Surety** (party A) guarantees the performance (**Surety Bond**) or the honesty (**Fidelity Bond**) of the **Principal** (party B) to the **Obligee** (party C). The **Surety** (party A) will pay the **Obligee** (party C) if the **Obligee** loses money as a result of the poor performance/dishonesty of the **Principal** (party B).

A. Surety Bonds

A Surety bond is a contract involving **3** parties. No, not *that* kind of party—take off that ridiculous hat and put down that noisemaker. Sheesh.

The **Surety bond** is issued by the first party, the **Surety**, and that guarantees that a second party, the **Principal**, will perform a specific obligation or duty. The **Surety** pays the third part, the **Obligee**, for any losses if the **Principal** doesn't do a good job or fulfill his/her obligation.

The surety is a person/company guaranteeing the conduct/quality of a second party to a third party. If the second party fails to complete the work, or the work is sub-par, the **Surety** will pay all related damages.

The **Principal** fulfills the duty or obligation (sometimes referred to as an “obligor”). The **Principal** has to purchase the bond, in order get the contract.

The **Obligee** is the insured. The bond covers damages to the **Obligee** if the Principal fails to fulfill his/her obligations.

B. The Big 3 C's

The Surety guarantees the Principal using certain criteria, which we'll refer to as the big **3** Cs:

1) Character

Does the Principal have a reputation for honesty, fairness, and a good, sturdy character? Is the Principal the kind of trustworthy go-getter who will fulfill the obligations guaranteed by the bond?

2) Capacity

Does the Principal have essential knowledge and experience to do a good job? Does he/she have a record of successful projects?

3) Capital

Does the Principal's financial statements show stability and adequate assets?

Note: Principals who can't secure bonds from Sureties may not be able to obtain the necessary license to do business in a city or county. Nor will a Principal be able to compete for jobs when a bond is a prerequisite to submitting a bid. Some examples of common Principals could include plumbers, electricians, building contractors, etc.

2. Surety Bonds and Insurance Policies

There are a few key differences between Surety bonds and Insurance policies. We've put together a totally righteous graph to outline these differences:

Totally Righteous Graph

Insurance Policies	Surety Bonds
The insured doesn't have to reimburse the insurance company for claim payments.	The Principal has to reimburse the Surety if payments have to be made to the Obligee.
The insurance policy protects the Insured—the second party.	The surety bond protects the Obligee—the third party.
An insured can cancel an Insurance policy at any time.	A surety bond can't be canceled until the obligation or job is fulfilled.
Insurance policies have premium payments that the Insured pays in exchange for coverage.	The premium for a surety bond is more like a service fee, which gives the Principal use of that Surety's good name, credibility, and financial strength.

3. Types of Surety Bonds

The following list gives you an idea of the variety of **Surety bonds**:

A. Contract Bonds

Contract bonds are used in the construction business to guarantee that the Principal fulfills the obligation. These bonds include:

- **Bid Bonds** promise that once the contractor has been awarded the contract, the contractor will accept that contract and supply a Performance bond.
- **Performance Bonds** are a promise that the work will be completed. This is one of the most important contract bonds since the Surety guarantees the work will be completed according to contract specifications.

- **Payment (Labor and Materials) Bonds** guarantee that the Principal will pay for all labor and materials.
- **Completion Bonds** guarantee that a supplier will furnish all necessary supplies.
- **Maintenance Bonds** guarantee the correction of all faulty work or materials.

B. Commercial Surety Bonds

The following bond is an important type of Commercial Surety bond:

- **License and Permit Bonds** are Occupational bonds that guarantee that the licensee (the contractor) will pay any damages and fees if they fail to fulfill their duties/obligations.

C. Judicial Bonds

Judicial bonds relate to legal proceedings. These bonds are required by various courts to guarantee that someone will complete court-related jobs. For example: many times the court will require that an administrator or executor of an estate post a bond. This guarantees that the executor will do his/her job of distributing assets, liquidating assets, and paying taxes with competence and honesty.

The following are different kinds of **Judicial bonds**:

- **Fiduciary Bonds** guarantee that someone handling someone else's legal affairs will act in an honest and responsible manner. This applies to guardians, trustees, executors, etc.

- **Litigation (Court) Bonds** guarantee that the Principal will pay if he/she loses a lawsuit.
- **Appeal Bonds** guarantee that the Principal will pay if he/she loses an appeal.
- **Attachment Bonds** guarantee that if the court rules against the Principal, he/she will pay damages resulting from a court order that blocks the use/sale of the property.
- **Cost Bonds** guarantee payment of court costs.
- **Injunction Bonds** guarantees payment of damages if an injunction isn't granted.

Note: An **injunction** is when a court issues an order prohibiting someone from some sort of action.

- **Replevin Bonds** are a security given by someone asking the court for recovery of goods that have been wrongfully taken or detained. The person will agree to return the goods if so ordered by the court.
- **Bail Bonds** guarantee a Principal's appearance in court.

Note: You really need to memorize the different kinds of bonds and their function. We recommend giving each bond its own personal context. For example, to us, **Replevin** sounds like an evil sorcerer bent on world domination, so we never forget it. And yes, it's entirely possible that we watch too many movies.

D. Public Official and Miscellaneous Bonds

A state or local treasurer might be required to carry a Public or Official bond, since they manage public funds. Tax collectors,

auditors, and sheriffs may also need to post a bond to guarantee their performance.

4. Fidelity Bonds

Fidelity bonds are more like Insurance than Surety bonds.

Employers buy **Fidelity bonds** to protect themselves against any dishonest acts from their employees. The Surety guarantees the Principal's/employee's honesty and reimburses the Obligee/employer for any loss.

Fidelity bonds cover employee dishonesty, such as:

- Larceny
- Theft
- Forgery
- Embezzlement
- Misappropriation of monies

Financial institutions, such as banks, savings and loans associations, and credit unions frequently purchase Fidelity bonds, because so many of their employees have access to valuables.

Note: Business firms and educational institutions generally purchase Commercial Fidelity bonds instead of Fidelity bonds, because money and valuables don't play a significant role in the business's daily operations.

Part B: Crime Insurance

1. Crime Insurance

It's natural to go from Fidelity bonds to discussing **Crime insurance**. A Fidelity bond covers the losses to a business due to a dishonest employee, whereas **Crime insurance** covers losses to someone outside the business.

Crime insurance covers:

- Burglary
- Robbery
- Theft

Crime insurance can be purchased individually or as part of the CPP. The insured selects the desired coverages and chooses any endorsements.

A. Loss Sustained versus Discovery Forms

Loss Sustained and **Discovery forms** are provisions in Crime insurance containing their own conditions and exclusions.

For example:

- **Loss Sustained Forms** cover losses that happened during the policy period. The loss can be discovered either during the policy period or up to **1** year later. Losses discovered during the current policy period that occurred in a previous policy period are also covered.
- **Discovery Forms** cover losses discovered during the policy period and up to **60** days after the policy expires.

Exclusions: The most important crime insurance exclusion relates to any losses that occur because the Insured was dishonest.

Important: You should know that certain people may not be covered under the policy, including officers, employees and independent contractors.

B. Covered Perils

Crime insurance covers the following more common perils:

- **Theft, Disappearance, and Destruction** provides coverage for loss of money or securities on or off covered premises due to theft, disappearance, or destruction.
- **Theft** can be perpetrated either by an employee or someone outside the company. It can occur inside or outside the business premises. Theft is defined as any act of stealing and includes:
 - o Robbery
 - o Burglary
 - o Embezzlement
 - o Forgery
- **Mysterious Disappearance** means property disappears and no one knows for certain how. It's assumed the disappearance was the result of theft, but if theft can't be absolutely determined, it's referred to as **mysterious disappearance**.
- **Robbery and Safe Burglary** covers personal property on the premises, and personal property kept in a locked safe or vault.

C. Coverage D

Robbery and Safe Burglary (Coverage D) insures any losses a business could sustain. Coverage D consists of several forms that can be purchased separately, or together, including:

- **Robbery of a Custodian** covers the losses when a security guard or janitor is robbed, or the premises are robbed while the custodian is incapacitated.
- **Robbery Outside of the Premises** covers property (excluding money) stolen off the premises from an armored car or a business messenger.
- **Safe Burglary** covers property (excluding money) stolen from a safe. There have to be signs of forced entry for this coverage to apply.
- **Premises Burglary** occurs when property is taken from inside the premises.
- **Custodian Coverage** covers the Insured's partners or employees if the Insured's property is stolen from them.
- **Messenger Coverage** covers losses if a messenger is robbed off the premises.
- **Guard or Watchperson** covers any theft or damages to property in the care of a guard or watchperson.
- **Computer Fraud** covers loss of money or securities when someone uses a computer to make illegal transfers.
- **Kidnapping, Ransom, and Extortion** covers losses for ransom demands paid in exchange for people or property.
- **Forgery** covers losses from any alteration of documents.

Section PC 11

COMMERCIAL AUTO

Objectives

Businesses need liability and physical damage coverage for their vehicles. So now we're going to focus on the kind of auto insurance specifically designed for the business world.

This unit includes:

- Commercial Auto Policy
- Business Auto Policy (BAP)
 - Section 1: Covered Autos
 - Section 2: Liability
 - Section 3: Physical Damage Coverage
 - Section 4: Policy Conditions
- Garage Coverage Form & Garage Keepers Insurance
- Other Commercial Auto
 - Truckers Coverage
 - Trailer Interchange Insurance
 - Motor Carriers Form
- General Business Auto Coverage Endorsements

1. The Commercial Auto Policy

The **Commercial Auto Policy** can be written separately or included in a **Commercial Package Policy (CPP)**.

Private or commercial auto?: A commercial vehicle is used for the transportation of persons for hire, compensation or profit, or for the transportation of property. Private passenger automobiles are not. RV's (including those as large as 6 wheels) are generally both designed as and used as private passenger vehicles, not commercial vehicles. Once an RV is added to a private auto policy, the existing coverage of the policy is extended to the RV.

The **Commercial Auto Policy** is comprised of:

- Declarations
- Conditions
- One of five possible coverage forms:
 - 1) Business Auto
 - 2) Business Auto physical damage
 - 3) Garage
 - 4) Truckers
 - 5) Motor Carrier
- Declarations for the selected coverage form

2. Business Auto Policy (BAP)

The Business Auto Policy Form (BAP)

The Business Auto Coverage Form insures private passenger and commercial autos used by a business. This form is comprised of **4** sections:

- 1) Covered Autos
- 2) Liability
- 3) Physical Damage Coverage
- 4) Policy Conditions

A. BAP Section 1. Covered Autos

Here is a quick overview of the kinds of autos you'll find in

Section 1:

- **Owned Auto** means any auto owned or acquired while the policy is in effect.
- **Hired Auto** means any auto the insured hired, rented, or borrowed. For example, a limo hired to pick important clients up at the airport would be considered a **hired auto**.
- **Non-owned Auto** protects the insured for accidents arising from a vehicle not owned, borrowed, or leased.

Putting it Into Context:

*Jane uses her own vehicle to drive to the bank to make deposits for her boss who owns Snappy Auto Repair. One day she has an accident. The attorney involved sues Jane and Snappy Auto Repair because the accident happened in the course of her employment. Snappy Auto Repair is protected under the **Non-owned Auto Policy** coverage.*

- **Temporary Substitute Auto** means an auto the insured is using while his/her/their primary auto is being repaired or replaced.
- **Private Passenger Auto** means an auto used specifically to transport people in connection with the company or business.

Section 1 uses a numerical system to designate insurable autos. The insured chooses the kinds of autos he/she/they want to

insure by putting **1-9** next to the desired coverage. This takes place on the declarations page.

1-9 Covered Autos

1	Any kind of auto	- o Any auto owned, leased, or borrowed - o Liability only
2	Owned autos only	- o Any auto the insured owns - o Liability and other coverages
3	Owned private passenger autos only	- o Any private passenger auto the insured owns - o Any coverage under the BAP form
4	Owned autos that are not private passenger autos	- o Other kinds of autos the insured owns: motorcycles, trucks, trailers, etc. - o Any coverage under the BAP form
5	Owned autos subject to no-fault benefits	o 12 states and Puerto Rico have different varieties of mandatory no-fault laws: Florida, Michigan, New Jersey, New York, Pennsylvania, Hawaii, Kansas, Kentucky, Massachusetts, Minnesota, North Dakota, and Utah
6	Owned autos in states that require uninsured motorist	o Most states require uninsured motorist coverage
7	Specific autos	o The business may want to cover a particular car, which would be specifically listed in the declarations
8	Hired autos only	o This coverage is for any autos

		leased, borrowed, or rented by the insured. o Physical Damage and/or Liability only
9	Non-owned autos	o This coverage is for autos used in the course of business that are not leased, borrowed, or rented o Liability only

B. BAP Section 2. Liability

Section II deals with liability for:

Bodily injury and property damage

Pollution damages caused by a covered auto

Putting it Into Context:

What would be an example of pollution damages? Pollution damage could be caused by a company truck parked by a body of water. If that truck leaks oil into the water, the company is responsible for pollution damages.

The liability limits may be **split limits**. You may have seen **split limits** written as such: **50,000 / 100,000 / 50,000**. This insured has a liability limit of **\$50,000** per person, **\$100,000** per accident, and **\$50,000** in property damage.

Split limits are common in Personal Lines Auto Insurance, but most commercial policies utilize the **Combined Single Limit**. **Combined Single Limit** is the maximum amount the insurance

company will pay for Bodily Injury and Property damage in any one accident.

“Who is insured” ?

- The insured
- Anyone using a company car with permission
- Anyone liable for the conduct of the insured

Who isn’t covered?

- Someone driving a family member’s or employee’s car
- Anyone who works in auto-related businesses
- Non-employees moving property to or from a covered auto
- The people who own the hired or borrowed auto

Important: The **fellow employee exclusion** in commercial auto policies means that an insurer does not have to pay for the losses or injuries of one employee caused by another employee (e.g., bad driving, falling asleep at the wheel, etc) other than to pay the statutory minimum liability coverage required by the State. This liability, say insurers, is more the responsibility of workers compensation insurance. An fellow employee endorsement can be added, however, to provide employee protections not covered by workers compensation.

Who and what else is excluded under 2?

- Anyone who hurts themselves intentionally
- Anyone who assumes liability under **contractual liability**
- Anyone who has primary coverage through workers compensation
- Damages to property owned by the insured or in the insured’s care

- Damages to property being moved by a mechanical device that is not attached to a covered auto (e.g. forklifts, cranes, etc.)
- Damages resulting from the operation of mobile equipment (devices used to raise or lower workers, such as telephone wire repairmen)
- Anything that falls under **completed operations**
- Pollution damages other than covered pollution damages
- Any car being used for any kind of racing activity
- War

C. BAP Section 3. Physical Damage Coverage

The **BAP Section 3** has **3** coverages for losses to the auto or its equipment:

- 1) Collision** covers any losses to the auto other than those resulting from collision or the auto flipping over (upset).
- 2) Comprehensive** covers any losses to an auto for reasons other than flipping over or collision. Including:
 - o Glass breakage
 - o Hitting an animal
 - o Falling objects
 - o Thrown objects or missiles
- 3) Specified Cause of Loss (named perils)** covers particular losses that are specific risks for that auto. This allows the insured to pay a lower premium, because it covers less perils than comprehensive. Covered perils include:
 - o Fire
 - o Lightening

- o Explosion
- o Theft
- o Windstorm
- o Hail
- o Earthquake
- o Flood
- o Vandalism or Mischief
- o Sinking
- o Burning
- o Collision

Putting it into Context:

Kevin doesn't want to pay a higher premium for more commercial auto coverage, when all he really needs is protection against vandalism or mischief. The company car has been vandalized three times in the past year. Therefore, Kevin is going to opt for **Specified Causes of Loss** under his **BAP Section 3**, so he doesn't have to pay for more insurance than he thinks he needs.

Coverage Extensions

For private passenger autos there is automatic coverage for:

- **Temporary Transportation Expenses Due to Theft**
provides up to **\$20** a day up to **\$600** starting **48 hours** after a covered auto is stolen. This coverage only applies to an auto covered by **comprehensive** or theft in **specified causes of loss coverage**.

- **Towing** provides up to whatever limit is specified in the declarations per disablement. This varies from policy to policy.

BAP Section 3—Physical Damage Exclusions

Like any other policy, the **BAP Section 3** has certain exclusions. These exclusions are:

- Sound systems
- Wear and tear
- Mechanical or electrical breakdown
- Freezing
- Damage to tires
- Autos used in a race
- CB radios that are not necessary for the business
- Nuclear hazards
- War

And finally...

D. BAP Section 4. Policy Conditions

The conditions in the BAP Section 4 are similar to other insurance contract conditions, so you may notice some repetition. Conditions include:

- **Settling Claims** refers to how the insurer will choose to settle a claim. Usually this means repairing or replacing. In the case of theft, it can also mean paying for recovery of the auto, paying for any damages, or simply replacing the stolen auto.

- **Legal Action Against Us** means the insured can't sue the insurer UNLESS the insured fully complied with all the terms of the policy and the lawsuit is brought within **2 years** of the claim.
- **Other Insurance** means that the **BAP** form is the primary coverage for the insured's owned autos.
- **Two or More Policies From the Same Insurer** means each insurer pays a pro-rata share of the loss.

3. Garage Coverage Form & Garagekeepers Insurance

The **Garage Coverage Form** covers auto dealers and auto-related businesses, many of which are usually excluded by other forms of General Liability insurance. Such businesses could include car dealers, repair shops, service stations, and public garages. This form is comprised of **4 sections**:

- 1) Covered Autos
- 2) Garage Liability Coverage
- 3) Garagekeepers Coverage
- 4) Physical Damage Coverage

A. Garage Section 1. Covered Autos

The **Garage Section 1** allows the insured to choose what kind of auto gets what kind of insurance—similar to the **BAP Section 1**. The Numerical system is **21-31**, with **21-28** identical to **1-8** of the BAP covered autos. So, we'll only worry about **29-31**:

29-31 Covered Autos under Garage

29	Non-owned autos used by the named insured for the named
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	insured's garage-related business.
30	Autos that the named insured is in charge of servicing, storing, repairing, or restoring.
31	Dealer's autos and other autos being held for sale.

B. Garage Section 2. Garage Liability Coverage

The **Garage Section 2** provides auto and business liability that could result from:

- Ownership, servicing, or use of a covered automobile
- General Garage Operations

Note: The definition of **garage operations** includes use, maintenance, and ownership. These general operations apply to any business that has to do with autos: repair, sale, parking, etc.

Who is an Insured under Garage Section 2?

- The insured
- Employees
- Business partners
- Shareholders while acting within the scope of professional duties
- Anyone using a covered auto with permission
- Anyone using a covered auto while selling, servicing, or parking the auto
- Customers who DO NOT have their own liability insurance

Note: Customers that don't have their own liability are covered by Garage, but only minimally. The insured can add coverage that protects customers to the full limits of the policy.

Any **supplementary payments** are the same as in the **BAP**.

Similarly, all the **BAP** exclusions apply, with a few exclusions **unique to Garage**:

- Leased autos unless rented to a customer
- Defective products
- Damage to the insured's products because of defective products
- Watercraft
- Aircraft
- Financial losses due to the insured not completing promised repairs
- Losses from a recall
- Liquor liability

C. Garage Section 3. Garagekeepers Coverage

This coverage is optional, but still a doozy. We'll explain: the garage coverage form excludes liability for any damages to the property of others while in the ***care, custody or control*** of the insured. So this means that customers are not covered while they are in the garage being repaired.

The way to add coverage to those vehicles being held for repair is to add **garage keepers coverage**. So for most people that own car-related businesses or perform car-related services, this coverage is really, really important to have.

Otherwise, the insured will be paying out of pocket for damages to their customers' cars.

Garage keepers offers the same **3 coverages** offered by the BAP:

1. Comprehensive
2. Collision
3. Specified cause of loss

The insured can also choose coverage between:

- **Legal liability** – Covers damage to a customer's car when the insured is legally liable, .e.g., a mechanic damages a car during a test drive.
- **Direct damage** – Covers damage regardless of whether the insured or customer is at fault.

Garagekeepers exclusions are:

- Contractual liability
- Theft by the named insured or an employee of the named insured
- Defective parts, products, materials
- Sub-par performance by the insured or employees of the insured
- Loss to any equipment other than the auto or equipment that was installed by the manufacturer, such as:
 - o Sound systems
 - o Radar detectors
 - o XM radio
 - o CB Radio

D. Section 4. Physical Damage Coverage

Physical Damage Coverage primarily covers anyone who holds cars for sale, either dealers or non-dealers.

Physical Damage Coverage does NOT cover customers' automobiles.

Exclusions are similar to the **BAP**, plus:

- **False Pretense** which means false representation of facts or circumstances in order to mislead. Basically, any sneaky, illegal action the insured could take involving cars trying to make a few extra bucks falls under **false pretense**.
- An unexpected loss in dealership profits
- Collision damage to automobiles being removed from the point of purchase or distribution if the destination is more than fifty miles away

4. Other Commercial Auto

The commercial auto policy has to take the type of business into consideration in order to provide the best possible coverage. Along those lines, there are many different commercial areas dependent on automobiles either for sale or transportation.

A. The Truckers Coverage Form

The **Truckers Coverage Form** is a modified version of the **BAP** that covers businesses that specialize in transportation or hauling for hire. The **Truckers Coverage Form** is designed to fit an industry with unique operations and regulations.

Covered Autos

The numerical system is similar to the one found in the **BAP**, but the numbers are different. Don't stress too much about memorizing the numbers, because it's highly unlikely they'll end up on the exam. The only numbers you may want to keep in mind with regards to the **Truckers Coverage Form**, relate to **Trailer Interchange Coverage**.

Covered Autos **48-49**

48	- Any trailer the insured has borrowed or leased - Any trailer the insured has accepted liability for losses under a trailer interchange agreement - Coverage is Comprehensive, Collision, or Specified Causes of Loss
49	Any trailer the insured owns or rents while that trailer is in someone else's custody under a trailer interchange agreement

The **Truckers Coverage Form** includes **3 coverages**:

1) Liability

2) Physical Damage

3) Trailer Interchange Insurance which means borrowed or Rented Trailers

The liability and physical damages are similar to the **BAP**. The third coverage, however, is unique to the **Truckers Coverage Form**.

B. Section 3. Trailer Interchange Insurance

A lot of times truckers borrow or rent trailers from other trucking companies. Under a normal **BAP**, any damages to borrowed trailers wouldn't be covered. **Trailer Interchange Insurance** covers damages or loss to a borrowed or rented trailer if:

- The loss results from a covered peril
- The trucker accepts liability in a written interchange agreement

C. Motor Carrier Coverage Form

The **Motor Carrier Coverage Form** is similar to **Truckers Coverage**. Both forms can include people who haul for a living, but here's where it gets tricky: the main difference between the **Truckers Coverage Form** and the **Motor Carriers Coverage Form** is a matter of regulation versus contract. **The Truckers Coverage Form** refers to the insured's business as a trucker and to the insured's operating rights. **The Motor Carrier Coverage Form** doesn't refer to the business or the operating rights, focusing on the contractual relationship between the insured and his/her clients.

Let's try to simplify that: **Truckers Coverage** protects the business, whereas **Motor Carrier Coverage** protects the contractual relationship between the insured and the clients. Obviously, there's some natural overlapping between these two contracts, and it's possible for truckers to be insured by both.

D. The Motor Carrier Act of 1980

The Motor Carrier Act of 1980 requires truckers to file proof of financial responsibility to pay for any third-party BI or

property damages. These limits are higher than normal to meet the state's financial responsibility requirements:

- **\$750,000** when transporting nonhazardous materials
- **\$1 million** when transporting oil and other hazardous materials
- **\$5 million** when transporting explosives, radioactive materials, or poisonous gasses

5. General Business Auto Coverage Endorsements

The following endorsements can be added to Commercial Auto Coverage Forms:

- **Drive Other Car (DOC) Endorsement** extends coverage to include autos that are not owned, rented, or borrowed by the insured, while the auto is being used by the person named in the endorsement. So if there's some chance the insured or someone connected with the insured is going to be driving any other car, they can insure that car under the **DOC Endorsement**.
- **Broadened Named Insured Endorsement** extends commercial auto coverage to the insured's immediate family members. This provides coverage to any family members who may use a non-owned auto similar to **Personal Auto Policy Coverage**.
- **Changes in Commercial Auto Coverage Endorsement** is a required endorsement that is used with all **Commercial Auto Coverage Forms**. It gives the insured coverage for rented autos. Coverage is limited to **\$15 per day** with a MAXIMUM of **\$450**.

- **Medical Payments Endorsement** provides coverage for the insured's personal medical or funeral expenses, *not* for third party expenses (liability). Coverage is limited to expenses within **3 years** from the date of the accident. There is a single **Limit of Liability** that applies to all injured parties involved in one accident.
- **Uninsured Motorist Endorsement** protects the insured if the insured is involved in an auto accident involving an uninsured motorist.
- **Underinsured Motorist Endorsement** protects the insured if the insured is involved in an auto accident, the other motorist is at fault, and the other motorist does not have sufficient insurance to cover the insured's medical and damage expenses.
- **Additional Insured—Lessor Endorsement** extends coverage to leased vehicles.
- **Mobile Equipment Endorsement** extends coverage to mobile equipment.

Section PC 12

WORKERS' COMPENSATION **EMPLOYER'S LIABILITY**

Objectives

Injuries during the course of employment do occur, and when they do, both the injured party and the commercial owner/manager need protection from potential financial instability.

This unit includes:

- The Workers Compensation
- Employers Liability
- Sections 3-6
- The Components of Workers Compensation and Employers Liability
- Federal Regulations and Self-Insurers
- Noteworthy Aspects of California's Workers Compensation

Part A: The Workers Compensation and Employers Liability Contract

1. The Workers Compensation Contract

There are 6 sections to a Workers Compensation and Employers Liability contract:

- 1) Workers Compensation
- 2) Employers Liability
- 3) Other States Insurance

- 4) Your Duties if Injury Occurs
- 5) Premiums
- 6) Conditions

A. Section 1: Workers Compensation Insurance

In California, Workers Compensation coverage is mandatory. In some states, employers are exempt from this requirement if they have a minimum number of employees. In California, even if the employer only has one employee, the employer still has to provide Workers Compensation benefits.

Workers Compensation reimburses people and their family for injury, disability, occupational diseases, or death that happens during employment. Workers Compensation is a trade-off between employers and employees: the employer will pay for all work-related injuries, and in return, the employee can't sue.

Prior to the enactment of Workers Compensation laws, a worker had to sue their employer and prove the employer's negligence to be reimbursed for a work-related injury.

A major landmark that changed all this was the **Occupational Safety and Health Act (OSHA) of 1970**. The act helped to establish minimum standards for safety regulations. The act was specifically designed to protect workers from unsafe working conditions.

Now Workers Compensation laws are designed to protect employees against work-related injuries, including occupational

diseases. The laws assume that the cost of most work-related injuries and occupational diseases are the employer's responsibility, regardless of fault. In turn, the cost is passed on to the consumer as part of the cost of production.

The benefits in Workers Compensation laws are the only means employees have to be reimbursed for work-related injuries. Employees can't—after collecting Workers Compensation—sue their employers for additional compensation. This is referred to as **exclusive remedy**.

Workers Compensation covers an employer's Absolute Liability. Absolute Liability means the employer is always liable, no matter who was at fault. Workers Compensation insurance covers the injured employee for:

- Accidental Bodily Injury
- Occupational Diseases—diseases caused by or made worse by the job

NOTE: In the insurance world, there are workers' compensation policies sold to employers by agents. In addition, companies can also establish their own self-funded or self-insured workers' compensation plans for their employees. The terms aggregate excess and aggregate stop-loss refer to specially allowed limits on unpredictable losses for self-insured or self-funded workers' compensation plans operated by employers. THESE FEATURES ARE ONLY FOUND IN SELF-FUNDED PLANS. As such, it is a misdemeanor for agents to sell, advise or promote the availability of these features in conventional workers' compensation policies.

B. Workers Compensation Benefits

The types of benefits that are provided under Workers Compensation are:

- **Medical benefits** are provided without limiting the time or dollar amount for all necessary medical/surgical expenses.

Alert!

There are **no limits** for Workers Compensation for covered medical benefits either for time or dollar amount. Physical therapy and chiropractic services, however, are now limited to **24 treatments** per claim.

- **Disability benefits** are provided for employees who've suffered work-related disabilities. There is a **3**-day elimination period, and if the disability continues for **14** days, Workers Compensation benefits are then paid. The benefits are paid retroactively to cover the waiting period as well. For permanent total or temporary total disabilities, the maximum weekly benefit is **66 2/3 %** of the worker's weekly income.
- **Death benefits** include burial expenses and these benefits provide income for the surviving dependents in **2** possible ways:
 - 1) **Lump Sum Burial Allowance**—this method is determined by the number of dependents and how financially dependent they were on the deceased.
 - 2) **Weekly Income Benefit**—the maximum weekly benefit is **66 2/3 %** of the deceased's weekly income.

- **Supplemental Job Benefits**—this method helps to rehabilitate or retrain a disabled person to allow them to return to work as quickly as possible. This could include paying the expense of altering their lifestyle to incorporate the disability, or it could include vocational training, which trains the disabled person for a completely new job.

C. Workers Compensation Endorsements

The following endorsements can be added to Workers Compensation, so that it can fit circumstances that might otherwise be excluded from most Workers Compensation policies:

- **Voluntary Compensation Endorsement**—this endorsement is for employees who are exempted from state law. If coverage isn't required, an employer still might offer this endorsement to avoid any potential lawsuits.
- **Longshoremen and Harbor Workers Endorsement**—this endorsement covers anyone who loads, unloads, repairs, or constructs ships. Federal laws provide higher benefits to workers in this category, so adding this endorsement to a Workers Compensation policy would make sure the person is properly covered.
- **Maritime Coverage Endorsement**—under the Jones/Merchant Marine Act, the crews of ocean-going ships are allowed to sue their employer if they're injured on the job. The Maritime Coverage Endorsement offers more protection for the employer, by limiting the insurance and adding more exclusions.

- **Foreign Voluntary Compensation Endorsement**—this endorsement extends the coverage from the 8 hour a day, 5-day work-week, to **24-7** coverage. This endorsement also adds diseases one could pick up in foreign countries, to the definition of “occupational disease.” This endorsement also gives the insured the option to get Repatriation coverage.

Note: **Repatriation coverage** would pay the expenses of bringing a sick/injured person back to their home country. A lot of commercial airlines won’t allow a sick/injured passenger on the flight, which means that person would have to charter a flight in order to get home. Repatriation coverage covers those expenses.

D. Workers Compensation Exclusions

The following **exclusions** apply to Workers Compensation:

- Intentional injuries, either self-inflicted, via prank, or otherwise
- Injuries resulting from intoxication
- Injuries resulting from the employee’s failure to use provided safety equipment
- Pain and suffering

E. Workers Compensation Policy Cancellation

The insurer can only cancel a Workers Compensation policy for the following reasons:

- Nonpayment of premium
- The insured/policyowner fails to follow the rules and conditions of the policy

- The insured/policyowner fails to follow state or federal regulations
- There is increased loss exposure
- Serious misrepresentation

F. California Workers Compensation Inspection Rating Bureau

A Licensed rating organization and the designated statistical agent of the CA Insurance Commissioner this organization provides:

- (a) Reliable statistics and rating information with respect to workers' compensation insurance and employer's liability insurance
- (b) The collection and tabulation of information and statistics for the purpose of developing pure premium rates to be submitted to the commissioner for issuance or approval.
- (c) Formulate rules and regulations in connection with pure premium rates and the administration of classifications and rating systems.
- (d) Inspection of risks for classification or rate purposes and to furnish to the insurer and upon request of the employer and after notice to the insurer, to furnish to the employer full information concerning the rates applicable to the employer's insurance.
- (e) Examination of policies, daily reports, endorsements or other evidences of insurance for the purpose of ascertaining whether they comply with the provisions of law and to make reasonable rules governing their submission.

2. Section 2: Employers Liability

Workers Compensation doesn't cover all job categories, leaving some employers open to litigation—that's where Employers Liability comes in.

Employers Liability protects the employers when their employees aren't eligible for Workers Compensation. In this instance, the employer could end up with an expensive lawsuit if the employee incurs an injury. A minimum amount of **\$100,000** per accident applies.

Employers Liability insurance covers damages owed to an employee under the Dual Capacity Concept. The Dual Capacity Concept means the employer has liability coverage as both an employer and a product manufacturer.

A. Common Law Duties

However, even employers who provide Workers Compensation to their employees can leave themselves open to lawsuits if they violate any of their **Common Law Duties** to their employees, such as:

- The employer has to provide a safe workplace.
- The employer has to hire competent/trained workers.
- The employer has to warn the employees if there are any dangers or hazards.
- The employer has to implement safety procedures.

Employers Liability protects employers against the possibility of expensive lawsuits. The following coverage is provided:

- Lawsuits brought by injured employees
- Lawsuits brought by the family/dependents of injured employees
- Legal defense expenses
- Employee's who aren't eligible for Workers Compensation
- Other supplemental benefits

B. Common Law Defenses

If an employer is found to be negligent regarding one of their Common Law Duties, they can use one of the following Common Law Defenses to try to prove they aren't liable:

- **Fellow Servant / Employee Rule** states that if one of the injured worker's fellow worker directly caused the injury, then the worker is liable, and not the employer.
- **Contributory Negligence** means if the injured worker was even a tiny bit responsible for the injury, the employer can't be held liable.
- **Assumption of Risk** means that the injured worker knew the rules or the possible dangers, and went ahead and did it anyway. Therefore, the injured worker is liable for their own injuries.

Note: Remember, under Strict Liability—as opposed to Absolute Liability—the employer is automatically liable for any employee injuries, no matter who was at fault. However, the employer is allowed to defend themselves and try to prove that they weren't liable.

The following **Exclusions** apply to **Employers Liability**:

- Contractual Liability
- Anything that's covered under Workers Compensation, Unemployment Compensation, or Disability
- If the employer intentionally caused the injuries
- If the injury happened outside the boundaries of the US, US territories, or Canada
- If a violation of employment laws caused the damages
- Any lawsuits brought by injured employees who were hired illegally
- Work-related injuries to an employee who was knowingly hired illegally

3. Section 3-6: Other States Insurance and Insureds Duties if Injury Occurs

A. Other States Insurance (Section 3)

Other States Insurance applies to someone who has transferred to a new job in a new state. That person's Declaration page specifies which states their Workers Compensation covers them in, and Other States Insurance provides temporary coverage in the new state. The insured has to let the insurer know that the policy and the premium need to be updated within **30** days.

B. Insureds Duties if Injury Occurs (Section 4)

In the case of an injury, the insured is required to:

- Provide immediate medical/first aid required by law
- Provide the insurer with the names/addresses of anyone who was injured, and any witnesses

- Provide notices of any legal action
- Cooperate with the insurer to the fullest degree
- Allow the insurer to recover payment from a third-party
- Not make any payments out of pocket

E. Premiums (Section 5)

Premium determination is based on:

- The type of job/job classification
- The size of the business
- The total payroll

F. Conditions (Section 6)

The following **Conditions** apply to the Workers Compensation and Employers Liability Contract:

- The insurer has the right to inspect the workplace for potential risk exposures at any time.
- The insured's rights and duties under the contract can't be transferred unless the insured gives their written consent.
- The insured can cancel the policy at any time by giving written consent to the insurer.
- The insurer can cancel the policy after providing written notice to the insured **10** days in advance.
- The first named insured assumes all the policy responsibilities, such as changes, premiums, and notice of cancellation.

G. Extra Information

Here's a few facts about Workers Compensation and Employers Liability insurance that's just good to know:

- The **National Council on Compensation Insurance** develops and regulates the rates for work classifications.
- Total remuneration (payroll, etc.) is used to determine premiums because it's considered the best way to measure an employer's exposure to risk.
- Premiums for work classifications are determined by multiplying the rate by the total remuneration. An insured with a good loss record pays less in premiums than an insured with a poor loss record.
- The very first premium is an estimate. The final premium is determined at the end of the policy term by taking into account total remuneration, and any other relevant situations that may have happened during the policy period.
- **Retrospective Rating** is a plan that's available to operations with a large premium volume. It's used in conjunction with the experience rating. It adjusts the insured's premium after the policy expires, depending on whether or not there were any losses during the policy period. This plan is designed to charge a premium that reflects the actual cost of a specific company's risk, and the cost of insuring that specific company.
- **Participation / Dividend Plans** are used to provide dividends to insureds whose losses are lower than anticipated. As the loss ratio declines and premiums increase, the dividend amounts increase.

Part B: The Components of Workers Compensation and Employers Liability

1. Eligibility

Most jobs are eligible for Workers Compensation.

A. Ineligibility

It's simpler to put it this way: here are the people that aren't eligible for Workers Compensation:

- **Public sector clerks/deputies who don't receive an income for their duties**
- **Domestic employees who:**
 - **Earn less than \$100 in the past 90 days**
 - **Worked less than 52 hours in the past 90 days**
 - **Amateur athletes, or students participating in sporting events**
 - **Volunteer/charity workers working at locations operated by nonprofit organizations.**

Note: Even if a job category is considered exempt from Workers Compensation, it's still recommended that the employer carry Employers Liability in case of lawsuits.

B. Ineligible Groups

The following groups are excluded from receiving Workers Compensation benefits:

- **Independent contractors and their employees**
- **Captains or seamen on vessels that deal with interstate or foreign commerce (see the Merchant Marine Act/Jones Act)**

- **Someone's whose employment isn't in the usual course and scope of the employer's business**
- **Anyone doing something illegal—like diamond smugglers (for example)**

2. Definitions

Here are some terms and concepts relevant to Workers Compensation and Employers Liability:

A. Occupational Disease

An occupational disease is a medical condition someone gets from their job. For example, people who work with dangerous chemicals are exposed to potentially lethal toxins. If they aren't properly protected, they can end up with cancer, and/or other degenerative diseases. Such diseases would be considered occupational diseases.

Note: The burden of proving an occupational disease is on the person requesting the benefits.

B. Subsequent/Second Injury Fund (SIF)

The SIF was originally set up after World War 2 to encourage employers to hire veterans suffering from permanent disabilities.

The SIF makes 2 types of payments:

- 1) Payments to injured workers who qualify for life-long benefits**

2) Reimbursements to insurance carriers who've been making Workers Compensation payments, but now the case is being amended or disputed

The SIF is funded by unclaimed death benefits. If someone dies and they don't have any beneficiaries, that money goes into the SIF.

C. Exclusive Remedy

This means that Workers Compensation is the only way someone can be compensated for work-related injuries (if they're covered by Workers Compensation, that is). They can't collect their Workers Compensation payment and then sue.

The only time a lawsuit could happen is if the injury and/or work-related death happened because the employer did something very wrong: either did something intentionally, or made a major mistake. The term for this is Gross Negligence.

D. Elimination Period

Workers Compensation doesn't start until someone has been disabled by a work-related injury for more than 3 days. After the employee has been disabled by the injury for more than 14 days, they start receiving Workers Compensation retroactively: that is, they are compensated for the elimination period.

E. Filing a Claim

Once an employee or employer files a claim for Workers Compensation, the administrator has 30 days to respond to that claim. Within those 30 days, the administrator has to make contact with the injured party to inform them of their rights and benefits.

F. Employee's First Notice of Injury

After an employee suffers an injury, they have 30 days to report the injury. This should be done in a couple of different ways:

- 1) The employee should give their employer oral or written notice of the injury ASAP.**
- 2) The employee should go to a physician for an examination ASAP.**

If the employee fails to report the injury within 30 days, it's concluded that the injury is non-work-related, and the employee is no longer eligible for Workers Compensation benefits.

Note: If a person waits longer than 30 days to report the injury, they can still refute the claim or conclusion that their injury is non-work-related. At that point, however, they have to provide a lot of evidence that they should still be eligible for Workers Compensation.

G. Claim Payments

After the employer receives the first notice of injury, and if the injury isn't disputed, payments have to start within 20 days.

H. Subrogation

Once the insurer pays a Workers Compensation claim, the insurer can go after the responsible party for recovery of payment.

Note: You've run into subrogation before. Just don't be surprised if it crops up in a few Workers Compensation questions.

J. Work-Related versus Non-Work-Related

Work-Related **injuries are injuries that happen while the employee is:**

- Working on the premises
- Taking a scheduled break
- In transit between job sites

Non-Work-Related **injuries are injuries that happen while the employee is:**

- **Not working**
- **Loafing around**
- **Driving to and from work**

3. Styles

Workers Compensation is always either:

- Compulsory/Mandatory, **meaning it's required by law**
- Elective, **meaning the company can choose whether or not to have Workers Compensation coverage**

A. Types of Workers Compensation Coverage

There are 3 ways an employer can obtain Workers Compensation coverage:

- 1) Obtain Workers Compensation from a private company**
- 2) Obtain Workers Compensation from a state fund**

Note: *The California State Compensation Insurance Fund, which is also referred to as the State Fund, is an insurer run by the state. The state fund competes with private insurers within the insurance marketplace, for Workers Compensation business. Sometimes, if someone can't obtain Workers Compensation insurance through private sources, they'll go to the state fund as a last resort. Despite that, the state fund is still considered competitive with the private insurers. Workers' compensation through the State Fund can be purchased direct or through an agent/broker that has an established business relationship with State Fund.*

3) Self-insurance

4. Benefit Categories

There are specific rules about how much an injured party will get and for what kind of situation. There are 4 benefit categories that Workers Compensation covers:

- 1) Total Disability means the employee—due to work-related injury or disease—will never be able to return to their normal job.**
- 2) Temporary Partial Disability means the employee can do most of their usual duties because the injury isn't that**

serious. Compensation pays the difference between the employee's pre-injury and post-injury wages.

- 3) Permanent Partial Disability means the injuries don't result in an inability to do the work, but the injuries aren't temporary. This includes loss of hearing, sight, or a limb.**
- 4) Temporary Total Disability means the injured person can't work at all for a limited period of time. Lost wages are paid on a scheduled basis.**

Part C: Federal Regulations and Self-Insurers

1. Federal Workers Compensation Laws

The following laws are significant because they've either changed or affected Workers Compensation and Employers Liability:

A. Federal Employers Liability Act (FELA) [45 USC 51-60]

FELA protects employees of interstate railroads.

The act allows injured railway workers to sue their employers for negligence, and employers aren't allowed to use certain Common Law Defenses. In fact, the Supreme Court ruled that applying Common Law Defenses to situations involving injured railway workers was an act of "judicial hostility."

Contributory Negligence was completely abandoned in favor of Comparative Negligence, meaning the

percentages of fault are taken into account when assessing damages.

FELA also made it difficult for railway employers to claim the Fellow Servant/Employee Rule, because railway work was considered so inherently dangerous. If the railway employed incompetent people, or had people working dangerously long shifts, the railway was ultimately responsible for any resultant injuries.

Even though the law was passed in 1908, railroad employees still favor the law over Workers Compensation benefits, because the benefits offered under FELA are substantially better.

B. US Longshore and Harbor Workers Compensation Act [33 USC 904]

This act covers employees who build, repair, load or unload vessels. The US Longshore and Harbor Workers Compensation Act provides better protection to injured workers than state law.

If an employer is eligible for the US Longshore and Harbor Workers Compensation, the employer can add an endorsement to the state Workers Compensation policy to comply with federal law.

C. The Merchant Marine Act/Jones Act [46 USC 688]

The Merchant Marine Act / Jones Act protects captains and crews of ocean-going ships.

This act allows an injured seaman to sue their employer for damages and to have a jury trial. The injured worker is also entitled to the following benefits:

- **Wages**
- **Transportation**
- **Maintenance**
- **Cure**

This is very similar to normal Workers Compensation benefits, except with the Merchant Marine / Jones Act there aren't any caps put on maximum wage loss.

Insurance can be obtained by attaching a Maritime Coverage endorsement to the Employers Liability coverage.

2. Self-Insurers

Sometimes with Workers Compensation, companies decide to insure themselves instead of going through an insurance company. The company decides it would rather retain the risk than pay premiums.

In order to be self-insured, the company has to get permission from the state. In order to get permission, the company has to:

- **Prove it's financially capable of retaining the risk**

- **Adopt required safety features and procedures**

A. The Necessary Elements of Self-Insurance

For self-insurance to be a possible option, these 2 elements have to be present:

- 1) The exposures have to be large enough for accurate loss prediction**
- 2) Losses have to be “pre-funded,” based on that prediction**

B. Stop-Gap Insurance

Sometimes a company will also have to purchase Stop-Gap insurance if they’re going to be self-insured. Stop-Gap insurance covers any losses that are above what the company can handle. This keeps the company from being crippled by any catastrophic losses.

3. Noteworthy Aspects of California Workers Compensation

There are several significant aspects to the California code regarding Workers Compensation, that you should know:

A. Twenty-Four Hour Coverage

This coverage combines Workers Compensation with Health insurance to cut back on the administrative costs and paperwork required for an employer to have two separate policies. Twenty-Four Hour coverage has been around since 1995, but the insurance industry is still working out the kinks: there have been some problems

with overlapping coverages and coordinating deductibles, copayments, etc.

B. The California Open Rating System

January 1, 1995, the Workers Compensation market was deregulated in California. This means that insurers can determine their own premium rates as long as they notify the California Department of Insurance.

C. Experience Modification Rating System

This means an insurer could raise or lower Workers Compensation premiums based on a company's loss experience. If the company has more losses, their premiums may go up. If a company has less losses that are less than what was predicted for the year, their premiums will go down.

D. Misrepresenting Payroll Amounts

If an employer misrepresents their payroll, it means the premium amount has been incorrect for however long the Workers Compensation has been in effect. The penalty for this could be up to 10 x the difference between the lower premium and the correct premium.

Exclusions: Workers' compensation coverage does not cover federal workers' compensation or employer liability issues related to legislation such as the Jones Act, USL&H and the Defense Base Act. For the most part, these laws require employers to provide liability protection for employees in non-traditional workplaces like the open sea or overseas (see Chapter 6).

Summary

Workers Compensation and Employers Liability is very significant. Work-related injuries are so common, and people need the financial protection to keep an injury from destabilizing the finances of an employee's family or a company. This insurance is designed to protect anyone who is at all affected by the commercial world (employers, employees, dependents)—and that's just about everybody.

Section PC 13

HOMEOWNERS INSURANCE VALUATION

Objectives

Agents selling homeowners insurance in California must take specific 3-Hour training (Homeowners Insurance Valuation) BEFORE soliciting ANY homeowner insurance business. This training was deemed necessary after the recent fires in California found many homeowners grossly underinsured. The Department of Insurance, now requires that agents have an understanding of home values in order to better help clients establish reasonable replacement cost coverage. This unit gives you some of the general concepts in homeowner insurance valuation, including:

- Introduction to Homeowners Valuation
- AB 2022
- Homeowner vs Dwelling Policies & Coverages
- Concepts of Property Valuation
- California's Residential Property Disclosure Form
- Loss Mitigation
- Property Valuation Tools

INTRODUCTION

A home often represents the largest investment its owner will ever make. Its contents include the most important possessions of its residents. Within these two reasons alone is enough motivation for

most people to purchase insurance to protect their home and property. Add to these motivating factors that most mortgage arrangements require some form of homeowners coverage and the result is that homeowners insurance is one of the most common forms of insurance purchased.

In assisting applicants and insureds in this decision, agents are charged with advising on the type and limits of this insurance coverage. One of the most controversial elements in this coverage in recent years has been replacement cost endorsements. The term itself may have led to many consumers believing they were fully covered when, in fact, the values of their home have been underinsured.

This was demonstrated during one of California's worst fire seasons . . . between 2007 and 2008 . . . where nearly one million people were forced to evacuate their homes. Approximately 1,500 homes were destroyed statewide. Many were grossly underinsured. In fact, a Marshall & Swift/Boeckh's 2008 survey reported that 64 percent of U.S. homes are undervalued for insurance purposes, with the average homeowner having enough insurance to rebuild only about 81 percent of his dwelling. For most families, this is a major problem.

A Word On Underinsurance In California & AB 2022

The sheer volume of underinsured homes after the California fires has led to the crafting and passage of **AB 2022** . . . effective 7/1/11 . . . which revises the California ***Residential Property Disclosure Form***

(see sample language below), making it more accurate and easier for consumers to read and understand their coverage by laying out a checklist of major variables in their policy as well as improved and more responsive claims handling practices. Applicants and insureds choose from among actual cash value, replacement cost and guaranteed replacement cost forms of coverage. Agents or insurers must indicate on the disclosure form which category of coverage the applicant or insured has selected or purchased.

AB 2022 also simplified and revised the ***California Residential Property Insurance Bill of Rights*** (see sample language below) which explains the ***legal rights*** a consumer has when a loss has occurred.

The law mandates that the Disclosure and Bill of Rights be sent out with every newly-issued residential property insurance policy and on an every-other-year basis upon renewal. The goal of both this new legislation is to reduce underinsurance by providing consumers reliable estimates of what it might cost to completely rebuild a destroyed home. Until now, such estimates were previously unregulated.

AB 2022 also requires:

- All California resident fire and casualty broker-agents and personal lines broker-agents who have not already done so to satisfactorily complete one, three-hour training course on homeowners insurance valuation (this course) prior to estimating the replacement value of structures in connection with, or explaining the various levels of

coverage under a homeowners' insurance policy. Agents need to take this course on or before 6/30/11 before discussing (soliciting) dwelling fire or homeowners' insurance.

- Insurers, agents and brokers that provide replacement cost estimates to applicants and insureds must document who created the estimate and the sources or methods used to calculate the replacement cost estimate. **Note:** CCR 2695.183 does not require agents to conduct their own replacement cost estimates. A company provided system or outside sources like appraisers can be utilized to satisfy the replacement cost requirement.
- All replacement cost estimates communicated to applicants or insureds be complete, based upon specifically enumerated standards.
- Records must be kept on the name, job title, address, phone and license number, if applicable, of the person providing the estimate of replacement cost or construction costs or the source of the estimate, e.g., an online replacement cost calculator, contractors' estimate, appraisal, etc.
- Agents who provide the estimate of replacement cost must give the insured a copy at the time the policy limit is set and maintain records of this estimate for the entire term of the insurance policy PLUS five years thereafter. Any changes or updates to the replacement cost estimate must be provided to the applicant or insured within 60 days from the time it is generated. If an estimate

was made but a policy never issued, estimate records must be kept for three years. (CCR 2695.182)

- Replacement cost estimates MUST NOT include a cost associated with **demand surge** . . . where the construction costs can dramatically increase after a major catastrophe. Agents should disclose to potential insureds that this demand cost has not been and legally cannot be taken into account in the estimate of replacement cost (CCR 2695.183). Agents can, however, apprise customers that additional coverage may be obtained to protect for this contingency (extended guaranteed replacement cost).
- Licensees who provide estimates of replacement cost or rely on estimates of others in regard to a recommended homeowner insurance policy MUST be sure the estimate includes all expenses that would reasonable by incurred to rebuild the insured structure in its entirety, including, but not limited to (CCR 2695.183):

Type of foundation

Type of frame

Roofing materials and type of roof

Siding materials and type of siding

Whether structure is on a slope

Geographic location of property

Number of stories

Materials used in, and types of, interior features and finishes

Cost of demolition and debris removal

Architects plans

Age of structure

Higher costs associated with replacing a single home versus multiple dwellings

The replacement estimate ***should not***:

Be based on resale value of the land or the outstanding balance of any loan

Include a deduction for physical depreciation

- An agent that provides an applicant or insured a copy of a replacement cost estimate that does not meet the above standards shall explain exactly what elements above it does not address and why.
- When an insurer requires an agent utilize a specific source or tool to create an estimate of replacement cost or construction costs the following must be followed:
 - ✓ The insurer shall prescribe procedures to be followed when they use the source or tool
 - ✓ The insurer will provide the agent training to properly use the tools or source
 - ✓ The insurer and not the agent will be responsible for any noncompliance

Many of these issues are discussed in greater detail throughout this course.

Underinsurance and Agents / Insurers

In a perfect world, every replacement cost estimate you do will be accurate and result in all your insureds being fully covered in a major disaster. Of course, this doesn't always happen.

What happens if your estimate is wrong and, more specifically, the homeowner is found to be underinsured in a major loss?

Before AB 2022, the general rule was that an insured is responsible for the establishment of their policy limit and an insurance agent or broker did not have a duty to volunteer that an insured should procure additional or different insurance coverage (*Fitzpatrick v. Hayes*, (1997) 57 Cal.App.4th 916 [67 Cal.Rptr.2d 445].)

Exceptions to this rule evolved over time:

Jones v. Grewe (1987)

In *Jones*, the court determined that an insurance agent could *not* be held liable for failing to obtain sufficient limits on a *third-party* liability policy. The *Jones* court reasoned that an agent could not accurately forecast the upper limit of liability insurance that the insured would need and further noted that extending liability to agents for not obtaining sufficient liability limits would effectively transform the agent into an excess insurer.

Free v. Republic Insurance Co (1992)

In this case, the insured asked his broker whether the policy limits would be sufficient to cover his home in the event of a total fire loss, and the broker represented that he was **fully insured to value**. When the insured was determined to be underinsured after a loss, the broker was held liable. In so ruling, the *Free* court made a distinction between misrepresentations about limits on *first-party* property coverage as opposed to misrepresentations on *third-party* liability coverage as was involved in *Jones*. The *Free* court reasoned that in a *first-party* setting, an agent or broker *can* objectively determine the amount of coverage necessary to replace a dwelling after a total loss which was the basis it distinguished itself from *Jones*, which as stated above dealt with third party liability limits.

Desai v. Farmers (1996)

Here, the insured advised his agent that he wanted **100 percent coverage** for his dwelling in the event of a total loss. However, the policy that was delivered to the insured only provided for coverage up to \$150,000, and there was no Guaranteed Replacement Cost benefit. After the Northridge Earthquake, the cost to repair the insured dwelling was \$546,757. The Court held that the agent could be held liable because the agent “negligently represented that the policy in fact provided the 100 percent replacement cost coverage that [plaintiff] demanded ... This is not a ‘failure to recommend more coverage’ case; it is a ‘failure to deliver the agreed-upon coverage’ case” (*Id.* at 1119 (Emphasis added).)

Fitzpatrick v. Hayes (1997)

In this case, the court analyzed the history of authorities dealing with liability of agents and brokers for under-insurance as reflected, among other cases, in *Jones*, *Free*, and *Desai*. The *Fitzpatrick* case then summarized and set forth the three recognized exceptions under California law to the general rule of no liability of agents and brokers for under-insurance as follows: As a general proposition, an insurance agent does not have a duty to volunteer to an insured that the latter should procure additional or different insurance coverage....The rule changes, however, when - but only when - one of the following three things happens:

- a) The agent misrepresents the nature, extent or scope of the coverage being offered or provided;
- b) There is a request or inquiry by the insured for a particular type or extent of coverage; or
- c) The agent assumes an additional duty by either express agreement or by “holding himself out” as having expertise in a given field of insurance being sought by the insured.

Agents & Home Values In The Real World . . .

In all of these cases, the focus was generally on whether the agent **represented** to the insured that the limits were sufficient; whether the insured specifically asked about the sufficiency of the limits; and/or whether the insured requested that he/she be fully covered and protected, etc.

So the issue is not whether the agent **guaranteed** that the estimate was sufficient, but rather, whether through interaction with the insured the agent misrepresented the adequacy of the limits or failed to deliver upon the full protection requested. There are also cases where the insured never spoke with the agent or broker about the policy limits. Because, in some cases, insureds blindly rely upon the agent to set sufficient limits without ever questioning or discussing it. Here, an attorney might attempt to prove the insured relied on the agent or perhaps the agent held himself out to be an expert in homeowners insurance.

What about new computer programs and tools to estimate value? They may help protect the agent / insurer because they are reliable third party sources, but if the homeowner still asks **will it provide full protection** and the agent affirms adequate coverage, liability continues with the agent / insurer under Fitzpatrick even where the agent **never guaranteed** that the limit would be sufficient and that any proposal they made about the policy limit was “just an estimate.” Plaintiff attorneys will also likely attempt to poke holes in the quality of the valuation tools (estimates way off track, faulty calculations, etc) or use agent language that praised the tools as “accurate” or “backed by millions of dollars of research” to pursue an underinsurance claim.

There could also be language in the actual policy that implicates liability of the insurer. Here is one such example:

The limit of liability shown on the Policy Declarations for ‘Coverage A – Dwelling Protection’ will be revised at each policy anniversary to reflect

the rate of change in the replacement cost of your dwelling as identified in the Policy Declarations.

This carrier has contractually obligated itself to increase the policy limit to keep pace with the rate of change in the replacement cost of the dwelling. This could be yet another basis for liability in an under-insurance case.

Everett v. State Farm (2008)

In a reversal of many of the above cases, in *Everett* the court held that the homeowner, rather than the property insurer, had the duty to maintain insurance policy limits equal to replacement costs. In reaching this conclusion, the court relied on the current version of the residential property disclosure which places the burden of determining whether a higher policy limit is needed on the homeowner.

The ***passage of AB 2022***, however, appears to effectively ***nullify Everett***. Pending new litigation, it looks like the liability ball is back in the agent-insurer court. Agents / insurers must determine replacement cost value.

HOMEOWNERS VS. DWELLING POLICIES

To understand how new valuation rules apply, we need to differentiate between homeowner and dwelling policies.

Under California Insurance Law (10087) a ***policy of residential property insurance (homeowners policy)*** shall mean a policy insuring ***individually owned residential structures of not more than four dwelling units***, individually owned condominium units, or

individually owned mobilehomes, and their contents, located in this state and used exclusively for residential purposes or a tenant's policy insuring personal contents of a residential unit located in this state."

A policy of residential property insurance, as defined, shall not include insurance for real property or its contents if used for any commercial, industrial or business purpose, except a structure of not more than four dwelling units rented for individual residential purposes. A policy that does not include any of the perils insured against in a standard fire policy shall not be included in the definition of "policy of residential property insurance."

Dwelling policies differ from homeowners in that they typically do not cover liability, medical payments or contents. They are designed for a residence owned by an insured that he or she does not occupy.

HOMEOWNERS VS. DWELLING COVERAGE

Homeowners Coverage

Homeowners need protection from **3** major risks:

- 4) Damage or destruction to the house
- 5) Damage or destruction to personal property
- 6) Liability (and any lawsuits)

Homeowner policies (HOPs) are designed to protect a person or family against the **3** above risks. Whether an insured owns or rents a home, a HOP provides valuable and necessary protection.

Most insurance companies offer Homeowners Package Policies that provide coverage for all the risks. Besides combining coverages for the dwelling, personal property, and personal liability, the HOPs also include **fire**, **theft**, and **vandalism**, along with other extended and additional coverages.

HOPs cover any and all common problems associated with owning or renting a home. The HOP is also more complete and convenient than the dwelling policy (DP), which is why Homeowners Package Policies are more popular. The coverage definitions and policy contract terms are similar between the HOP and the DP.

Not only do HOPs offer “one-stop shopping” coverages, the packages are often priced more competitively than the DPs. In order to protect competitive pricing, insurance companies look for clients who are “better-than-average” risks, e.g., clients who show pride of ownership and live in preferred dwellings.

A client must meet the following eligibility guidelines for an HOP:

- The house has to be occupied by the owner with a maximum of **2**-family units (remember the DP allows up to 4-family units)
- The home has to be inspected to make sure heating, plumbing, and electrical systems meet state codes, and are installed properly.
- The owner has to be checked for his/her “loss history”—the number and type of insurance claims he/she has filed in the past.

- Property is inspected for Pride of Ownership—is the house in good condition? Is the house well-constructed? Is the landscape well-kept? Are there any uninsurable risks on the premises?
- The house is a residential property, and is never used for commercial purposes.

Dwelling Coverage

Dwelling insurance is used more frequently for landlord (tenant) properties and homes that don't qualify for "standard" or "preferred" homeowners insurance policies.

Dwelling policies are similar to homeowners policies. Both provide property insurance for:

- Residential dwellings and contents
- Appurtenant structures/other structures on covered premises
- Loss or damage to the dwelling

Eligible and/or ideal Dwelling policy properties are:

- Rental properties (1-4 units or apartments)
- Older and/or lower-valued homes
- Homes with minor cosmetic problems
- Homes with a market value that's below replacement cost
- Customers with credit and/or loss problems
- Dwellings under construction, vacation homes, or rentals
- Permanent mobile homes—a mobile home that isn't on wheels
- Offices, studios, or storage facilities

Under certain circumstances, an insured could prefer a Dwelling policy (DP) over a Homeowners policy (HOP). Such as:

- The property is vacant
- The insured isn't living in the dwelling, but could be renting it
- Up to five roomers or boarders occupy the dwelling
- The dwelling is rated poor to good based on condition, value, and age
- The insured is required to only carry coverage protecting the dwelling

BASIC CONCEPTS OF PROPERTY VALUATION

Loss Settlement Provisions & Underinsurance

Loss settlement provisions in homeowner policies define the method that will be used to determine the **amount of money** the insured will receive for a claim.

Usually this provision stipulates that claims will be paid on an actual cash value (ACV) or replacement basis. This provision also determines how claims will be paid per item, per loss, e.g., items A, B, and C are all covered on an ACV basis, but items X, Y, and Z are covered on a replacement basis.

Here is how a typically replacement cost loss settlement provision might read:

If, at the time of loss, the amount of insurance in this policy on the damaged building is 80% or more of the full replacement cost of the building immediately before the loss, we will pay the cost to repair or replace, after application of any deductible and without deduction for depreciation, but not more than the least of the following amounts:

- 1) The limit of liability under this policy that applies to the building;*
- 2) The replacement cost of that part of the building damaged with material of like kind and quality and for like use; or*
- 3) The necessary amount actually spent to repair or replace the damaged building.*

How Do Loss Settlement Provisions Apply?

In the homeowners form, the loss settlement provision cited above is used specifically to determine whether the insured gets full replacement cost (RC) for the loss. If the proper amount of coverage is carried, the insured gets a full RC settlement up to policy limits. If coverage is not sufficient, the policy provision goes on to state that the insured will either receive a proportionate amount of the RC or the full ACV, whichever is greater.

Unlike commercial "coinsurance," the HO program has no "penalty." The insured, assuming adequate limits to cover the amount of loss, always gets a minimum of the full ACV, with a maximum of full RC.

So our question above is not about penalties, but simply whether the insured can expect a full RC settlement of his "other structure" loss (or losses). Let's take the policy language exactly as written and walk through a possible scenario.

The insured has \$300,000 of Coverage A. He has three "other structures" covered by his policy: a \$27,000 detached garage, a \$5,000 gazebo and a \$20,000 swimming pool. (There are a myriad of other possibilities, such as mailboxes, satellite dishes and kid's playground equipment, but we don't want to get bogged down in a debate over whether some consider those Coverage C instead of Coverage B.)

If the garage is damaged by a covered peril, how should the policy loss settlement provision be applied?

The key wording is "If, at the time of loss, the amount of insurance in this policy on the damaged building is 80% or more of the full replacement cost of the building immediately before the loss...".

Assuming that "building" is to be read, for Coverage B purposes, as "structure", the clear language states that the limits of insurance are to be applied to the specific structure (singular) damaged. So the question becomes, "Is \$30,000 (the coverage B limit provided by \$300,000 Coverage A) at least 80% of the value of the garage? Yes, it is. The insured gets a full RC settlement for the garage damage.

Since no policy language states or implies that for purposes of the settlement clause the values of all the other structures must be added together to calculate the compliance with the 80% provision, the clear language must be taken as is. The amount of insurance available on the damaged structure is the route to take.

Does it make a difference whether multiple "other structures" were damaged? Although it can be argued that the situation would then be less clear, we don't think so. The policy language appears to allow the settlement provision to be applied similar to a "separation of insureds" clause-to each damaged structure as if the others didn't exist. So if all three other structures in our example were damaged, the insured could argue that each is in full compliance with the loss settlement provision, since the \$30,000 Coverage B limit is more than adequate to meet the 80% test for each structure.

If such an analysis seems overly generous to the insured, keep two things in mind: First, we aren't arguing coverage, only whether the insured gets an RC settlement or ACV for a covered claim. Second, as in the "separation of insureds," this doesn't increase the carrier's liability. It is still limited to a total of \$30,000, no matter how many damaged structures the insured adds to the claim.

Does it make any difference if the insured increases Coverage B, either in blanket fashion or by specific coverage for certain structures by endorsement? Barring specific language in the endorsements modifying the basic policy loss settlement provision, no. Adjust each structure separately and let the RC limits fall where they may.

Underinsurance and Settlements

The obvious result of underinsuring a home is the inability to replace it. At actual cash value, the homeowner receives less when depreciation is factored. Even if the homeowner purchased replacement cost coverage, all may not be well at settlement time. As we discussed above, replacement cost policies typically contain a co-insurance clause. The coinsurance clause may require a homeowner to insure the property in question for at least 80% of its replacement cost. Replacement costs can fluctuate over the course of an insurance policy. So, for a \$300,000 home, one would be required to carry at least \$240,000 in coverage for the dwelling.

If a homeowner insured his home for only \$150,000 because that's all he owed on the mortgage, and suffered a total loss, he would incur a financial penalty for having it underinsured. The penalty usually consists of having to cover a certain percentage of the underinsured

portion of the home value. However, the settlement it is never less than actual cash value. This clause protects the insurance company from issuing replacement cost policies where the home is insured for much less than it would cost to rebuild.

Some insurers offer an endorsement (extra addition) to their homeowner's insurance policy that add an additional 25% to 50% replacement cost coverage in the event it's necessary. This is often referred to **as extended replacement cost**. Applied to the case above, the \$300,000 home would qualify for an additional \$75,000 in replacement cost coverage if one chose the 25% extended coverage. So if it costs \$350,000 to rebuild this home exactly the way it was, this homeowner would be covered. Of course, this option costs a little more.

Actual Cash Value vs. Replacement Cost Value

The terms "replacement cost" and "actual cash value (ACV)", are loss valuation methods insurance companies use to determine how much money they will pay out in the event of a covered cause of loss (claim) after any deductible is applied.

NOTE: Replacement cost for a home and for the contents of your home are two different policy endorsements. If one wants personal items to be replaced at their cost to purchase new, he must request that separately.

The best way to discuss replacement cost and actual cash value is by a settlement example. Let's say the cost to build a home is \$400,000. Unfortunately, it burns down as a result of an electrical fire caused by

a clothes dryer. How the homeowner is reimbursed differs by the loss settlement method he agreed to and paid for:

Actual Cash Value Settlement

If the homeowner purchased ACV coverage, he (and the lender if he had a mortgage) would be paid the actual cash value of the home at the time of the loss. ACV is calculated as the replacement cost of the home minus depreciation. Depreciation is the loss in value of a piece of property over time.

**\$400,000 replacement cost – \$100,000 in depreciation =
\$300,000 ACV**

He would receive a check for \$300,000. Of course, the lender gets their share of the money first. You can easily see how the homeowner would not receive enough money to rebuild his \$400,000 home. In fact, he'd be exactly \$100,000 (how much his home depreciated since its purchase) short. This is not a good position to be in.

Likewise, if the ACV was \$300,000, and he owed \$350,000 on the mortgage, he would be stuck with a \$50,000 bill owed to the lender. This is why mortgage lenders often require replacement cost coverage on a mortgaged home.

A home typically costs quite a bit more to rebuild than it did when one originally purchased or built it. Likewise, homes are often built in large numbers in certain developments, which drives down the construction costs. So, having to rebuild only one home is likely to cost more. For this and other reasons, homeowners purchase a replacement cost policy.

Replacement Cost Value Settlement

Had the above homeowner purchased replacement cost coverage, he would receive the entire \$400,000 in the event his home burned down. The depreciated value of the home is not a factor in the settlement received from your insurer.

California Residential Disclosure

The new disclosure form, drafted in plain and simple language, improves the current form and makes understandable the differences in residential insurance coverages available to California insurance consumers. The changes, however, are much more than stylistic.

Residential Property Insurance Disclosure Statements

Starting in July 1993, every residential property insurance policy must provide the insured a copy of the California Residential Property Insurance Disclosure Statement and a California residential Property Insurance Bill of Rights. In July 2011, AB 2022 modified these forms to reflect new homeowner insurance valuation requirements. It is important to note that these disclosure forms must accompany policies you deliver to your clients.

The regulations establish standards for accurate replacement cost estimating, broker agent training on replacement cost estimating, and new record keeping requirements. The Proposed Regulations place the burden of accurately estimating replacement value of a home squarely with the insurer and agent. The new disclosure form, the first step

towards this regulatory reform, removes critical language found in the current disclosure form that obligates the consumer to determine and maintain the proper policy limits on their home.

PART 1

California Residential Property Disclosure Form . . . Effective July 1, 2011

Effective **July 1, 2011**, insurance companies must use the new disclosure form. The new form eliminates legalese and presents the different coverage levels in a reader friendly manner. The new form calls specific attention to the fact that “actual cash value” coverage is “the most limited level of coverage listed,” while “guaranteed replacement cost” coverage is “the broadest level of coverage.” The new coverage definitions are as follows:

- **ACTUAL CASH VALUE COVERAGE** pays the costs to repair the damaged dwelling minus a deduction for physical depreciation. If the dwelling is completely destroyed, this coverage pays the fair market value of the dwelling at the time of loss. In either case, coverage only pays for costs up to the limits specified in your policy.
- **REPLACEMENT COST COVERAGE** is intended to provide for the cost to repair or replace the damaged or destroyed dwelling, without a deduction for physical depreciation. Many policies pay only the dwelling’s actual cash value until the insured has actually begun or completed repairs or reconstruction on the

dwelling. Coverage only pays for replacement costs up to the limits specified in your policy.

- **EXTENDED REPLACEMENT COST COVERAGE** is intended to provide for the cost to repair or replace the damaged or destroyed dwelling without a deduction for physical depreciation. Many policies pay only the dwelling's actual cash value until the insured has actually begun or completed repairs or reconstruction on the dwelling. Extended Replacement Cost provides additional coverage above the dwelling limits up to a stated percentage or specific dollar amount. See your policy for the additional coverage that applies.
- **GUARANTEED REPLACEMENT COST COVERAGE** covers the full cost to repair or replace the damaged or destroyed dwelling for a covered peril regardless of the dwelling limits shown on the policy declarations page.
- **BUILDING CODE UPGRADE COVERAGE**, also called Ordinance and Law coverage, is an important option that covers additional costs to repair or replace a dwelling to comply with the building codes and zoning laws in effect at the time of loss or rebuilding. These costs may otherwise be excluded by your policy. Meeting current building code requirements can add significant costs to rebuilding your home. Refer to your policy or

endorsement for the specific coverage provided and coverage limits that apply.

The new disclosure form also **removes** the following statements from the replacement cost coverage definitions in the current disclosure form:

To be eligible for [this coverage], you must insure the dwelling to its full replacement cost at the time the policy is issued, with possible periodic increases in the amount of coverage to adjust for inflation and increases in building costs; you must permit inspections of the dwelling by the insurance company; and you must notify the insurance company about any alterations that increase the value of the insured dwelling by a certain amount (see your policy for that amount)."

To be eligible to recover this benefit, you must insure the dwelling to [company shall denote percentage] [] percent of its replacement cost at the time of loss."

The agent or insurer shall indicate on the disclosure form which category of coverage the applicant or insured as selected or purchased (CIC 10102).

California Residential Property Insurance Bill of Rights . . . Effective 7/1/11

The revised bill of rights that must accompany the new disclosure form eliminates the first 16 lines of the current disclosure form. The omitted lines include statements concerning the applicant's/policyholder's burden to determine and maintain proper policy limits such as: *"Take time to determine the cost to rebuild or replace your property in today's market."* *"Once the policy is in force, contact your agent or*

insurance company immediately if you believe your policy limits may be inadequate.”

Depreciation and Claims

As previously discussed, actual cash value is replacement cost less depreciation. The entity responsible for determining the depreciation is ultimately the insurance company. They decide the amount of depreciation and will subtract that amount from the cost to repair the property. The rate will stand as they decide unless a homeowner challenges their calculations . . . some do.

The way these rates are determined is through published depreciation tables. These tables list the useful life and depreciation of a wide variety of properties. Such depreciation tables can be accessed through most insurers and may even be found online. More often than not, home insurance adjusters, and their claims departments, have computer software that has the insurance depreciation tables factored in. Such software makes figuring depreciation very easy and almost error free. The insurance adjuster simply fills in the type of property, its condition and its age and the software figures the depreciation automatically.

California Claims

California law is very specific on the handling of dwelling claims:

California Insurance Code 2051.5

Under an open policy that requires payment of the replacement cost for a loss, the measure of indemnity is the amount that it would cost the insured to repair, rebuild, or replace the thing lost or injured,

without a deduction for physical depreciation, or the policy limit, whichever is less. If the policy requires the insured to repair, rebuild, or replace the damaged property in order to collect the full replacement cost, the insurer shall pay the actual cash value of the damaged property, as defined in Section 2051, until the damaged property is repaired, rebuilt, or replaced. Once the property is repaired, rebuilt, or replaced, the insurer shall pay the difference between the actual cash value payment made and the full replacement cost reasonably paid to replace the damaged property, up to the limits stated in the policy.

The process of retaining a portion of the claim until work is down is called **depreciation holdback**. It is a fairly standard practice in replacement cost policies. The concept is relatively simple: Policies obligate insurers and they are liable for such costs until repair or replacement had been completed. To be sure this is done, the insurer will **holdback** an amount until repairs are made. The amount held back is typically the difference between actual cash value and the replacement cost. In essence, they holdback the amount of the depreciation, thus it is called the depreciation holdback. Homeowners are often frustrated in learning this as they are now charged with the task of completing repairs without the full amount needed to make them. However, most contractors understand the holdback concept and will work with homeowners to finish repairs and wait for their full payment until the homeowner has received the holdback amount.

Again, the values we are discussing with regard to claim valuations is replacement cost and actual cash value **not** market value. The market value of a property may be completely different than replacement cost or ACV.

LOSS MITIGATION

Loss mitigation is the process of reducing insurance claims before they happen. This can be accomplished in a number of ways as you will learn below.

Insurance Agents & Loss Mitigation

Insurance agents practice loss mitigation when they provide tips to their clients on ways to avoid claims. It is important to know, however, that an agent must never use language or strategies designed to talk a client out of filing a claim, .e.g, if you file a claim your rates will increase or you will be cancelled. Under the law, insureds must be free to file claims at will.

Loss of life, property, and resources due to California Wildland Urban Interface (WUI) land fires can be reduced if planners, developers, fire agencies, and homeowners work together to define, enforce, and maintain reasonable fire safety standards. Reducing or removing fire hazards in the WUI requires an assessment of potential risks, programs and standards for fire safety, and fuel management. These three sets of activities may be conducted at national, state, local or individual levels.

Risk and Hazards

Despite the availability of programs and options for reducing hazards, there are many barriers to fire mitigation. Even in areas prone to wildfires, many residents prefer to wait for the event to occur and then respond, rather than take precautions to minimize risk. WUI residents

may even deny that a wildfire is likely to occur or discount its potential impact. Some people feel that WUI fires are inherently uncontrollable and the resulting damage is essentially random, resulting in little support for investments in firefighting infrastructure and steps to safeguard their properties. If a home is destroyed, insurance spreads the costs among a large group of people, encouraging continued residence in high-risk areas. Several insurance companies are beginning to withdraw coverage if high risk factors are not corrected. It is unfortunate that actually experiencing a wildfire may be the only modifier of risky behavior.

Some of the more widely know risks include:

Topography

Hills, brush, wetlands, rocks and more inhibit the ability of fire responders and rescue. These are the same issues that make properties difficult to maintain and escalate replacement costs.

Fuel Management

Fuel management modifies the hazard posed by vegetation and structures by:

- Reducing the available fuel (dead and living) in broad areas using prescribed fire or other methods .
- Creating defensible space by converting the vegetation to a less-flammable type and distribution that is less hazardous

Fuel reduction techniques are used to decrease hazardous fuels (i.e., flammable vegetation). Fuel management is especially critical in forest ecosystems located adjacent to residential areas because of the

increased risks to people and property, enhanced resource values, and the increased difficulty of fire control and suppression. Fuel modifications may be broadcast across large areas, applied to small selected lots, or designed as strips of various widths to impede fire spread into a developed area such as:

- **Prescribed burning** is the careful application of fire to achieve land management goals. Fire is a natural component of most ecosystems that encourages the growth of some native plants and enhances wildlife habitat in addition to reducing accumulated fuels. Prescribed fire can usually be completed at comparatively low-cost. Disadvantages to using prescribed fire include smoke management and public health issues, limitations on the number of acres that can feasibly be burned each year, the necessity for repeat treatments as vegetation grows back, and the risk of fire escapes. Smoke problems from a prescribed burn in the wildland urban interface are minimized by burning during favorable, daytime, smoke dispersal conditions.
- **Herbicides** have longer lasting effects on the vegetation than other methods, and they may be the only treatment for invasive exotic species. Herbicides do not modify the soil structure, nor do they enhance the regeneration of most fire dependent organisms unless chemical treatments are combined with prescribed burning. Herbicides do not reduce dead biomass accumulations; in fact, they temporarily increase dead fuels and the potential fire danger for one to three years. Herbicides have comparatively moderate costs and generally low public acceptance.
- **Mechanical fuel treatments** such as mowing, disking, roller chopping, and hand removal are generally risk free, have a high level of public acceptance, and are the only methods that modify

or disturb soil, if that is needed. Disadvantages to using mechanical treatments include the necessity of repeat treatments, moderate to high costs, limitations on wet sites and steep slopes, follow-up burning is often required, and personal safety concerns associated with the use of hand tools such as machetes and chainsaws.

Defensible Space

Defensible space is the area of modified vegetation between **wildland fuels and structures** that can reduce the intensity of fires close to structures, provide firefighters the chance to stop a wildfire quickly and efficiently, and reduce a structure fire when firefighting personnel and equipment are not immediately available to help. Homeowners need to take proactive, preventative actions to reduce the wildfire risk to their property by modifying structures and creating a defensible space. Materials for roofing, siding, decks, and vents, plant selection, landscape design, and maintenance are the most critical elements for a fire-safe home. Defensible space can be a 30-foot clearing with tree islands or a greenbelt surrounding a planned community. A study in Florida showed that structures with less than 10 feet of brush clearance were 60% more likely to burn during a wildfire than homes with at least 30 feet of cleared brush. Homes with non-flammable roof coverings (asphalt shingles, metal, tile) that are surrounded by 30 to 60 feet of modified vegetation are over 85% more likely to survive a wildfire than homes with flammable roofs and no vegetative clearance. Defensible space can include firewise plants and native species that are low in flammability.

Firewise plants have a high moisture content in the leaves and branches, broad and thick leaves, open and loose branching patterns,

deciduousness, low amounts of dead materials, and low amounts of resin. Some less flammable plants are dogwood, viburnum, redbud, sycamore, magnolia, oaks, red maple, wild azalea, sweetgum, winged elm, black cherry, persimmon, wild plum, and ferns. Fire-prone plants to avoid near structures are junipers, young pine trees, cedars, palmetto, wax myrtle, rhododendron, mountain laurel, tall ornamental grasses and yaupon holly. Landscaping tips for mitigating fire hazard and creating defensible space include:

- Space plants carefully - use shrub islands or patches of perennials rather than continuous beds or plantings.
- Prune plants regularly - thin trees so branches do not touch each other.
- Remove all ladder fuels - trim lower branches up to 10 feet on tall trees, remove vines from trees and keep shrubbery away from pine trees so a fire in surface fuels cannot climb up these ladder fuels to the treetops.
- Remove dead leaves and other litter from around trees, shrubs and vines, and from a 3-5 foot strip next to the structure.
- Provide the landscape with sufficient moisture when fires are imminent

Fire resistant construction tips

Structural modifications to improve fire resistance include:

- Metal, asphalt shingle, or tile roof
- Balconies and decks constructed of materials approved for 1-hour fire resistance in accordance with the American Society of Testing Materials Standard E 119

- Attic vents, soffit vents, foundation openings and other such openings covered with 1/8" mesh noncombustible corrosion-resistant metal screen
- Street address clearly posted on the main street
- Dual or triple pane thermal or tempered glass windows and glass doors, or fireproof shutters for windows
- Sprinkler systems installed on roof or around eaves.

Multiple Analysis Approach

In any fire mitigation program it is important to mention that there is ***more than one tool in the tool box***. A complete fire protection plan recognizes all of the elements above to reduce fire hazards in high risk areas. Where available, replacement cost coverage in such areas is very desirable and should include options for Ordinance and law and additional living expenses (ALE). In very remote areas where the time to reconstruct could linger beyond normal, it might be wise for applicants or insureds to extend ALE beyond 12 months.

PROPERTY VALUATION TOOLS

Whether you use long established companies like Marshal Swift, or newer companies like 360Value, there are many competent sources of proprietary valuation tools available to agents.

Cost estimates from these companies are determined by daily research on material and labor costs needed to rebuild a particular structure, down to the screws and nails (according to company brochures), and/or analysis of damage repair estimates for claims. Most are component-based property replacement estimates meaning they break

results down to the integral parts of construction such as foundation, framing, appliance, trim, finishes and more.

Replacement costs can be estimated during quoting and underwriting, updated for renewals, and recalculated periodically. Estimates can be calculated through the web-based user interface or desktop reference books.

Nearly all localize costs down to zip code level.

Appraisals

The cost of using an appraiser to determine replacement cost coverage for an applicant or insured may be more costly than using an online service, however it is allowable as long as the appraiser uses the component approach illustrated above and in compliance with 2695.183.

Insurance Company Valuation Software

More likely than not, most agents will be using software or valuation systems made available by their main carriers. As stated above, when an insurer requires an agent utilize a specific source or tool to create an estimate of replacement cost or construction costs the following must be followed:

- ✓ The insurer shall prescribe procedures to be followed when they use the source or tool
- ✓ The insurer will provide the agent training to properly use the tools or source
- ✓ The insurer and not the agent will be responsible for any noncompliance

In addition, this software must use the component approach detailed in 2685.183 above.

Contractor / Expert Opinion

Local and knowledgeable contractors are great sources of replacement cost as they are ***in the trenches*** rebuilding and repairing houses on a daily basis. As good as they are, it is unlikely they will provide an agent detailed component bids on an ongoing basis for free or less than the cost of online software.

Cost Per Square Foot

For years, the insurance industry has relied on cost per square foot estimates to value the replacement cost of homes. It is determined by using known construction costs and dividing by the home's square footage. However, there are too many factors such as demolition, building codes, quality of construction and more that limit the cost per square foot estimate as a back-up or second opinion course. Further, using a cost per square foot does not comply with the component requirement that all replacement cost estimates must pass.

Insured's Opinion

When the law placed the responsibility of establishing a replacement value on the homeowner, his opinion was as good as any. However, this has changed with AB 2022. Most insureds do not have a realistic grasp on construction costs to reasonably estimate the cost to

reconstruct an entire home. Further, they are more likely to confuse replacement cost with market value which, depending on current times, could be below the actual cost to replace the same home. An insured's opinion is just that . . . an opinion. It cannot be used by the agent to estimate replacement cost.

Custom Home Elements

Given the trend in the renovation of older homes and the popularity of upscale homes, replacement cost valuation methods need to adapt to special elements of custom home replacement in the event of a loss. This can mean replacement cost valuation of such things as:

- Full dimensional lumber, original wood flooring, lath and plaster walls and ceilings, heavy rafters and sheathing, stone foundations, extensive use of solid wood trim and doors, crown moldings, etc.
- Impacts of requiring updating to building codes, environmental issues, such as lead paint, asbestos and fire code upgrades which have to be remediated (particularly older homes).
- Demolition and debris removal costs.
- Higher average **skilled** labor costs in a rebuilding project.

These more accurate valuation estimates account for rebuilding an exact replica of the home, including original materials. Replacement cost contracts require this unless the insured is willing to accept commonly used materials (or if the insured doesn't know he has modified replacement cost on his policy).

Accurately generating replacement cost is an important step to take when closing on a house or reviewing homeowners coverage. It is

particularly important to the owners of pre-1940 houses and custom homes.

Location and Construction Type

Homes built in housing tracts by merchant builders and homes built in suburban (but not remote) areas tend to cost less than custom homes built in well-developed metropolitan areas. Exclusive locations behind guarded gates and subject to association architectural rules require more planning and costs as well.

Construction costs are higher in some states than in others. Most valuation programs or systems account for this using an index that compares costs in nationwide. This index considers all the major construction cost variables, including labor, material, equipment, climate, building codes, likely job conditions and markup. Many are sensitive down to a given zip code.

Section PC 14

REPLACEMENT COST COVERAGE

Objectives

Since it is impossible to predict today the exact cost to replace a home or commercial building, it is important to have sufficient coverage to replace it. This value can differ significantly from market value. The market value of real estate is the amount the buyer would pay for real estate regardless of how much it cost to build. Replacement cost is the rebuilding cost necessary to repair or replace the entire home. Replacement cost insurance is extremely important coverage for which we dedicate this section. Following are the topics we will cover:

- Types of Replacement Cost Coverage
- Determining Value
- Market Value vs. Replacement Cost
- Functional Replacement Cost
- Replacement Cost Among Different Structures

TYPES OF REPLACEMENT COST COVERAGE

REPLACEMENT COST COVERAGE is intended to provide for the cost to repair or replace the damaged or destroyed dwelling, ***without a deduction for physical depreciation***. Many policies

pay only the dwelling's actual cash value until the insured has actually begun or completed repairs or reconstruction on the dwelling. Coverage only pays for replacement costs up to the limits specified in the policy.

EXTENDED REPLACEMENT COST COVERAGE is intended to provide for the cost to repair or replace the damaged or destroyed dwelling without a deduction for physical depreciation. Many policies pay only the dwelling's actual cash value until the insured has actually begun or completed repairs or reconstruction on the dwelling. Extended Replacement Cost provides ***additional coverage above the dwelling limits up to a stated percentage or specific dollar amount.***

GUARANTEED REPLACEMENT COST COVERAGE covers the full cost to repair or replace the damaged or destroyed dwelling for a covered peril regardless of the dwelling limits shown on the policy declarations page.

Replacement Cost Exclusions

The biggest exclusion possible in a replacement cost policy is underinsurance. An improper valuation could leave a family with less than needed to rebuild or replace their home. Other than that, replacement cost coverage under many policies may limit or not include the cost of removing the debris of the original building and demolishing whatever is left of it. This can be very expensive and time-consuming especially if any environmental issues exist such as lead, asbestos, chemicals, etc.

Replacement cost coverage may also ***not include***:

- An allowance for architectural or engineering fees.
- Permits that may be required
- Additional costs for tenant improvements, offices, additional wiring, air conditioning, etc
- General Contractor's overhead and profit.
- Financing costs such as interest and fees.
- Mortgage payments while the home is being repaired.

There may have been a change in building codes that do not allow the building to be rebuilt the way it was.

In the event of a total loss of an insured structure, no California policy may contain a provision that limits or denies payment of the replacement cost in the event the insured decides to ***rebuild or replace the property at a location other than the insured premises***. However, the measure of indemnity shall be based upon the replacement cost of the insured property and shall not be based upon the cost to repair, rebuild, or replace at a location other than the insured premises. In essence, the cost to rebuild at another location may be significantly more. The added costs would not be covered.

Building Ordinance

Ordinance and Law coverage, is an important option that covers additional costs to repair or replace a dwelling to comply with the building codes and zoning laws in effect at the time of loss or rebuilding. These costs are otherwise excluded by most policies. Meeting current building code requirements can add significant costs to rebuilding a home.

Appurtenant Structures

Structures on your property that are not attached to the house are considered **other structures**, and are usually covered for an amount of up to 10% of the dwelling coverage on the policy. If that amount is insufficient, one can increase Other Structures Coverage to cover things like in-ground pools, workshops, storage buildings, garages, etc. Above-ground pools are considered personal property, and not an Other Structure.

Extended or Guaranteed Replacement Cost

Guaranteed replacement cost coverage pays for the full cost of replacing or repairing a damaged or destroyed home, even if it is above the policy limit.

Extended replacement cost coverage pays a certain amount above the policy limit to replace a damaged home, generally 120 or 125 percent. It is similar to a guaranteed replacement cost policy, which has no percentage limits. Most homeowner policy limits track inflation in building costs. Guaranteed and extended replacement cost policies are designed to protect the policyholder after a major disaster when the high demand for building contractors and materials can push up the normal cost of reconstruction.

Full Risk Misuse

Agents need to know that it is considered a misuse to rely on replacement cost to insure a client's full risk. The exclusions cited above are evidence that not everything is covered in a replacement cost endorsement.

METHODOLOGY OF DETERMINING VALUE

Agents have several options to determine replacement cost values for applicants or insureds. However you determine value, keep in mind your responsibilities:

- Agents who provide the estimate of replacement cost must give the insured a copy at the time the policy limit is set and maintain records of this estimate for the entire term of the insurance policy PLUS five years thereafter. Any changes or updates to the replacement cost estimate must be provided to the applicant or insured within 60 days from the time it is generated. If an estimate was made but a policy never issued, estimate records must be kept for three years. (CCR 2695.182)
- Replacement cost estimates MUST NOT include a cost associated with “demand surge” . . . where the construction costs can dramatically increase after a major catastrophe. Agents should disclose to potential insureds that this cost has not been and legally cannot be taken into account in the estimate of replacement cost. (CCR 2695.183). Agents can, however, apprise customers that additional coverage may be obtained to protect for this contingency.
- Licensees who provide estimates of replacement cost or rely on estimates of others in regard to a recommended homeowner insurance policy MUST be sure the estimate includes all expenses that would reasonable by incurred to rebuild the insured structure in its entirety, including, but not limited to (CCR 2695.183):
 - Type of foundation
 - Type of frame

- Roofing materials and type of roof
- Siding materials and type of siding
- Whether structure is on a slope
- Geographic location of property
- Number of stories
- Materials used in, and types of, interior features and finishes
- Cost of demolition and debris removal
- Architects plans
- Age of structure
- Higher costs associated with replacing a single home versus multiple dwellings

The replacement estimate ***should not***:

- Be based on ***resale value of the land*** or the ***outstanding balance of any loan***
 - Include a ***deduction for physical depreciation***
- An agent that provides an applicant or insured a copy of a replacement cost estimate that does not meet the above standards shall explain exactly what elements above it does not address.
 - When an insurer requires an agent utilize a specific source or tool to create an estimate of replacement cost or construction costs the following must be followed:
 - ✓ The insurer shall prescribe procedures to be followed when they use the source or tool

- ✓ The insurer will provide the agent training to properly use the tools or source
- ✓ The insurer and not the agent will be responsible for any noncompliance

A Word on Estimates

The intent of any cost valuation program is to maintain a high level of accuracy, recognizing that costs are subject to change. A good system will use the following to accomplish this:

- Collect data on a regular basis.
- Collect wage rates . . . union and non-union.
- Follow thousands of line items of construction, including productivity rates and crew sizes to install each of them.
- Take into account regulations, debris removal stipulations and license fees for all municipalities.
- Study reconstruction/replacement cost data from past claims to more closely reflect the cost insurers pay when a loss occurs.
- Consider local cost concerns such as building code requirements, hillside foundation costs, architect fees, and variables for older structures.
- Conduct extensive quality control analyses to validate real cost activity from claim settlements, both partial and total.

Some of the following evaluators may do this, some do not. Keep in mind, however, that a software provider, appraiser, builder or contractor who provides an accurate estimate of what it might cost to rebuild the structure is basing their cost estimators on current codes. Building codes have the potential to change rapidly and not all jurisdictions apply the same rules of what constitutes major damage.

Structures built more than three to five years ago, for example, are most likely deficient in some aspect of the applicable building code. Of course, Ordinance or Law Coverage is designed to financially address these deficiencies and can pay the additional costs and loss of income resulting from the application of **ANY** ordinance or law affecting the reconstruction of the covered structure.

Then too, another possible claim scenario involves multiple causes of loss where some perils are covered by the underlying property policy and some portion of the loss is excluded from the coverage. The best and most recent example is the combination of wind and flood damage. In combined-loss situations such as this, the Ordinance or Law Coverage will pay pro-rata based on the percentage of damaged caused by each peril. So, if the wind causes 40% of the damage and the flood the other 60%, the Ordinance or Law coverage will pay only 40% of the loss in all three coverage parts.

Lastly, with the time value of money and improvements in construction methods and materials, using old estimators and adjusting them to current values will not provide an accurate estimate.

MARKET VALUE VS. REPLACEMENT COST

Many people confuse market value and replacement cost. ***Insurers do not use a home's market value as a loss valuation method.*** The terms have different meanings when it comes to insurance. For example, a home may have a replacement cost of \$400,000, an ACV of \$300,000 due to depreciation, but due to a lagging economy for instance, a market value of only \$250,000.

Market value fluctuates and is not a number that can be calculated using a mathematical formula or by calculating the costs of labor and materials to rebuild. The market value of a home changes at the whim of who would be willing to buy it for a certain price at any given point in time.

REPLACEMENT COST AMONG DIFFERENT STRUCTURES

Another element of confusion among insureds is the type of structure and its affect on replacement cost. Let's look at two different but similar sized houses:

One is a fine tract home built in 2004 and the other is a 2 1/2 story federalist style brick home built in 1860 in a historic district of town. Both have a market value that is roughly the same, but the construction techniques are very different.

The tract home has 2800 SF and a combo of vinyl and stone facing on the exterior. Common asphalt roof, poured concrete basement, framed with 2X4, 2X6, engineered floor trusses and manufactured roof framing. Steel exterior doors and wood/vinyl windows. Interior is plywood sub-floors with carpet, ceramic tile, vinyl sheet tiling, and engineered wood flooring, walls are drywall. Interior doors are hollow core 6 panel with basic oak baseboard and door trim. The kitchen has standard appliances, granite tile counter tops and semi-custom cabinets. It also includes a pre-fabricated gas fireplace with manufactured mantel and surround, a modern furnace & HVAC. A very nice home in a upscale neighborhood, it has a market value around \$400,000. Good quality all around, but nothing unusual in the construction materials. Almost everything in the house can be

purchased or ordered at Lowe's and any competent handyman or construction crew can repair the house.

The 1860 house at 2200 SF has original antique brick exterior with a slate roof. The basement walls are field stone and mortar; at some point the original basement floor has been replaced with poured concrete. The framing is full dimensional lumber with original hardwood floors. Original solid wood exterior doors, original wood windows some leaded decorative windows. Solid wood interior doors, antique oak trim, including hardwood stairs, handrails, chair rails, crown molding (man you'd think the stuff grew on trees). Original brick fireplaces (four of them) and original gas lights (refitted for electric). Modern kitchen and cabinetry, upgraded plumbing, electric & HVAC. A historic home in a upscale historic neighborhood, market value also \$400,000. All materials in home need to be repaired since replacement is difficult. To find existing or matching trim, material needs to be salvaged or recreated from antique material. Handymen are usually not up to the job, craftsmen with a specialty in older construction are needed and they don't work cheap.

Functional Replacement Cost

Some policies specify loss settlement terms as *functional replacement cost*, wherein the insurer would cover the loss at replacement cost to build an old Victorian home using the most new or modern day techniques and materials. This usually results in a lower cost to the insurer. A homeowner with a fully restored home, however, may not be pleased.

Realistically, the cost to recreate outdated construction techniques from the 19th century, when the home was originally built, could be staggering and not a good deal for the insurance to pay \$700,000 of insurance coverage for a home that's only really worth \$400,000. Additional coverage, however, may be available for homeowners wanting original quality replacement.

So what would replacement cost be on both houses? On the newer house, a percentage of the retail value comes from the price of land in a trendy of the neighborhood. Using an industry calculator, the replacement cost for the house might range from \$290,000 to \$360,000 depending on features inside the house. This would suggest the land value of the lot is around \$75,000.

Using the same calculator on the older house, replacement cost would range from \$650,000 to \$750,000. The price of the house is dictated more by the market demand for this type of house and less by the value of the land and reconstruction costs. Yet at a real estate closing table, both parties want to see the same replacement cost on their insurance policy. In fact, even after a extensive explanation of historic house replacement, the owner of the 1860s house would probably insist on a lower replacement cost to keep his homeowners premium down.

Section PC 15

CONSTRUCTION & VALUES

Objectives

Property and Casualty Agents deal with real estate on a daily basis. To understand the coverage you recommend, it is also important you understand the types of construction and how different construction affects value. In other words, you must help clients determine value in order to know how much to insure their property.

Following are the topics covered in this section:

- Types of Building Construction
- How Components of Property Affect Value

TYPES OF BUILDING CONSTRUCTION

According to the International Building Code, there are five major types of residential construction. They are listed below based on fire rating. Most homes in California today fall in the Type V category, that being wood frame.

TYPE I (Fire Resistive) - This **concrete and steel structure**, called fire resistive when first built at the turn of the century, is

supposed to confine a fire by its construction. This type of construction in which the building elements are of noncombustible materials such as concrete and steel. The roof is also of noncombustible material such as concrete or steel .

TYPE II (Non-Combustible) - This type building has steel or **concrete walls, floors and structural framework** similar to a type I construction however, the **roof covering material is combustible**. The roof covering of a type II building can be a layer of asphalt water proofing, with a combustible felt paper covering. Another layer of asphalt may be mopped over the felt paper.

TYPE III (Ordinary) - This type of constructed building is also called a **brick and joist structure** by some. It has masonry bearing walls but the floors, structural framework and roof are made of wood or other combustible material. For example; a concrete block building with wood roof and floor trusses.

TYPE IV (Heavy Timber) - These buildings have **masonry walls** like Type III buildings but the **interior wood consists of heavy timbers**. In a heavy-timber building a wood column cannot be less than eight inches thick in any dimension and a wood girder cannot be less than six inches thick. The floor and roof are plank board. One difference between a heavy timber type IV building and type III construction is that a heavy-timber type IV building does not have plaster walls and ceilings covering the interior wood framework.

TYPE V (Combustible) - Wood-frame construction is the most combustible of the five building types. The interior framing and exterior walls may be wood. A wood-frame building is the only one of the five types of construction that has combustible exterior walls. This

is the typical single-family home construction method. These buildings are built with 2x4 or 2x6 studs and load bearing walls, wood floor trusses or wood floor joist and wood roof framing.

Protected "A" means that all structural members of a building or structure has ***additional fire rated coating or cover*** by means of sheetrock, spray on, or other approved method. This additional fire rated coating or cover extends the fire resistance rating of structural members at least 1 hour.

Un-protected "B" means that all structural members of a building or structure has ***NO additional fire rated coating or cover***.

COMPONENTS OF PROPERTY AND VALUE

Replacement cost valuation has many variables. Licensees who provide estimates of replacement cost or rely on estimates of others in regard to a recommended insurance policy **MUST** be sure the estimate includes all expenses that would reasonable by incurred to rebuild the insured structure in its entirety, including, but not limited to (CCR 2695.183):

- Type of foundation
- Type of frame
- Roofing materials and type of roof
- Siding materials and type of siding
- Whether structure is on a slope
- Geographic location of property
- Number of stories
- Materials used in, and types of, interior features and finishes
- Cost of demolition and debris removal

- Architects plans
- Age of structure
- Higher costs associated with replacing a single home versus multiple dwellings

The replacement estimate ***should not***:

- Be based on resale value of the land or the outstanding balance of any loan
- Include a deduction for physical depreciation

Following is a more detailed discussion of considerations that should be addressed in any replacement cost valuation:

CORNERS

The shape of the outside perimeter is an important consideration in estimating the total construction cost. Generally, the more complex the shape (more corners), the ***more expensive the structure*** is to replace. The shape classification of multiple story or split-level homes is based on the outline formed by the outer most exterior walls, including the garage area, regardless of the varying level. Most structures have 4, 6, 8 or 10 corners. Small insets not requiring a change in the roof shape can be ignored when determining the shape.

FOUNDATIONS

House foundations vary enormously from one part of the country to the other. There are three major types of foundations that are used when building a home. In much of the south, the most common type of foundation is the slab on grade. Another common type of foundation

is the pier and beam and the third most common is basement or t-shaped, which is found in more Northern areas.

The **t-shaped** foundation or basement is a traditional foundation method to support a structure in an area where the ground freezes. This is where you have a concrete slab poured on the ground down at the bottom of the hole. A footing is placed below the frost line and then the walls are added on top. The footing is wider than the wall, providing extra support at the base of the foundation. According to ConcreteNetwork.com, a website dedicated to concrete information, a t-shaped foundation is placed and allowed to cure, the walls are then constructed and then the slab is poured between the walls. This foundation is used in colder climates, typically in northern states. The walls are used to support the house.

Another foundation used is the **slab on grade** foundation. This foundation is the most popular in southern and many western states. It is a single layer of concrete that is several inches thick. The slab is poured thicker at the edges to form an integral footing and then rods are placed to strengthen the thick edges. The slab is sometimes poured on a bed of crushed gravel to improve drainage. Also, a wire is placed in the concrete to reduce the chances of it cracking in the future. A slab on grade is typically used in areas where the ground doesn't freeze. It can also be used with insulation in northern states to prevent it from being affected by frost.

The third type of foundation is the **pier and beam**, also called a crawlspace because it is an accessible space with limited headroom, between the soil and the bottom of the first floor of a home. This

foundation is used in areas with heavy clay content in the soil, such as Texas. They typically have a concrete wall that goes around the outside with a wood floor that spans from one side of the wall to the other. A footing needs to be poured and short foundation walls are built to support the home. A majority of the spaces are only 16 to 18 inches between the bottom of the floor joists and the soil. This foundation is considered the most economical of the three choices. This space allows installation of plumbing and heating utilities for accessibility. However, this space needs to be insulated. If not, water vapor can cause mold and moisture problems in the future. Also, if a trapdoor is installed, this can provide entry for when severe weather hits.

ROOFING

Like foundations, roofing varies by location and customer preference. Concrete tiles are very popular in California, but not as practical on the east coast. Here some considerations and varieties:

Steel or Metal

Steel roof is good and durable. The structure of the roof will be more flexible and solid. Basically the corrugated steel roof is less weighty in comparison to other roofing devices. A metal roof is durable, however, they can be quite costly due to materials and special onsite installation. This may be offset by the fact that a typically metal roof will last at least 25 years -50 years. Metals like copper and zinc are so strong and solid they have been known to last over 100 years without any special upkeep. Of course, these same materials come at a premium cost.

Concrete Tile

Concrete roof has been used by many homeowners. They have high durability, flexibility in handling, good design and great style. One problem: concrete roofs require substantial structural support over other forms of roofing.

Flat Roof

Flat roofs are generally constructed of a plywood underlayment, followed by an asphalt roofing paper and a topping of crushed rock. A properly designed flat roof will have enough pitch to let water runoff without leaving puddle pockets or puddles. These roofs would not be suitable in areas where snow falls frequently.

Slate Roof

Authentic slate roofs use slate obtained from the rocks and mountain belt, making these roofs among the most expensive. Real slate slabs are heavy in weight. But, these weighty slates will be more helpful to make a roof which will outperform other roofing materials and metal sheets. There is also a type of synthetic slate roof which acts in the same as the original. Synthetic slate is not only lighter in weight but less costly.

Green Roofs

These are very expensive and complicated roofing systems consisting of a waterproof substrate topped with growing material such as soil or

grass. Benefits include added insulation value and the ability to actually grow a garden on your roof!

Solar Roofs

Solar roofs provide a lot of benefits but the panels and systems that make them work can be very costly and involve more maintenance than other roofs. A solar roof can be as simple as a row of solar panels or solar roof shingles/tiles with photovoltaic materials which transform sunlight into solar energy.

SIDING

Stucco

Traditional stucco is cement combined with water and inert materials such as sand and lime. Many homes built after the 1950s used a variety of synthetic materials that resemble stucco. Some synthetic stuccos have been prone to problems. However, a quality synthetic stucco will prove durable. Tint the stucco the color you want, and you may never need to paint.

Stone Veneer

When you think of ancient monuments and temples, you think stone that has stood the test of time. Granite, limestone, slate, and other types of stone are beautiful and nearly impervious to the weather. Unfortunately, they are also extremely expensive so precast stone

veneers and facings are now used for siding. These surfaces are durable, add beauty but can be costly to buy and install.

Cement Fiber

Fiber cement siding can have the appearance of wood, stucco, or masonry. This durable, natural-looking material is often called by the brand names HardiPlank® and HardiPanel®. Fiber cement siding is fireproof, termite-proof, and may have a warranty up to fifty years. Some older homes have Cement Asbestos Siding made from Portland cement and asbestos fibers. Removing that type of siding can be hazardous, so remodelers often apply a new, modern siding on top.

Wood Clapboard

Modern science has given us many synthetic wood-look products, and yet solid wood (usually cedar, pine, spruce, redwood, cypress, or Douglas fir) remain favorite choices for finer homes. With periodic care, wood siding will outlast vinyl and other pretenders. As with cedar shingle siding, wood clapboards can be stained rather than painted. Many wood frame houses built centuries ago still look beautiful today.

Brick Veneer

Made of fired clay, brick comes in a wide variety of earthy, eye-pleasing colors. Although it is expensive, brick is desirable because it can last centuries and probably won't need any patching or repairs for

the first twenty-five years. Quality brick veneers are also attractive and durable, although they don't have the longevity of solid brick.

Cedar Shingle

Homes sided in cedar shingles (also called "shakes") blend beautifully with wooded landscapes. Made of natural cedar, the shingles are usually stained browns, grays, or other earthen colors. Shakes offer the natural look of real wood, but usually require less maintenance than wood clapboard. By using stain rather than paint, you can minimize peeling.

Engineered Wood

Engineered wood, or composite wood, is made with wood products and other materials. Oriented strand board (OSB), hardboard, and veneered plywood are examples of engineered wood products. Engineered wood usually comes in panels that are easy and inexpensive to install. The panels may be molded to create the look of traditional clapboards. Because the textured grain is uniform, engineered wood does not look exactly like real wood. Still, the appearance is more natural than vinyl or aluminum.

Seamless Steel

Seamless steel siding is very strong and resists shrinking and bulging when the temperatures change. The siding is custom fit to the exact measurements of your house. You can purchase steel siding with a

wood-look texture. Or, for a modern house, consider the industrial look of corrugated steel.

Aluminum Siding

You may think of aluminum siding as an old-fashioned option, but some builders offer it as an alternative to vinyl. Both materials are easy to maintain and fairly durable. Aluminum can dent and fade, but it won't crack the way vinyl will. Also, aluminum is fireproof and is not usually considered harmful to your health or the environment.

Vinyl Siding

Vinyl is made from a PVC (polyvinyl chloride) plastic. Unlike wood or cedar, it won't rot or flake. Vinyl is usually less expensive to purchase and install than most other siding materials. There are, however, drawbacks. Vinyl can crack, fade, or grow dingy over time. Vinyl is also controversial because of environmental concerns.

Vinyl Coatings

If one likes the idea of vinyl but don't like the look of vinyl panels, another option is to spray on a liquid PVC coating. Made from polymers and resins, the paint-like coating is about as thick as a credit card when it dries. Liquid PVC became widely available only a few years ago, and reviews are mixed. The damage caused by poor application can be devastating.

QUALITY CLASS OF HOME

Homes and commercial buildings vary widely in quality and quality of construction is a major cost variable. In any given analysis of valuation, one must determine the grade of materials (windows, counters, appliances, insulation, roofing, etc) and construction (extensive trim, complicated framing, etc) in order to arrive at a proper valuation. Following is a possible system of rating quality:

Class 1 construction is the most expensive commonly encountered and Class 6 is the minimum required under most building codes. Most homes with features that fall in class 4, 5 or 6 are "spec" homes, built for sale to the public from stock plans. Class 1 and 2 homes have more than ten exterior corners and are usually built from custom plans prepared by an architect retained by the property owner. Most single-family homes have some characteristics of several quality classes. Note that exterior walls are either Frame (wood or light steel) or Masonry.

LOCATION OF PROPERTY

Homes built in housing tracts by merchant builders and homes built in suburban (but not remote) areas tend to cost less than custom homes built in well-developed metropolitan areas. Commercial buildings built in the heart of a busy city will cost more to build than a suburban structure. Exclusive locations behind guarded gates and subject to association architectural rules require more planning and costs as well.

Construction costs are higher in some states than in others. Most valuation programs or systems account for this using an index that compares costs in nationwide. This index considers all the major construction cost variables, including labor, material, equipment,

climate, building codes, likely job conditions and markup. Many are sensitive down to a given zip code.

BUILDING CODE UPGRADES

Older homes and buildings may have fallen under previous building codes. The same home needing replacement today might require additional upgrades to meet current building codes. An example might be a home built in the 60's using aluminum wiring, this home would need more expensive copper wiring when reconstructed. In California, there would most likely be some additional earthquake standards where additional shear walls and earthquake straps must be incorporated in any repairs.

Today, insurers are generally forced to offer law and ordinance coverage by law. If the insured does not obtain a policyholder's written refusal of law and ordinance coverage, any policy covering the dwelling is typically deemed to include the law and ordinance coverage--limited to 25% of the dwelling limit.

APPURTENANT STRUCTURES

Is there an attic, balcony, basement, attached or detached garage, outbuildings, etc.? Are these spaces finished or unfinished? Are they part of the occupied home or rentals? Everything affects value.

OTHER AREAS OF VALUE

Is the house or building air conditioned? Is it central or individual units? How many furnaces? Electrical wallboard heaters? Electric wall heaters? How many fireplaces? Are they zero clearance? Do they have forced air blowers? Are they upstairs as well? Is the soil

condition normal or clay? Is the home built on a slope adding to costs? Carpeting type and quality? Wood floors? Mirrors? Countertops, bath accessories, plumbing fixtures, cabinets, garage doors . . . they all affect the final valuation, as does their grade of quality. In addition to these costs, there are permits, cleanup, demolition, debris removal, insurance, loss of use (other accommodations during construction) and the cost of new plans to consider. Further, an estimate of reconstruction a home must also account for the fact that a single property is being rebuilt compared to multiple homes or a tract of homes . . . obviously, costs will be higher. So, as you can see, a lot goes into the valuation estimate.

Section PC 16

CATASTROPHE COVERAGE

Objectives

Natural disasters have been more prevalent in the last 10 years leading to many changes in property and casualty coverages. It is important for agents to understand what is available AND unavailable in this special area of insurance. This section will address the following topics:

- Catastrophe Coverage . . . Earthquake, Flood, Hurricane, Mold Landslide
- How Catastrophe Coverage Effects Value . . . Demand Surge, Shortages, Regional Influences, Building Codes, Delayed Repairs, Debris, and more

CATASTROPHE COVERAGE

The 10 most expensive natural disasters in U.S. history all have occurred in the last decade. These catastrophes have resulted in insurance companies having to cover losses averaging \$10 billion each year since 1989, compared with just \$2 billion yearly from 1980 to 1988.

With the potential catastrophe payouts insurers face far exceeding their reserves, it's no surprise that major companies, are raising catastrophe-policy premiums and deductibles and excluding certain coverages. For instance, if one lives in a high probability area of wildfires in certain areas of California, fire coverage, under a normal homeowner's policy is not available other than by supplemental coverage. The insurance industry is saying to the homeowner, If you choose to live here, that's great, but you have to take on more of the risk.

Following are some catastrophe coverages available:

EARTHQUAKE ENDORSEMENT

The **earthquake endorsement** covers not only earthquakes, but volcanic eruptions, landslides or any other type of earth movement. A single earthquake is defined as all shocks occurring within a 72 hour period. The earthquake endorsement has a **percentage deductible** equal to 5% of the coverage for the main residence, with a minimum deductible of \$250. Higher deductibles can be chosen to reduce the cost of the premium. However, in states with a relatively high frequency of earthquakes, such as California, the percentage deductible can range from 10% to 25%.

FLOOD

A handful of private insurers provide flood insurance, but the largest flood catastrophe insurer is the National Flood Insurance Program (NFIP) administered through FEMA.

Most homeowners in a moderate-to-low risk area are eligible for coverage at a preferred rate. Preferred Risk Policy premiums are the lowest premiums available through the National Flood Insurance Program (NFIP), offering building and contents coverage for one low price. If one does not qualify for a Preferred Risk Policy, a standard rated policy is still available. Even though flood insurance isn't federally required, nearly 25% of all NFIP flood claims occur in moderate-to-low risk areas.

For a high-risk area, a standard rated policy is typically the only option. It offers *separate* building and contents coverage. The Dwelling Form provides insurance for buildings with one to four units, including single-family condominium units and townhouses. The General Property Form provides insurance for other- residential and commercial buildings. Both forms provide flood insurance on contents, if this optional coverage is purchased.

Flood insurance premiums are calculated based on factors such as:

- Year of building construction
- Building occupancy
- Number of floors
- The location of its contents
- Its flood risk (i.e. its flood zone)
- The location of the lowest floor in relation to the elevation requirement on the flood map (in newer buildings only)
- The deductible chosen and the amount of building and contents coverage

If a home is in a high-risk flood area and the homeowner obtained a mortgage through a federally regulated or insured lender, he is required to purchase a flood insurance policy.

HURRICAN / TORNADO COVERAGE

Normally, a basic homeowner policy may already have this coverage under ***wind damage and wind-driven rain***, but hurricane coverage per se is being excluded by an increasing number of insurance companies.

The cost of comprehensive hurricane coverage can vary wildly, from as little as \$300 for a modest house in a low-risk area to upwards of \$20,000 for a luxury home in a high-risk zone. On top of the premium, policies issued in states that are most susceptible to storms can come with hurricane deductibles, which typically range from 1% to 5% of the insured value of a home. A standard deductible, say \$500, would apply to claims that aren't hurricane-related.

Hurricane deductibles usually kick in when damage results from a named storm. That means if a house is insured for \$200,000, and it's damaged in a hurricane, then the hurricane deductible will range between \$2,000 (1% of insured value) and \$10,000 (5%). Some states allow homeowners to choose the hurricane deductible—the higher the deductible, the lower the premium—while others set deductible levels

One common misconception about hurricane / tornado insurance is that it includes flood insurance. The two are very different insurance entities and a homeowner may need to purchase both insurances to become fully protected. Hurricane insurance is often limited to wind

damages and does not include flooding even when the obvious cause is the hurricane.

MOLD REMEDIATION

As a general rule, mold and other problems caused due to lack of maintenance or wear and tear are not covered under most policies. The resulting mold from floods, storms and hurricanes is yet another uncovered event for most policies. Chances are, however, for an additional \$200-\$300 a year, one can obtain about \$25,000 of "mold remediation coverage." That's generally the minimum amount of coverage needed if mold is an issue.

LANDSLIDE

Soil expansion, subsidence and landslides affect a lot of homes every year yet they are events typically excluded from homeowners' policies. Properties might be covered where the subsidence or landslide caused a large boulder to roll down and damage a property. Otherwise, this coverage is rare and hard to find.

EFFECTS OF CATASTROPHES ON VALUE

DEMAND SURGE

After certain ***large-scale natural disasters***, insured losses (prices for materials and labor) ***rise significantly***, compared to losses from smaller-scale events. Basically, the widespread nature of the catastrophe causes ***materials, labor, fuel shortages, transportation issues*** and a host of other supporting services to be in greater demand. Thus, in turn, places rising pressure on costs to increase. As a result, insurance claims greatly exceed expectation.

Insurers have been known to pay double or more the normal settlement . . . even in cases where the homeowner was underinsured. An early observation of this phenomenon—known variously as “**demand surge**,” “loss amplification,” “catastrophe inflation,” etc.—followed the 1906 San Francisco earthquake and fire, and it has been noted frequently in the aftermath of major hurricanes and floods.

Agents & Demand Surge

Regardless of the reason for demand surge prices, replacement cost estimates by insurers or agents **MUST NOT** include a cost associated with “demand surge”. Agents should disclose to potential insureds that this cost has not been and legally cannot be taken into account in the estimate of replacement cost. (CCR 2695.183). Agents **can**, however, apprise customers that **additional coverage** may be obtained to cover it

The amount of reconstruction work regionally is a sum of the repair work at individual properties. Understanding how much work is done at an individual property informs the understanding of the amount of work regionally. Individual property owners may attempt to reduce damage to their properties in disasters of any size. A property owner may take measures before the event to prevent damage or make emergency repairs immediately after the event to reduce additional damage. The scale of the disaster, however, may affect these efforts.

Damage may also accumulate in clustered events, possibly negating any efforts of the property owner. In a catastrophe, properties may be more likely to decay because of neglect (for example, mold can flourish in untended, water-damaged buildings). Properties damaged in a catastrophe may be more prone to additional damage because, for

example, local authorities do not allow the population to return soon after the event (as in Hurricane Katrina), or property owners do not have immediate financing for repairs, or temporary patching materials may be in short supply. Thus, the amount of damage at an individual property may be greater because the property was damaged in a large-scale natural disaster.

A sample of first-hand accounts and explanations of demand surge provides a good explanation of the phenomenon. A structural engineer who accompanied claims adjusters after the 1994 Northridge, California, earthquake said that his insurer client routinely paid for obviously preexisting damage unrelated to the earthquake. The payment was made largely to expedite claims in a situation where the volume of claims would otherwise have been overwhelming. He estimated that, in aggregate, the insurer overpaid by a factor of perhaps two.

The 1991 Oakland Hills, California, fire, which destroyed 3,500 residences, provides another example of amplified insured losses. Many insurers found it politically prudent to compensate policyholders for the full replacement cost, even in the presence of gross underinsurance or policies lacking guaranteed replacement cost coverage. By settling claims in this manner, the insured loss may have been double what was owed strictly according to the policy.

SHORTAGES

Whether an *event overwhelms systems* refers to the degree to which demand exceeds locally available supplies of construction materials

and labor or claims adjusters. If the latter occurs, insurers may rely on several measures to *handle claims*. Insurers may send in-house claims adjusters from other areas or rely on inexperienced adjusters. In anticipation of demand surge, insurers may have made agreements with contractors before an event to perform reconstruction work. Two additional issues that arise following large-scale events are ex gratia payments and the problems associated with concurrent causation.

The *scope of reconstruction work* at an individual property refers to: changes in the kind and quantity of construction materials; number of man-hours of skilled and unskilled labor; and any special equipment required because of the large scale of the event, such as backup generators that would not otherwise be required. It might be quantified by a ratio of contractors' direct costs (before overhead and profit) in the catastrophe environment to the direct costs in the absence of urgency or material and labor constraints.

The *prices of materials, labor, and equipment* refers to the change in the cost of a fixed basket of construction goods and services to construction contractors. This collection of goods and services is affected by: the distance from which goods and services must be brought to the affected area (i.e., *remoteness*); *transportation* delays caused by damage to the transportation network; and pre-disaster state of the *economy*, meaning construction unemployment and reserves. *Contractor profit* refers to the premium contractors can charge over their direct and overhead costs in the presence of high demand.

PRIVATE VS. GOVERNMENT INSURERS

Private property insurers do not indemnify all perils. For example, a standard homeowner's policy covers most fire, wind, and hail damage but not seismic or flood damage. Governments may provide coverage in hazardous areas not served by private insurers. Here, the peril may affect demand surge because the source of reconstruction financing depends on the peril: Insurers may be better able to provide immediate funds, whereas a government entity may provide delayed or reduced compensation. As an example, under the standard flood insurance policy dwelling form, the United States National Flood Insurance Program pays replacement costs only if the insured property is a single-family dwelling and the policyholder's principal residence, and the insurance is 80% or more of the full replacement cost or the maximum available. Otherwise, the NFIP pays actual cash value, except for mobile homes and travel trailers. The NFIP always pays actual cash value for detached garages, personal property, appliances, carpets and pads, outdoor equipment, and property abandoned as debris. Sufficient and immediately available reconstruction financing enables the demand for materials, labor, and equipment. Thus, the demand for materials, labor, and equipment and the supply of financing may provide more fundamental explanations of demand surge after an event than which peril is involved.

REGIONS

The region affected by a disaster may be similarly misleading. The "remoteness" of an area has been suggested to explain some past demand surge events. Isolated populations, such as those in Darwin, Australia, or on Kaua'i Island in Hawaii, may pay significantly more for

reconstruction following disasters. However, geographic remoteness may not be a fundamental concern. In terms of demand surge, the ability to supply an affected area determines its **remoteness**. In Hurricanes Andrew and Katrina, contractors and materials were brought into the affected region. The relevant question then is not how far away, but more immediately, at what cost the materials, labor, equipment, and financing can be brought to the affected area. Thus, information on the capacity and costs of transportation and of temporary housing for workers seems more fundamental than distance. The particular region may also inform an assessment of the pertinent socioeconomic issues for demand surge.

Although the demanded materials, labor, equipment, and financing may be available and readily transported, local authorities may restrict the free movement of supplies and prices. Authorities may choose to set prices or place ceilings through anti-price gouging laws. The migration of labor from outside an affected area may be restricted or entirely prohibited. Thus, demand surge may vary by region, not because of physical geography, but rather because of the fundamental questions of physically supplying an area and any restrictions on the flow of those supplies.

TIMING

Like the peril and region, the year of an event may not be fundamental to demand surge. Rather, the year may be a proxy for issues such as materials supply and the capacities of transportation systems. For example, materials suppliers may now rely on just-in-time-supply chains, rather than inventories. Thus, the reconstruction after recent

disasters may be more vulnerable to materials shortages than after disasters of twenty or fifty years ago. In regions with recently well-developed transportation systems, however, the ease of moving materials may offset the problem of smaller inventories. Again, the year *per se* may not provide fundamental information about demand surge.

The sequence, or timing, of events may also not directly affect demand surge. A single event, isolated in time and location from another event, might be seen as a standard disaster to which other disasters can be compared. Thus, it can be used in comparisons with the more unusual catastrophe-following-catastrophes or clustered events. For a catastrophe following catastrophe, there is the inherent problem of widespread concurrent causation. Insurance adjusters would be asked to distinguish the source of damage, making their work more difficult (and thus more expensive) after a catastrophe following catastrophe than after a single event.

MORE EVENTS

A cluster of events raises additional considerations. At the regional level, the demand following a first event may have exceeded the local supplies, and efforts began to meet this demand. Thus, a second, third, or fourth event may not cause a disequilibrium in supply and demand as large as the original disruption. Also, events subsequent to the first in a cluster may not cause as much damage because many properties have not been repaired after a previous event. In this case, the demand for materials, labor, equipment, and financing may not increase as much after a subsequent event as after a first event.

In summary, the typical characterization of an event according to its peril, region affected, and year of occurrence does not appear to be useful for understanding demand surge. Our current understanding suggests that there are more fundamental questions surrounding the demand and supply of materials, labor, equipment, and financing, which are more directly relevant to a qualitative and quantitative description of demand surge.

BUILDING CODES

The level of repair required by building codes, and enforced by the building authority, may also affect the amount of work at a property. The building code in force during the reconstruction period may require a heavily damaged structure to be built to a higher standard than what was required when it was originally built. The rebuilding requirements affect the amount and type of construction materials and the necessary skill of the labor. Although newer building codes tend to become more strict, there can be exceptions: building codes may not be enforced (for example, before Hurricane Andrew, or the local building department may temporarily suspend certain provisions to allow for speedier recovery (for example, after Hurricanes Iwa and Iniki. Furthermore, insurers or property owners may not have accounted for changes in building code requirements when determining the replacement cost of properties. This is properly a valuation problem for the insurer, but it can masquerade as demand surge in catastrophe models, which usually rely on multiplying a damage factor by (in this case, an erroneously low) replacement cost.

PERFORMANCE

Judgment may also affect the amount and speed of work performed at a damaged property. Contractors and insurance claims adjusters may be pressured to quickly define the amount of work to be done. The adjuster might have a long list of properties to visit, making each loss assessment quickly and carelessly. Contractors and claim adjusters may not have enough, or the right, information available about repair work at a property at the time of a repair estimate or claim adjustment. An initial assessment of damage may not identify all damage, and unanticipated damage may be encountered only after demolition and repair work have begun. These types of judgments about the amount of repair work following a catastrophe must be made but may not be fully informed.

DELAYED REPAIRS

The time when reconstruction begins at a property may affect the final loss. Delayed repairs may be more expensive because of deterioration of, or additional damage to, the property. Also, labor wage rates, contractor overhead and profit, and materials prices can change during the reconstruction period. These issues may be more significantly affected by the regional factors described in the following paragraphs than by characteristics of the property. A backlog of properties damaged in a previous event or a construction boom in the region may delay work at a recently damaged property (for example, during the 2004 and 2005 hurricane seasons in Florida). The organization of the reconstruction effort, if any, may determine the prioritization of work. Contractors may determine a work schedule on a first-come-first-

served basis, or they may prioritize work according to potential profit. The government may prioritize the repair of damaged properties, as was the case after the 1999 Sydney Hailstorm. If the general population evacuated, there may be a delay in reconstruction until there is a critical mass of people. The disruption of electrical power may also affect the timing of rebuilding, unless there are sufficient supplies of portable generators.

DEBRIS REMOVAL

Debris removal can be critical before reconstruction can begin at a property. Storm surge in Hurricane Katrina pushed substantial quantities of debris onto properties near the shore along the Mississippi coast, hindering access. In addition to disposing of structural components and building contents, there may be hazardous materials requiring special attention, as was also the case in Katrina. Debris removal may also be hampered by insufficient landfill space. The efforts of local and national governments may affect the timing of reconstruction. Rebuilding may not begin until the local government allows the release of building permits. For example, as of 30 June 2008 in Cedar Rapids, Iowa—seventeen days after flood-waters crested—the building department was issuing plumbing, electrical, mechanical, and building permits for flood repairs outside the 500-year floodplain only. The Cedar Rapids building department expected to release plumbing and electrical permits a few days after this date, but they would not grant building permits until the city decided on a reconstruction plan. For properties in the 100-year floodplain, the city had to consider the guidelines and regulations of the National Flood Insurance Program. As of 30 June, it was not clear whether the city

would allow any rebuilding on the 100-year floodplain or adopt the NFIP requirement that properties with damage valued over 50% of the structure's value be rebuilt at least one-foot above the 100-year floodplain. The city recommended that property owners clear debris, dry the structure, and wait for a city council decision. The approach taken in Cedar Rapids suggests that local governments can affect the progress of reconstruction. The municipality may actively influence repairs and rebuilding, or it may passively allow reconstruction to be determined by property owners, financing, and the availability of materials, labor, and equipment. Finally, the building department may be overwhelmed, and permitting and inspections may be delayed (for example, after the 2004 hurricane season in Florida).

OTHER FACTORS

In addition to the above demand surge pressures, one must also consider extra services required after a disaster as part of the additional costs to reconstruct. Services might refer to expenditures by insurers to claims adjusting firms, or by insurers to construction contracting firms, or by construction contracting firms to businesses that serve them while they mobilize, market their services, do the repairs, etc. Since insurance claims include additional living expenses and other time-element losses, services in this context could mean virtually any expenditure paid to businesses at any distance from the catastrophe by any insured entity during the life of any time-element claim.

Section PC 17

INSURANCE TERMS & CONCEPTS

Objectives

Insurance has a language of its own: in Life insurance, Health insurance, Property insurance, and in Casualty insurance, as well as Individual or Group. We'll look at some of the common terms in this unit, but refer to the glossary for additional information. This unit includes:

- General Terms and Concepts (no big mystery there)
- More Terms and Concepts

1. General Terms and Concepts

Just so you know, In California, the word:

- "Shall" means mandatory
- "May" means permissive
- "Person" means any individual, association, organization, partnership, business trust, limited liability company, or corporation.

Note: Any provision of the code can be sent out by mail.

Here are some general terms and concepts you're going to frequently run into when dealing with insurance:

A. Insured

In Life insurance, the **insured** is the person on whose life an insurance company writes a policy. The insured and the policyowner may not be the same person.

In Property or Casualty insurance, it usually means the “named insured,” or the one(s) named on the policy.

B. Insurable Interest

Insurable interest is required in the purchase of insurance to protect against an economic loss.

In **Life insurance**, the insurable interest has to exist when someone first applies for the policy.

In **Property** and **Casualty** insurance, insurable interest has to exist at the time of loss.

B. Insurable Events

Insurable Events are any contingent or unknown event, which may indemnify a person having an insurable interest, or create a liability against him, may be insured against.

C. The necessary Elements in a Policy

All insurance policies must contain:

- 7) Information about the parties involved in the contract
- 8) Description of the property or the life insured
- 9) The insured's insurable interest
- 10) Information about the risks the insurance covers
- 11) The policy period
- 12) Premium rates

Note: The financial rating of the insurer is not required.

D. Principle of Indemnity

The Principle of Indemnity is the restoration to the approximate financial position occupied prior to the loss, in whole, or in part, by payment, repair, or replacement.

E. The Law of Large Numbers

The Law of Large Numbers is a theory regarding probability. The Law of Large Numbers states that:

- 3) If you take a random sample from a larger population, it's more likely to represent the whole, than if you took a random sample from a smaller population.
- 4) The more people there are, the more the chance of risk increases.

F. Loss Exposure

Loss Exposure is defined as someone's potential for loss, or their loss exposure/exposure to loss. For example, a homeowner in a particular region of the country will have different kinds of exposures than a homeowner in another region. They may be more vulnerable to hail, tornadoes, or forest fires, so they have a higher exposure to loss to those particular perils.

Exposure is measured in **exposure units**, for which the price of insurance is the rate.

G. Adverse Selection

Adverse Selection is selection against an insurer by insuring more poor than good or average risks, and the tendency of poorer risks to buy and maintain insurance.

H. Concealment

Concealment is the withholding of facts or information by an applicant or insured that may materially affect the decision regarding an insurance risk.

I. Risk

Risk is the chance of loss. The term “risk” is often used in a general way to designate the entire subject matter of insurance covered under a policy or upon which an application for insurance has been received. Risk is also sometimes used to designate a policyholder (e.g. poor, standard, etc.).

There are **2** categories of risk:

- 3) **Pure Risk** is defined as the uncertainty as to whether or not a possible loss will actually happen. There could be a loss, but no one knows when or how. A pure risk is the chance of loss only.
- 4) **Speculative Risk** is a loss that's more predictable, such as gambling, business ventures, or playing the stock market. Speculative risk assumes that, based on the person's actions/decisions, a loss is inevitable. A speculative risk also has the chance of gain.

Note: Insurance only protects against pure risks.

J. Ideally Insurable Risks

The following criteria describes an ideally insurable risk:

- The loss must be **measurable**
- The loss must be **accidental**
- The loss must be **predictable**
- The **law of large numbers** has to apply
- The loss must create **financial hardship**
- Insurance must be **affordable and practical**
- The loss must not be **catastrophic**

K. Risk Management Methods

There are **4** Risk Management methods used to deal with the uncertainty of loss:

- 1) **Avoid** the risk
- 2) **Reduce** or control the risk
- 3) **Retain** the risk
- 4) **Transfer** the risk (insurance)

L. Hazard

Hazard is any factor that creates or increases the chance of loss.

There are different types of **hazards**:

- A **physical hazard** is created by the condition, occupancy, or use of the property itself. Examples include faulty breaks that increase the chance of collision, and faulty electrical wiring that increases the chance of fire.
- A **moral hazard** is a characteristic of the insured that increases the chance of loss. Examples include arranging an accident to collect the insurance, or inflating the amount of a claim.

- A **morale hazard** is carelessness or indifference to a loss because of the existence of insurance. One example is leaving the car keys in an unlocked car.
- A **Legal Hazard** is created by decisions or actions of the courts. If something could result in big, expensive lawsuits, this is considered a legal hazard.

M. Peril

Peril refers to the specific event causing a loss, such as fire, windstorm or collision.

N. Fraud

Fraud is the intentional and fraudulent omission, or the communication of information of matters, proving or tending to prove false, and entitles the insurer to rescind.

O. Concealment

Concealment is the neglect to communicate that which a party knows, and ought to communicate, and whether intentional or unintentional, entitles the injured party to rescind.

Information you aren't required to communicate includes information that is:

- Already known or should be known
- Waived by the other party
- Not material to the risk

Concealment, whether intentional or unintentional, entitles the injured party to rescind insurance.

P. Rescission

Rescission means the same as revoke or remove. An insurer could legally rescind an insured's policy if:

- There's been intentional or unintentional concealment
- There's been an intentional and fraudulent omission
- A misrepresentation comes to light after a policy has gone into effect
- A material warranty or a material policy provision has been violated

Q. Materiality

Materiality has to do with facts and information relevant to an insurance policy. Materiality can be determined using **3** questions concerning the information:

- 1) Can the information convince or dissuade either party to enter a contract?
- 2) Does the information create a disadvantage for either party?
- 3) Does the information have any affect on the risk or insurability involved?

Materiality concerns both the insurer and the insured. Each party involved in the contract has to have all the relevant information that could have any positive or negative affect on the contract.

R. Representations

Representations are statements on an application that the applicant represents as true and accurate, to the best of their knowledge and belief. Representations may be considered to be an implied warranty.

A representation may be altered or withdrawn before the insurance is effected, but not after. A representation is considered false when the facts fail to correspond with its assertions or stipulations.

Misrepresentations are the false representation of the terms or benefits of a policy by an agent, or an applicant who falsely represents the health or other condition of the proposed insured.

S. Warranty

A **warranty** is a statement made by the applicant that becomes a condition of the contract. False warranties void the entire contract.

Alert!

Warranties do not apply to Life insurance. No statement made on a Life insurance policy is ever considered to be a warranty. The final exam will definitely try to trick you on that one (all you potential Life agents out there).

A warranty is either:

- **Expressed** warranties are in written form and attached to the policy.
- **Implied** warranties are not written but still exist under the law. Some representations may qualify as implied warranties.

T. The Law of Agency

The Law of Agency is the authority of one to act as the agent of another, the insurer, with one of **3** types of authority:

- 1) **Express Authority**, what is spelled out in the contract
- 2) **Implied Authority**, what is assumed to exist
- 3) **Apparent Authority**, what is by conduct or action

U. Loss

Loss may refer to the claim itself, the amount sought in a claim, the reduction in value of an insured's property, or the amount paid on behalf of an insured under an insurance policy.

The **2** categories of loss are:

- 1) **Direct loss**, which is a loss that is the direct result of an insured peril.
- 2) **Indirect loss**, which is a subsequent loss, such as being unable to use a building after a fire.

V. Liability

Liability is something for which you are legally responsible.

Liability insurance provides coverage and pays for losses to other people and their property caused by negligence.

W. Negligence

Negligence is the result of carelessness, thoughtlessness, or inaction, but it's never intentional.

Before a court will award any damages to an injured party due to another's negligence, the **4** elements of negligence must be present:

- 5) **Legal duty** means the person has a legal responsibility to take the necessary precautions to avoid being negligent.
- 6) **Breach of duty** means the person failed to uphold their legal duty.
- 7) **Damage or losses** occurred as a result.
- 8) **The breach of duty** caused the damages or losses.

Here's a surreal story to help you remember the **4** elements:

Bob decided to put quicksand outside his driveway. He thought to himself, "I should really tell people about this here quicksand." (Legal duty)

When Gwen was walking by, she said, "Is that safe?"

Bob forgot about the quicksand, and said, "Yep. Safe as safe can be!" (Breach of duty)

Trusting him, she went on her way, and was promptly sucked into the quicksand. Luckily, she just happened to have a copy of "How to Escape from Quicksand," so she survived, but she still lost one of her tennis shoes. (Damages or losses)

"Hey," she said, "I lost one of my tennis shoes because you said it was safe!" (Damages or losses caused by the breach of duty)

True, it's a weird story, but we're sure you'll remember the **4** elements of negligence long after you've developed senility and forgotten everything else.

Note: If these **4** elements of negligence are present, the injured party has a good chance of winning a lawsuit.

X. Accident

Accident is an unforeseen and unintentional act identifiable in time and place.

Y. Occurrence

Occurrence is an event that results in a loss.

Z. Reinsurance

Reinsurance is the transfer of risk between insurance companies. Used in both Life and Health, as well as Property and Casualty, it's an agreement or "treaty" between insurance companies where one company may transfer, and one company will accept, all or part of the risk of loss of the other.

1. From the Top!

You may have noticed that we've run out of letters of the alphabet. Well, we're too enterprising to let that stop us! We'll just start over again! (Problem-solving!)

A. Cancellation

Cancellation is the termination of coverage in the policy period by the insurer.

B. Lapse

Lapse is the termination of coverage for non-payment of premium. A policy will lapse at the end of the grace period.

C. Renewal

Renewal is the continuation of coverage from one policy period to the next. **Non-renewal** is termination of coverage at the end of the policy period.

D. Unearned versus Earned Premiums

Unearned versus earned premiums are based on whether or not someone has paid for future coverage.

If someone pays an annual premium, and six months have gone by, then they have six months of:

- **Unearned premium**, for the six future months that are prepaid
- **Earned premium**, for the six months that have already gone by

E. Binders

A **binder** gives the insured temporary coverage. An insured may have just requested or applied for the insurance, and he/she doesn't actually have the official documentation in hand, but the **binder** means the insurer has agreed to provide temporary coverage pending approval.

Someone can receive a binder and still be denied insurance. If the insurance company gives the person a binder while the insurance application is being processed, that binder doesn't guarantee a certificate of insurance. If the insurance company decides not to insure someone, the company has to issue a legal

notice of cancellation. Until then, the binder will continue to provide coverage.

Note: Binders are not used with Life insurance.

Section PC 18

LICENSING

Objectives

This unit discusses how to obtain and maintain an insurance license, the importance of keeping accurate financial records, and which actions could result in suspension or revocation of a license. As future licensees, it is important to know that all of your actions as an insurance Producer will be checked through the Commissioner's office and honesty is critical to the longevity of your business.

SPECIAL NOTE:

Until 2011, agents who sold homeowners, auto, commercial, professional liability, workers compensation, flood, earthquake or personal property insurance did so under one license . . . called a **Fire and Casualty License**. Today, an agent selling these products is required to have two licenses . . . A **Property Broker-Agent License** and a **Casualty Broker-Agent License**. This course prepares you for **BOTH** licenses. Similarly, our property-casualty workbook materials (provided under separate cover), that prepare you for the State Exam, cover **BOTH** Property and Casualty topics.

It is also of interest that Property and Casualty Broker-Agents today are **NOT permitted** to sell health, disability and long term care

insurance products; products previously sold under the defunct Fire and Casualty License. The sale of these health insurance products today requires a separate Accident and Health License . . . a course available from our school.

1. People Required to have an Insurance License

California requires anyone who **transacts insurance** to have an insurance license. Transact means solicitation of insurance, negotiation and execution of insurance policies and dealing with matters that pertain to and arise subsequent to the execution of an insurance contract. Types of licensees include:

A. Producers

“Insurance Agents” are now known as “producers,” except in states where they’re still known as “agents”. Just think of the two as synonymous and you’ll do fine.

Producers are authorized by and on behalf of an insurer to transact insurance, i.e., sell and negotiate insurance policies to applicants and handle ongoing coverage with clients. Unless the producer has the proper license, they can’t sell, solicit, or negotiate any class of insurance.

A **Property or a casualty licensee** is a person authorized to act as an insurance agent, broker or solicitor. Licenses to act as a **property broker-agent** entitle the licensee to transact insurance coverage on the direct or consequential loss or damage to property of every kind. Licenses to act as a **casualty broker-agent** shall entitle the licensee to transact insurance

coverage against legal liability, including for the death, injury, disability, or damage to real or personal property. ***We believe that an agent adequately serving his homeowner, auto and commercial clients, needs BOTH a property and casualty license. This course provides training for BOTH licenses.***

A **Personal Lines Agent** is a person authorized to sell the following insurance: Personal automobile, dwelling and homeowners insurance, including earthquake, flood, umbrella policies and marine insurance covering personal property. He **cannot sell** commercial policies, pet insurance, worker's compensation or other lines available to a full property and casualty agent / broker.

A **Limited-Lines Automobile Agent** is a person **endorsed or appointed** to sell ONLY automobile liability coverage, automobile physical damage and automobile collision insurance. It is important to know that a limited lines automobile agent is an **agent license**. As such, these agents **cannot broker** limited lines auto insurance **nor charge broker fees. Nor can they serve other needs of the homeowner and commercial client.**

Here are a few other insurance agency categories:

- The **Broker** is paid for transacting insurance on behalf of another person (any line of insurance except Life).

- The **Consultant** makes recommendations to the insured for a fee.
- The **Administrator** works with Life insurance, Health insurance, and Annuities. Their duties include, collecting premiums and adjusting or settling claims.
- A **Managing General Agent** can be any person, firm, association, partnership or corporation that manages all or part of an insurer's business. Where direct written premiums equal or exceed 5% of a company's policyholder's surplus, the MGA can adjust or pay claims or even negotiate and bind reinsurance.
- An **Insurance Adjustor** determines the extent of the insurance company's liability when a claim is submitted.
- A **Public Insurance Adjustor** is a self-employed person who is hired by litigants to determine or settle the amount of a claim or debt.
- A **Surplus Lines Broker** is an insurance producer, *individually licensed* in surplus lines, specially licensed to solicit, negotiate and place insurance with eligible surplus line insurers. NOTE: individuals licensed as a Property and Casualty Broker-Agent may **not** transact surplus lines business on behalf of a surplus line broker's organizational license, without also holding an individual surplus line broker.
- An **Independent Agent** represents more than one insurer. He has a contract with each but typically owns the business, expirations and rights of renewal.
- An **Exclusive Agent** represents only one insurer. The company usually controls renewals and expirations.

- **Direct Writing Companies** are insurers who deal direct with insureds through their own salaried employees. No agencies are involved.
- **Direct Mail Companies** use direct mail advertising to solicit and conduct distribution of their policies.
- A **Solicitor** is an employee of an agent or broker who assists with client services. A solicitor cannot act as an insurance agent or broker or be employed by more than one property and casualty agent/broker. Similarly, agents should not portray themselves as a solicitor.

Any person who transacts insurance without a valid license is guilty of a misdemeanor and could be fined up to **\$50,000**, or imprisoned for a year, or both.

Title 18, Section 1033-1034 legislation (1994) says that certain **prohibited persons** cannot participate in the business of insurance (selling, reinsuring or the role as an officer, director or employer of an insurer) unless they have received written consent of the Insurance Commissioner. A **prohibited person** means any person who has been convicted of a felony, dishonesty or breach of trust. **Conviction** means a finding of guilty or plea of guilty or no contest in a criminal court of the U.S. **Felony** means a crime for which the maximum punishment exceeds one year incarceration. **Dishonesty** includes perjury, bribery, forgery, counterfeiting, making false statements, deception, fraud, schemes, material misrepresentation and failure to disclose material facts. **Breach of trust** means crimes of misuse, misapplication or misappropriation. The **penalty** for violating the above section is a fine of **not more than \$50,000 for each violation** OR the amount of compensation the person received for the prohibited conduct (whichever is greater) or **imprisonment for not more than 10 years or both**. **Failure to inform** the Department of Insurance of a prior felony conviction on a license application could result in a violation of this statute and/or constitute grounds for denial of an insurance license.

Future producers have to pass a written exam that tests knowledge of the different classes of insurance, the duties and responsibilities of Producers, and the state's statutes and rules.

Note: The CIC defines "Transact" when applied to insurance as any of the following:

- Solicitation
- Negotiations preliminary to execution
- Execution of a contract of insurance
- Any dealings before/after the execution of a contract, or any matters arising from the contract

2. Licensing Examination

Future producers have to pass a written exam that tests knowledge of the different classes of insurance, the duties and responsibilities of producers, and the state's statutes and rules.

People who want to be involved in certain kinds of insurance aren't required to take the final licensure exam—though they may still end up taking some form of test of knowledge. For example:

- Livestock
- Mortgage
- Travel and transportation
- Credit Life
- Credit Health
- Baggage, Trip Cancellation, and Interruption
- Lender's Property
- Motor Vehicle Physical Damage
- Mechanical Breakdown

- Credit Involuntary Employment

Applicants can take the state's examination after completing one or more of the following requirements:

- **40** hours of instruction in **Property and Casualty Insurance**
- **20** hours of instruction in **Life Only**
- **20** hours of instruction in **Accident and Health**
- **12** hours of instruction in **Code and Ethics**
- **20** hours of instruction in **Personal Lines**
- **20** hours of instruction in **Limited Lines Automobile**

3. Resident and Nonresident

A **resident** producer lives in the state they transact insurance for, whereas, a **non-resident** producer doesn't live in the state that they transact insurance for. If you get that one wrong on the final exam, we're coming to your house to slap you in person.

If someone wants to transact in another state, they have to obtain a license in their home state before becoming a nonresident producer.

All **non-resident** producers have to apply to the NAIC. The Commissioner acts as the Attorney-in-fact after the application is accepted. This means the Commissioner handles any legal actions brought against the non-resident producer.

The Commissioner can also arrange a reciprocal agreement, exempting certain people from taking the prelicensing examination. This agreement means that if someone from another state is allowed to transact insurance in California, then a California insurer will be allowed to transact insurance in that other state.

4. Temporary License

The Commissioner can issue a temporary license to someone before they've completed the final examination. The temporary license is valid for a maximum of **180** days.

A temporary license is granted if:

- A producer dies or is physically/mentally unable to follow through on their duties, a spouse or legal representative can obtain a temporary license to either give the producer time to recover or train their replacement.
- A producer enters into active military duty, a temporary license can be issued to allow the replacement producer time to train and obtain a license.
- The Commissioner revokes a producer's license and a temporary license needs to be issued, in order to give the replacement time to train and obtain their own permanent license.

The Commissioner can limit the temporary licensee's authority or revoke the license at any time.

5. Responsible Producers

California requires all producers to engage in honest and responsible insurance transactions. A producer has to meet certain qualifications before becoming licensed, such as:

- Be **18** years or older
- Establish a residence and business in the state of California
- Not committed a felony involving dishonesty or breach of trust (A violation of Title 18, United States Code, Section 1033-1034)
- Completes Pre-licensing Training from a school like Affordable Educators, college, or university registered with the Department of Insurance and received a Completion Certificate verifying educational hours (valid for up to **3** years)
- Passes the state examination with a score of **70 % or above**
- Pays the required fees
- Apply to the National Association of Insurance Commissioners (NAIC) Uniform Application. The Commissioner will send an Examination Eligibility Notice, which is valid for 180 days once approved

Note: Prohibited persons, such as felons, must request written consent from the Commissioner, pay a fee, provide all documentation, and receive consent prior to engaging in any business. It is a criminal offense, punishable by civil penalty up to **\$50,000** for each violation, and imprisonment for up to **5** years, to employ or permit prohibited persons to participate in the business of insurance without consent. The Commissioner may require additional information in some cases.

Businesses applying for Producer status must pay all applicable fees; plus, they are required to designate one person as the business' state rules and regulations compliance specialist.

6. Producer Appointment

Producers have to become affiliated with an insurer before they can transact insurance. Once someone is an affiliated producer, they represent the insurer, not the insured.

Being affiliated or appointed by a company basically means they hire a producer to sell their insurance. Just because you're licensed, doesn't mean you can immediately start selling your own brand of insurance: you need to represent an established insurance company.

Licensed insurance producers only represent the insurer that appointed them. They can't write policies or represent other insurers if they haven't been appointed. That being said, it's possible for a producer to be appointed by more than one company, and then they can transact insurance for each company.

Note: If a producer hasn't been appointed or affiliated, they can't legally transact insurance, even if they're licensed.

7. Termination of Appointment

An insurer may Terminate, or cancel, a Producer's Appointment or Affiliation at any time; however, the insurer must notify the Commissioner within **15** days of the termination. The Termination Notice needs to specify the reason(s) for

termination and either be delivered in person or mailed to the Producer's last known address. Whoever initiates the termination (either the insurer or Producer) is responsible to notify the Commissioner within **15** days of the effective termination date.

The insurer is exempt from notifying the Producer of an Appointment termination if the insurer ceases to sell insurance or if the termination is a mutual agreement.

The insurer can also terminate a Producer without written notice if any of the following occur:

- The license is denied, restricted, revoked, suspended, or cancelled
- The business is sold, transferred, or merged
- Bankruptcy is filed
- Fraud or intentional misconduct takes place

A licensee may **surrender his license** for cancellation by delivery of the license to the Commissioner, or if an insurer holds his license by written notice of the intent to cancel.

A license terminates upon the death of the licensee, or when an licensed entity ceases to exist or is otherwise terminated or dissolved.

A **co-partnership** however may continue to transact insurance if it files an application notify the Commissioner of the change in membership within **30** days.

A Producer may terminate an Agency Appointment at any time as long as the Commissioner and insurer are notified.

If a policy of insurance is issued regarding that application, the insurer is considered to have authorized the agent to act on its behalf, and the insurer is responsible for all actions of the agent that relates to the application and policy, as if the agent had been appointed. This has to happen no more than **14** days after the life agent submits an application for insurance to the insurer for which the insurer issues a policy. The insurer shall forward to the commissioner a **notice of appointment** of the life agent as the insurer's agent. However, nothing obliges an insurer to accept an application for underwriting from an agent.

An **inactive license** occurs when a licensed agent's appointment is terminated or the agent is NOT specifically appointed for a particular insurer. At that point, the agent cannot:

- Present a proposal to a prospective policyholder for insurance with that insurer
- Transmit an application for insurance to that insurer if the insurer requires all its life agents to represent only that insurer or a group of affiliated insurers of which that insurer is a member

Except when performed by a surplus line broker, the following acts are misdemeanors in California:

- Acting as agent for a non-admitted insurer to transact insurance

- Advertising a non-admitted insurer to transact insurance
- Aiding a non-admitted insurer to transact insurance

In addition to any other penalties, the person might have to pay **\$500** to the state, as well as **\$100** per each month the person continues the violation.

8. Obtaining a License

Here are the necessary requirements that must be completed if someone wants to obtain an insurance license in California:

A. Qualifications

Individuals in pursuit of a California insurance license must prove their qualifications to the Commissioner of the Department of Insurance.

The Commissioner will deny an application for any license if:

- The applicant isn't qualified
- Granting the license isn't in the public's best interest
- The applicant doesn't intend to actually engage in business
- The applicant doesn't have a good business reputation
- The applicant lacks integrity
- The applicant has been refused a professional, occupational or vocational license or had such a license suspended or revoked
- The applicant wants the license in order to avoid enforcement of insurance laws in California
- The applicant has knowingly or willfully made a misstatement in a document or application for a license, or

a false statement in testimony given under oath before the Commissioner

- The applicant has previously engaged in a fraudulent practice or a dishonest manner
- The applicant is incompetent and untrustworthy
- The applicant has knowingly misrepresented the terms or effect of an insurance policy or contract
- The applicant has failed to perform a duty or has committed an act expressly forbidden
- The applicant has been convicted of:
 - o A felony
 - o A misdemeanor by this code or other laws regulating insurance
 - o A public offense involving a fraudulent act or dishonesty in acceptance, custody or payment of money or property
- The applicant helped someone else do something which could result in the suspension, revocation or refusal of a license
- The applicant has permitted any person in his employ to violate any provision of this code
- The applicant has violated any provision of law under authority conferred by license
- The applicant submits a fake certificate to the Commissioner

Note: A judgment, plea or verdict of guilty or a conviction following a plea of “nolo contendere” is considered to be a conviction, so it’s best not to set even one toe in a courtroom.

In addition, the following acts could result in suspension or revocation of a license:

- The licensee makes the client cosign, or make a loan, investment, or gift of their policy
- The licensee talks the client into making them the beneficiary under the terms of any intervivos or testamentary trust, or the owner or beneficiary of a life insurance policy or an annuity
- The licensee talks the client into making them or any of their buddies a trustee under the terms of any intervivos or testamentary trust
- The licensee, acting as power of attorney for the client, used their position in order to buy insurance for the client that would give the licensee a commission.
- An entity that holds a license (a dba, corporation, etc) ceases to exist because of a dissolution of the corporation, partnership or membership.

Agent World: The insurance code is very specific: **Realtors or mortgage brokers** cannot require their customers to buy insurance as a condition of buying property or closing a loan. Nor, can they require customers to buy insurance through a particular agent or broker.

Producer applicants may eventually be qualified to receive a license in one of the following areas:

- Life Only Insurance
- Accident and Health Insurance
- Variable Life Insurance

- Property and Casualty Insurance
- Personal Lines Insurance
- Limited Lines Automobile Insurance

B. Written Consent

If a person who has been convicted of a felony or engaged in dishonest activity deemed inappropriate by the Commissioner, he/she may ask for Written Consent to transact insurance. The Commissioner will review each individual situation and, if applicable, establish rules or procedures for the individual to follow. If the person does not follow the Commissioner's mandates or commits other dishonest acts, he/she may not be able to transact insurance in the state of California.

C. Exemptions and Exceptions

The following people don't have to be licensed:

- An insurance company and its employees that are indirectly involved in insurance transactions. This includes an underwriter, loss control, inspection, processing, or claims settling employees
- Administrative, clerical, customer service, those in the position of receiving insurance premium, taking claims and requesting change
- A Producer or representative of a Fraternal Benefit Society, which is a non-profit group that provides Life and Health Insurance to its members. The Producer must not devote more than **50 %** of his/her time to selling insurance, plus not sell more than **\$50,000** of Life insurance coverage in a year.

- People who train others to become Producers and do not actually sell, solicit, or transact insurance
- An Attorney-in-fact who represents a Reciprocal Insurer, or an employee of the insurer or attorney
- A Real Estate Licensee who sells Home Protection or Warranty Insurance
- People who advise others regarding insurance, but do not solicit its sale

9. Maintaining a License

An individual is required to do the following in order to maintain their California insurance license:

A. Continuing Education

The Continuing Education Requirement promotes trustworthy and competent insurance agents for benefit of the public. All resident licensees must fulfill California's Continuing Education Requirement. An insurance license remains in effect (unless revoked or suspended) as long as applicable fees are paid and the Continuing Education Requirement is fulfilled.

This requirement does not apply to those persons holding resident licenses for any kind or kinds of insurance for which an examination is not required, nor shall it apply to any limited or restricted license the commissioner may exempt, or licensed nonresident agents who comply with the continuing education requirements or brokers of their state of residence.

Note: A licensee is exempt who submits proof satisfactory to the commissioner that he or she has been a licensee in good standing for **30** continuous years in this state and is **70** years of age or older.

Each new licensee is responsible for obtaining educational credit hours through approved instructional methods.

Upon renewal, these licensees must comply with the following requirement:

- Property Broker-Agents - A minimum of **24** hours per license term (every two years)
- Casualty Broker-Agents - A minimum of **24** hours per license term (every two years)
- Property Broker and Casualty Broker Agents - A minimum of **24** hours per license term (every two years)
- Life-Only and/or Accident & Health PLUS Property and/or Casualty Agents - A minimum of **24** hours per license period (every two years) following the date of the original license issuance.
- Personal Lines Agent -- A minimum of **24** hours per every license period following the date of the original license issuance.
- Limited Lines Automobile Agents -- A minimum of **24** hours per license period (every two years) following the date of the original license issuance.

The courses or programs of instruction that meet the standards for prelicensing or continuing education requirements, and the number of classroom hours for which they are equivalent, are as follows:

- Any part of the Life Underwriter Training Council (**LUTC**) Course Curriculum totaling **30** hours.
- Any part of the Chartered Life Underwriter (CLU) curriculum totaling 30 hours for the life-only license.
- Any part of the Insurance Institute of America's Accredited Advisor in Insurance (**AAI**) program totaling **25** hours
- Any part of the American Institute of Property and Liability Underwriters' Chartered Property Casualty Underwriter (**CPCU**) professional designation program totaling **30** hours
- Any part of the Certified Insurance Counselor (**CIC**) program totaling **25** hours
- Any insurance-related course approved by the curriculum board and the commissioner taught by an accredited college or university per credit hour granted totaling **15** hours
- Any course or program of instruction or seminar developed or sponsored by an authorized insurer, recognized agents' association, or insurance trade association, or any independent program of instruction, if approved by the curriculum board and commissioner, qualify for the number of hours assigned
- Any correspondence course approved by the curriculum board and commissioner qualify for the number of classroom hours assigned

B. Special CE Requirements

- **Ethics:** Every licensed agent must complete a minimum of **4** hours in specially-approved courses in ethics every

renewal period. Personal Lines and Limited Auto agents need only complete **2** hours. NOTE: This requirement is PART OF not in addition to the continuing education hours required and discussed above.

- **Annuities:** **Only life agent can sell annuities.** Every life agent who sells annuities shall complete an **annuity eight hour certification** course BEFORE soliciting or selling clients. Thereafter, **four hour certification refresher annuity training** must be taken **every two years** prior to license renewal. NOTE: This requirement is PART OF not in addition to the continuing education hours required and discussed above.
- **Long Term Care:** **Only accident and health agents can sell long term care.** Every agent who sells long term care insurance must complete an long term care **eight-hour certification course** BEFORE soliciting or selling long term care insurance. Thereafter, an **eight-hour certification long term care course** must be taken each renewal period. However, if the agent has been in business **less than 4 years, he must take** an eight-hour long term certification care course every year for the first 4 years in business in order to be certified to solicit and/or sell long term care. This does not increase the total continuing education hours required and discussed above.
- **California Partnership for Long-Term Care (PR):** **Only accident and health licensees can sell California partnership.** Accident and health agents who wish to solicit individual consumers for the California Partnership product must (prior to being authorized); complete one

specifically designated LTC training course (2004 LTC) and one specifically designated Partnership 8 hour course.

Maintaining authority to solicit individual consumers for the Partnership Product requires:

- o An **8**-hour specifically designated LTC training course (2004LTC) each year and must be accompanied by either a **4**-hour PR course every **12**-month period or an **8**-hour PR course every **2**-year license term.
- **Worker's Compensation:** Any life agent who wishes to sell **24-hour coverage** shall complete a course, or seminar of an approved continuing education provider on workers' compensation and general principles of employer liability. Satisfactory completion of this requirement is by proctored examination, administered or approved by the department.

Any person **failing to meet the requirements** and who has not been granted an extension of time within which to comply by the commissioner shall have his or her **license automatically terminated** until the time that the person demonstrates to the satisfaction of the commissioner that he or she has complied with all requirements.

Where a **person cannot perform the requirements** due to a **disability or inactivity** due to special circumstances, the commissioner will provide a procedure for the person to place his or her **license on inactive status** until the time that the person

demonstrates to the satisfaction of the commissioner that he or she has complied with all of the requirements.

C. Change of Address or Place of Business

Every licensee and every applicant for a license shall **immediately notify the Commissioner** in writing of any change in his address.

10. License Renewal, Nonrenewal and Fees

Not less than 60 days before a license will expire, the commissioner will mail, to the latest address of record, an application to renew the license for the succeeding license term. **It is the licensee's responsibility to renew** whether or not a renewal notice is received. (The commissioner may accept a late renewal. Application for renewal of a license may be **filed on or before the expiration date**. The application for **renewal of an expired license** may be filed up to one year later. The regular fee and a **delinquent fee of 50 %** of the regular renewal fee apply. Unless a license is suspended or revoked, a licensee **who has applied to renew** a license is entitled to continue operating under the existing license for **60 days after its specified expiration date**, or until notified the renewal application is deficient, whichever comes first, if the applicant has satisfied all license renewal requirements, including:

- The submission of the applicable renewal application and fee on or before the expiration date of the license.
- The satisfaction of all required continuing education or training requirements.

A. Military Service

If a licensed person enters the military service of the United States and is in the service at a time of a Renewal application, the filing of such application is waived, and the license held shall remain in force during the period of such military service and until the end of the license year in which he is released from such service but not for less than **6** months after such release. During this period a person can file an application and pay the fee without taking an examination or paying any penalty.

11. Suspension and Revocation of License

The Commissioner may suspend or revoke a license for any of the grounds on which he may deny an application. A suspension or revocation may be with or without notice or hearing based upon the reason for action.

The following are grounds for suspension, revocation and/or license penalties:

- Providing false or misleading information in the license application
- Violating any insurance laws or rules
- A violation committed by a partner or associate that was known or should have been known by the Producer
- Fraudulently obtaining or trying to obtain a license
- Mishandling money received through insurance transactions
- Intentionally misrepresenting the terms of a policy
- Having been convicted of a felony or misdemeanor where the Producer (or license applicant) was dishonest or breached the trust of others

- Fraudulently transacted insurance
- Demonstrated dishonesty in a business's financial matters
- Had a license revoked or suspended in another state (U.S. or Mexican) or Canadian Province
- Forged another person's name on an insurance document
- Cheated on the license examination
- Knowingly transacted business with an unlicensed individual
- Failure to pay a civil penalty or any fees to the Commissioner
- Failure to comply with the Continuing Education Requirement
- Refusal to renew a license by the Commissioner
- Transacting business with a non-admitted insurer, i.e., an insurer not approved to transact insurance in California (only surplus lines brokers are authorized to handle nonadmitted insurers).
- Requiring someone to buy insurance from you if they are securing a loan from a relative or affiliated party.
- Offering "free insurance" as an inducement to purchase or rent property or merchandise.

An accused Producer can request a hearing from the Commissioner. The Producer will have an opportunity to defend him/herself and will receive any decisions in writing.

Agent World -- Admitted vs, non-admitted insurer: For various reasons, you may only be able to place a client's insurance with a non-admitted insurer. A California **admitted insurer** is one that is domiciled (has a license to operate) in California. An admitted insurer is regulated by the State of California and also has the protection of the State's Guaranty Association – a fund used to protect policyholders by paying claims or guaranteeing insurance company investments much like the FDIC protects bank deposits. A **non-admitted insurer** is not subject to solvency and enforcement regulation by the State of California nor are they a member of the State Guaranty Fund. However, these types of insurers may be able to provide special types

of insurance, lower rates or more flexible underwriting not provided by admitted companies.

12. Records Maintenance

It is the obligation of each life, life and disability, and disability insurance agent and any other agent and insurer to preserve and maintain all applicable records in his or her possession, in addition to those records transmitted to the insurer, at his or her principal place of business for a minimum of **5** years. The records must be kept in an orderly manner, readily available, and open to inspection or examination by the commissioner at all times.

A. Reporting of Actions

If any administrative action has been taken against a Producer, he/she must report it to the Commissioner no later than **30** days after the final disposition or no later than **30** days of the initial pretrial hearing date in the case of criminal prosecution. The Producer must include all relevant documentation, including a copy of the court order, any complaints filed, plus the results of any hearings.

B. Assumed Business Name

Every individual and organization licensee and every applicant for such a License, shall file with the commissioner in writing the true name of the individual or organization and also all fictitious names under which he conducts or intends to conduct his business and after licensing shall file with the commissioner any change in or discontinuance of such names. The commissioner may disapprove the use of any true or fictitious name.

13. Fiduciary Responsibilities

A **fiduciary** is a person who is trusted to fulfill their responsibilities, especially where handling money is concerned. **All funds received** by an insurance agent, broker, or solicitor, life agent, life analyst, surplus line broker, special lines surplus line broker, motor club agent, bail agent, permittee, administrator, or solicitor, as premium or return premium for any policy of insurance, are held in a fiduciary capacity. Any person who diverts or appropriates those fiduciary funds to his or her own use is guilty of theft and punishable for theft as provided by law.

Producers accept payment for insurance premiums, plus handle money from business and personal use. It is extremely important that these premium funds are placed in a separate trust account and do not end up being mixed with other funds, except money used for the following:

- Advancing premiums
- Keeping reserves to refund premiums
- Paying bank charges and fees
- Paying for any other costs arising out of the process of receiving and returning premiums

A Producer must keep a **Client Trust Account** in the form of a checking account, demand, or savings account and fiduciary funds deposited into this account. If the insured makes the payment payable to the insurer, the Producer must forward it directly to the insurer.

Producers/agents must establish and maintain records in an appropriate accounting system for all client payments received. The **Commissioner** may request to see these records at any time during the **Producer's** business hours. If the **Producer** does not make these records available or maintain client premium fund records for **3** years following the policy cancellation date, serious consequences can result.

When receiving cash from a client for premium payments, the **Producer** must take the following steps:

- Give the person a receipt showing the amount of money paid, the date and time, the policy number, plus the policy holder's name
- Deposit the money into a **Client Trust Account**
- If the **Producer** does not have such an account, he/she must convert it into a money order, certified check, or cashier's check made out to the insurer
- Keep records of all money received and forwarded

Agent World – Return of Premium Offset: At any given time, an insured may be entitled to a refund or return of premium resulting from a reduction in coverage or cancellation of part or all of his policy. As an agent, you can use this refund to offset or pay for premiums owed on the same policy or another policy . . . as long as the amounts due and refund are for the same insured.

14. More Agent Responsibilities

In addition to fiduciary and records maintenance, items basic **legal responsibilities** as an agent can be summarized as follows:

- While it may not be your **legal duty** to secure **complete** insurance protection against every conceivable need an insured might have, but there is definite legal obligation to explain **policy options** that are **widely available at a reasonable cost**
- An agent has a legal duty to use **reasonable skill** in asking certain questions during the application process to determine types of coverage needed.
- Failing to determine the nature and extent of the coverage requested may subject you to a lawsuit and loss of license.
- In some cases, agents have been responsible for “after sale” duties to see that a policy continues to meet client needs. The more that your clients depend on you for their insurance needs and the longer you do business with them, the higher your standard of care is in selling and serving them.

Pretext Interviews: The insurance code prohibits the use of pretext interviews to collect information about potential customers. One such abusive scheme might involve an agent sponsoring a presentation or group function where potential clients are invited for one purpose (education or entertainment), under the **pretext** of collecting information about the client. Then, using that information to sell services or insurance products. An example involved living trust mills in the 1990's. Seniors were invited to seminars to learn about the benefits of starting a living trust. Asset information collected at **pretext interviews** was unethically shared or used by licensed agents to learn about client monies that could be repositioned in order to buy annuities or other investment products. This is illegal.

The **effect of authority** an agent assumes as a representative of an insurer varies. In general, the agent/broker generally assumes those duties normally found in any agency relationship. Your agency

contract is a good source of basic duties. There are three levels of authority surrounding agency agreements:

Express Authority: Specific authority you are given by the insurer . . . usually in writing. This can include your ability to represent the insurer, sell their products, solicit business, etc.

Implied Authority: Additional authority not specifically in writing but customarily given to agents of the insurer such as the ability to collect premiums.

Apparent Authority: Authority the public is lead to believe you have because of certain circumstances, e.g., an agent for Company ABC accepts a late premium payment and indicated the policy is reinstated. The agent may be acting beyond the scope of his authority but the public has not reason to doubt the agent is acting with authority.

15. Applications, Binding and Renewals

Insurance agents are more than sales people. You are involved in both pre-selection and post-selection process of evaluating clients or insureds. However, there are limitations on your involvement.

In the **pre-selection process**, you are typically asked to secure an application for insurance where the prospective insured completes answers to questions. The agent has a responsibility to the insurer to report to the insurer on the application to provide information the insurer requests, such as how long the agent has known the applicant, whether the agent has knowledge that the proposed insurance is being

purchased to replace existing insurance and to supply basic information the agent has knowledge of regarding the applicant's property, health, financial situation and general character. You certainly would not want to "lead" applicant answers simply to get him approved.

A **binder** is best described as temporary insurance used to cover the insured until the actual policy is issued. Depending on your insurer, you may be authorized to collect a premium and "bind" the coverage for the applicant on the spot. Certain lines of insurance, like long term care, prohibit binders as underwriting needs to take place before the client can be approved.

Certificates of liability insurance are forms produced by insurers or agents that provide evidence or proof to a third party that the insured has coverage. A bank or mortgage company, for example, would want to see evidence that your home is insured before or concurrent with making a loan.

Post-selection occurs when the insurer decides whether to continue or renew insurance. An insurer may decline to renew insurance or may offer narrower coverage. Responsibilities of the agent will be to help secure additional information or determine if the needs of the insured has changed.

Keeping or tracking client transactions or communications can be very important to serving a client and protecting yourself against lawsuits. A **suspense / diary system** is one such method. State law may

determine what you must include and how long records must be maintained.

As an agent, you may also be involved in securing a **lost policy release**. An insurer who cancels a policy is interested in being relieved from liability by requiring the policy be returned. If an insured has lost or misplaced his policy, a lost policy release form will help clear the air as the policyholder agrees to relieve the insurer from liability.

16. Agent Errors and Omissions Insurance

Like many professionals, insurance agents should carry E&O insurance. This is valuable protection for both you and your clients.

There is no standard errors and omissions policy. Most policies are written on a **claims-made** basis rather than on an **occurrence basis**. Claims made means the insurer is ONLY responsible for claims filed while the policy was in force. So, if a claim is made against you after you retire and cancel your E&O policy, it will not be covered.

Policies today also have some very significant limitations, caps, gaps, consent clauses and relatively high deductibles. Aside from the primary limits of the policy (\$1 Million seems to be the limit of choice for most agents) the **cost of defense** is the most important exclusion to watch. Does your errors and omission policy **include defense costs as part of the limit**? If so, the amount of money available to pay monetary or punitive awards will be significantly reduced. Defense costs can also be **limited to a percentage of policy limits**. Here, when the number is reached, **you** start paying for the balance of

defense costs. Obviously, the best errors and omission plan will pay for all ***defense costs in addition to policy limits***.

In addition, there are many other important coverage ***exclusions*** an agent must consider, such as: insurer insolvency, receivership, bankruptcy, liquidation or financial inability to pay; acts by the agent that are dishonest, fraudulent, criminal, malicious or committed while knowing the conduct was wrong; promises or guarantees as to interest rates or fluctuations of interest rates in policies sold, the market value of any insurance or financial product or future premium payments, etc.

Also, be aware of ***specific limitations***. You may not be covered errors and omissions in the following areas: punitive damages, business outside the state or country; failure to give notice if new employees or agents are added to your staff; fraudulent or dishonest acts of employees or agent staff; negligence may be covered, but bodily injury and property damage may not; judgements -- some policies only pay if a judgement is obtained against you; some exclude contractual obligations in the form of "hold harmless" clauses (watch them); outside services like the sale of securities, real estate or notary work.

Most errors and omissions policies are far from perfect. However, before losing interest in buying this valuable coverage, you should consider the high costs, and lost production time, associated in the defense of ***even one*** protected client claim and any subsequent judgement requiring an agent to pay any deficiencies and possible

attorney/court fees. The cost of the average errors and omissions policy is cheap when compared to these costs.

17. License Compliance

In addition to paying license renewal fees and performing continuing education, there are several areas where agents must comply in order to keep their license valid:

- **Agency Name (Fictitious Name):** Every individual and organization licensee and every applicant for such a license shall file with the commissioner in writing the true name of the individual or organization and also all fictitious names under which he conducts or intends to conduct his business and after licensing shall file with the commissioner any change in or discontinuance of such names.
- **Display of License:** Your license must be displayed in a prominent place in your office so it may be inspected by anyone to learn that it is current and the right license for the insurance you are selling.
- **Records:** Agents must maintain records in the principal office in the State of the agent's license and where the insured (customer) is served. Further, records must be maintained in an orderly manner and **readily available and open to inspection** by the insurance commissioner at all times. Records can be manual or mechanical (digital), and must provide an **audit trail** so that details like summary data, invoices, checks and statements can be identified. A record system should be able to trace any transaction back to its original source and sufficiently detail the application or process being performed. The following

records must be kept by agents for at least **five years after expiration or cancellation of a policy**: Name of insurer, policy number, effective date, termination date, gross premium amount, net premium amount, commissions and basis for same, names of others who received commissions or consideration, date premiums received, bank and account where premiums deposited (if any), date a premium was paid or mailed to another person or the insurer, etc. For at least one year after a policy is cancelled, these records must be kept in the office where the insured (customer) was served. For the remainder of the five years, they can be stored off premises as long as they are retrievable in two business days. **Violations** of recordkeeping may cause the insurance commissioner to require the agent to **restore records in 60 days**. Failure to comply can mean suspension or revocation your license.

- **Office Location**: Every resident insurance property and casualty broker-agent shall maintain a principal office in this state for the transaction of business. The address of the office shall be specified on all applications for license and renewal applications.
- **Change of Address**: Every licensee and every applicant for a license shall immediately notify the commissioner in writing of any change in his address.
- **Premium Financing**: Agents who arrange for the financing of premiums must disclose any and all compensation he may be receiving from the premium financier.
- **License Renewals**: After meeting all renewal requirements (fees and continuing ed), a licensee can continue doing business

for 60 days after his license expires pending the renewed license.

- **License Number:** Every licensee shall prominently affix, type, or cause to be printed on business cards, written price quotations for insurance products, and print advertisements distributed exclusively in this state for insurance products its license number in type the same size as any indicated telephone number, address, or fax number
- **Effective Date:** Agents are required to provide ALL applicants for insurance the circumstances (if known) under which coverage will be effective if there are conditions to that coverage.
Example: Your insurance will be effective when your premium is received by the insurer. You must notify applicants of their effective date at the time of application or when you provide a receipt for their premium payment.

Section PC 19

CODE & ETHICS

Objectives

Welcome to your courseware for **Code and Ethics**. This first unit will give you a **historical background** of the regulation of insurance, dating back to the 1850's.

This unit includes:

- Historical Background
- Federal versus State Regulation
- Ethics and History

1. Historical Background

The following timeline illustrates and explains important court decisions and events in the history of **Insurance Regulation** in the United States. You will come across many of these events again in your study of insurance and further down the road when you are a licensed agent.

A. Early 19th Century

There were no specific laws or regulations in place other than the individual state laws that governed corporations and private businesses. There were no state insurance laws on the books and no federal regulation of the industry. Resulting improprieties and abuses lead to a demand among the industry for regulation.

B. 1850

New Hampshire is the first state to establish a state **Insurance Commissioner**—still a very important office now. The states of Massachusetts, California, Connecticut, Indiana, Missouri, New York and Vermont soon appoint state Insurance Commissioners.

C. 1868

A Supreme Court decision in the case of **Paul vs. Virginia** rules that insurance is not interstate commerce. This establishes that states actually have the right to regulate insurance and not the federal government.

D. 1871

The **National Association of Insurance Commissioners** is formed. The **NAIC** seeks some uniformity with regards to state insurance regulation and reporting requirements. The organization also develops regulations concerning the solvency of insurance companies and methods for the exchanging of information between states.

E. 1905

In New York, the **Armstrong Investigation** of insurance is conducted to improve regulation and lessen abuses.

F. 1910

Again in New York, the **Merritt Committee Investigation** of fire insurers leads to greatly improved state regulation and a new state insurance code.

G. 1939

The state of New York adopts a rule that states all insurance companies doing business in New York *must* comply with the insurance laws of New York with regards to any state they do business in.

H. 1944

Another very important Supreme Court decision concerning ***Paul vs. Virginia***. The **South-Eastern Underwriters Case** causes the U.S. Supreme Court to overturn ***Paul vs. Virginia***, and rules that insurance was indeed interstate commerce when conducted over state lines and that federal anti-trust laws applied to the industry. The effect of this ruling left the industry virtually unregulated.

I. 1945

The **McCarran-Ferguson Act (Public Law 15)** is passed by Congress due to strong opposition against federal regulation of insurance. **This law gave back to individual states the right to regulate and tax insurance to the extent that it is not regulated by the federal government.** This is a landmark moment in the history of insurance regulation, and the **McCarran-Ferguson Act** is still an important law today.

2. Federal versus State Regulation

Current federal influence of the industry includes regulation by the Security and Exchange Commission (SEC) and the National Association of Securities Dealers (NASD) for securities regulation of certain insurance products; and the Internal Revenue Service (IRS) for tax code provisions regarding products and companies. Pension

legislation with regulations from the Labor department such as ERISA, protects plan participants and their beneficiaries. Health insurance legislation, such as the standardization of Medicare supplement policies, as well as long term care insurance, are areas of overlapping regulation by states and the federal government. The sale of insurance products in the banking industry will involve their regulatory organizations, The Federal Reserve and the Office of the Comptroller of the Currency.

Like any other industry, there is debate concerning the influences of federal versus state regulation.

Proponents of **Federal** regulation argue that:

- State regulation is not uniform which, leads to inefficiencies and other tangles. Despite improvement led by the NAIC's model legislation, this situation is unlikely to change.
- State regulation is ineffective in controlling insurance companies that operate on a nationwide basis.
- Federal regulation would be more effective as well as cheaper.

Proponents of continued **State** regulation argue that:

- State regulation is satisfactory, more flexible and capable of meeting individual state insurance needs. There is no real proof that federal regulation would improve conditions or be more efficient.
- The voluntary cooperation of state insurance departments has already made great strides in achieving uniform provisions.
- If federal regulation were imposed, it would lead to two regulatory systems instead of one cohesive system.

The future is likely to see more federal influence of the industry, however it is unlikely to become the sole regulator in all matters relating to insurance.

In state legislatures, and in Congress in recent years, there has been proposed legislation and passed legislation regarding current Life and Health insurance issues including; a tax on the cash value build-up in a life policy, certain mandated benefits such as Family or Maternity leave, privacy and authorization with HIPAA.

3. Ethics and History

The overall purpose of regulation is to **protect the public good** and the insurance consumer.

The state insurance department seeks to provide protection by regulation regarding three primary areas:

- 1) Company authorization and financial stability or solvency
- 2) Agent licensing and education
- 3) Sales practices

These regulations set minimum standards and form the basis of **ethical guidelines** by making certain actions unlawful. There remains a difference however between law and ethics. Witness the business scandals such as **Enron** and **World Com**, breaches in ethical behavior in the securities industry in spite of penalties that include prison as well as fines or civil penalties. An action may be lawful, but unethical.

Today, higher legal standards for the benefit of consumer protection will likely find an agent or company liable for their actions. Public perception of the industry has been affected by scandal, insolvency, class action lawsuits, and their own personal experiences.

How then, do insurance agents live up to higher expectations and responsibilities? To tell someone “Do the right thing”, may be too simplistic. A personal ethical or moral code is required to answer the question of what one should do in a given situation.

Ethical or moral codes have long existed, a universal norm being “The Golden Rule”, a version of it expressed by most religions including Christianity, Judaism, Islam, Hinduism, Buddhism, and Confucianism.

Ethics is the basis for trust, promises, and reliability in our business. Accepting ethics at the philosophical level is one thing, living the practicality of it in business daily is another. The evolution from insurance agent to insurance professional, and the responsibility of that role may help.

There are **7** requirements for recognition as a professional:

- 1) Specialized knowledge not understood by a lay person
- 2) Academic study of the subject
- 3) Licensing examination is required
- 4) Professional organization or society
- 5) Independence in their recommendations
- 6) Public recognition as professionals
- 7) A code of conduct (ethics)

Professional organizations include the National Association of Insurance and Financial Advisors (NAIFA), Society of Financial Service Professionals, the Million Dollar Round Table (MDRT), the American College, sponsor of the professional designations; Chartered Life Underwriter (CLU), Chartered Financial Consultant (ChFC) and Life Underwriting Training Council Fellow (LUTCF). Other designations in the industry are the Chartered Property Casualty Underwriter (CPCU), and Certified Financial Planner (CFP).

All of these organizations have a code of conduct, code of ethics, or pledge, that have as it's common theme, a recognition of obligations and responsibilities to those they serve:

- The best interests of the client come first
- Obey the law
- Loyalty to the company
- Professional conduct, truthfulness, confidentiality
- Duties to other professions, family, and self

Many of the regulations in our industry have to do with sales practices. Suitability, disclosure, sales illustrations, and replacement, the particulars of which you will learn later in units that follow, are the issues that concern regulators, companies, and ourselves as professionals.

The solicitation, selling, and servicing of insurance properly, may be accomplished by following some basic principles:

- Identify yourself as you are without misleading titles
- Use illustrations and sales materials properly

- Provide options or choices in recommendations
- Record all information requested on the application
- Protect client confidentiality
- Deliver the policy and explain things to your client
- Service with a regular review

Even so, the best professionals realize that mistakes are made, clients fail to remember what was once explained, and complaints occur.

Professional liability or malpractice insurance is a must today, and the professional agent carries **Errors and Omissions (E&O) coverage** for even a baseless lawsuit. If you are sued and the other party wins, E&O coverage will pay the loss, subject to policy limits and a deductible, in addition to defense costs.

An agent's exposure may be in one or more of several areas:

- Alleged misrepresentation of policy terms and coverages
- Misuse of policy illustrations
- Improper licensing for product
- Misunderstanding of tax ramifications
- Downside risk that is not explained
- Premiums or premium offset arrangements
- Incorrect information on an application
- Failure to provide proper coverage
- Inappropriate or unsuitable product recommendations

Agents can protect themselves with documentation of client files with copies of; checklists, questionnaires, factfinds, agendas, notes,

illustrations, disclosures, and phone logs. Maintaining client contact is important in the relationship also, and many agents use birthday or greeting cards, client newsletters, and periodic reviews to stay in touch.

Section PC 20

THE COMMISSIONERS & INSURERS

Objectives

In this unit we will discuss the office of **Commissioner of the California Department of Insurance (DOI)**. Another section of the Unit will describe the different types and classifications of Insurance Companies.

1. General Duties and Powers

The **Commissioner of the California Department of Insurance (DOI)** is the elected official responsible for administering and enforcing the laws of the California Insurance Code, and the California Code of Regulations.

Currently, the Commissioner has a **14** member executive team that includes a Chief Deputy Commissioner, General Counsel, Chief Deputy of Operations, and Deputy Commissioners for Enforcement, Financial Surveillance, Rate Regulation, Consumer Services and Market Conduct (underwriting, sales, ratemaking, claims handling), Legislative, Community Relations, Communications and Press Relations, as well as several assistants. Together they oversee 1350 employees, a \$200 million budget, and nine bureaus made up of Auto Enforcement, Sacramento Enforcement, San Francisco Enforcement, Corporate Affairs I and II, Policy Approval, Rate Enforcement, Fraud Liaison, and Government Law.

Note: In some states this office is referred to as the **Director** or the **Superintendent of Insurance**.

The **Commissioner** is responsible for enforcing the California Insurance Code, which are laws passed by the state legislature and the California Code of Regulations, and also the administrative law written by the **Commissioner** and staff to further interpret, explain, and enforce Code.

It is important to note that the **Commissioner** may *not* make changes to the Insurance code. Only the state legislature may make those changes. However, the **Commissioner** *may* review the Insurance Code and issue recommendations for changes.

It is also important that any notice required to be given to any person by any provision of this code may be given **by mailing notice**, postage prepaid, addressed to the person to be notified, at his residence or principal place of business in this State.

A. Issuing Orders

The Commissioner can issue orders, which are oral or written actions given to an insurance company, any representative of an insurance company, or anyone outside the DOI. An official order must include its intent, its effective date, the information the order is based on, and the specific Insurance Code provision that directly relates to the order.

A **Cease and Desist Order** is a written order from the Commissioner that tells someone they need to stop what they're doing. If the Commissioner determines that a Producer is doing something illegal or dishonest, the Cease and Desist Order means "knock it off or else..."

The Commissioner can issue a Cease and Desist Order to an authorized individual who is:

- Transacting insurance without the proper authorization
- Involved in dishonest or unfair acts
- In a hazardous condition
- In a hazardous financial condition
- Dangerous to the safety of the general public

Note: "Hazardous condition" is a legal term meaning the insurer/company is doing something construed as shifty. This could be filing a falsified financial report, not filing a financial report when its due, or claiming it has more/less money than it really does.

A **Cease and Desist Order** has to contain:

- The name and last known address of the person/organization
- A statement regarding the violations, and which parts of the code or which regulations were specifically violated
- The danger the violations could pose to the public
- The proposed penalty
- A command for the person/organization to immediately stop violating the code

B. Hearings

The Commissioner has the power to hold hearings. These hearings must be held upon written demand to the Commissioner. The written demand must include the reason for the Hearing. During the hearing, the Commissioner may:

- Deliver oaths and affirmations, subpoena witnesses and examine under oath any person who may be able to offer information towards the investigation
- Require the individual being investigated to produce any relevant evidence

The Commissioner may appoint examiners, administrators or deputies in order to collect evidence or conduct hearings. The Commissioner is responsible for the actions of these appointees and may revoke these appointments at any time. The Commissioner may act under the Insurance Code in a quasi-judicial capacity, in that the Commissioner may apply to any judge of any county circuit court for court-ordered contempt orders.

C. Issuing Penalties

The Commissioner can issue **3** different types of penalties towards those in the insurance industry:

- 1) Civil Penalties
- 2) Criminal Penalties
- 3) Disciplinary actions towards applicants or licensed agents

Here's a closer look at those **3** types of penalties:

Civil Penalties can be imposed on any insurance company that violates any provision of the Insurance Code. These penalties could be as high as:

- **\$1,000** per violation for individuals
- **\$10,000** per violation for companies

A Civil Penalty must be paid within **10** days after the order becomes final.

The Commissioner will impose **criminal penalties** if a violation of the Insurance Code leads to a criminal conviction for an individual. These penalties could be as high as:

- Up to **1** year in county jail, or a maximum fine of **\$1,000** for individuals
- A maximum fine of **\$10,000** for companies

Disciplinary actions towards applicants or licensed agents are actions the Commissioner may take against any licensed individuals or applicants for license. The Commissioner may revoke, suspend or refuse to renew a license for any business or classification of insurance. Also, the Commissioner may refuse to issue a license or grant authority for license to transact or engage in any business or class of insurance.

The following is a list of violations the Commissioner may penalize for:

- Incompetence or untrustworthiness of an agent
- Any dishonest or deliberately false act in relation to the insurance application or examination

- Violation or noncompliance with the Insurance Code
- Misappropriation, embezzlement or any illegal withholding of customer monies
- Conviction of any felony or imprisonment
- Material misrepresentation of policy terms
- Fraudulent or dishonest practices in transacting insurance business
- Failure to pay a civil penalty, fee, or charge assessed by the Commissioner
- Improper or illegal use of an insurance license
- Cancellation, revocation, suspension or refusal to renew the license by any other state or government agency
- Failure to comply with Continuing Education requirements
- Evidence of dishonesty, fraud, or misrepresentation of an agent even if such activity is not related to the insurance business

D. Financial Statements and Investments

All California insurers are required to submit a financial report to the Commissioner by December 31st **and due by June 30th**.

This annual report includes information on the company's/insurer's:

- Capital
- Stock
- Assets
- Liabilities
- Income
- Expenditures
- Balance sheet

- All insurance and premiums written in California.

Note: Audits determine the insurance company's financial condition, nature of operation, ability to fulfill insurance obligations and the presence of any Insurance Code violations. The insurance company under examination pays for any costs associated with these audits. The report becomes a public record.

2. National Association of Insurance Commissioners (NAIC)

The **NAIC** is an organization formed by the **Insurance Commissioners** from all **50** states, Washington, D.C., and Puerto Rico.

The purpose of the NAIC is to promote and support uniformity between the states in regards to the insurance business. The NAIC keeps a registry of all agent and producer licenses granted in each state that require such licenses.

Note:

With respect to the NAIC, insurance “agents” are now known as “producers,” unless you’re in a state where they’re still known as “agents.” In California, we call them producers, but if you think of the two as synonymous, you’ll do just fine.

This registry lists both licenses and appointments by state. The NAIC has formed a 'model bill' for each state to present to their state legislatures when attempting to make changes to State Insurance Code.

3. Classification of Insurance Companies

In California, **any person** capable of making a contract **may be an insurer**, subject to the restrictions imposed by this code. A “person” “Person” means any individual, association, organization, partnership, business trust, limited liability company, or corporation.

There are **3** different types of insurance companies for classification purposes:

- 1) Domestic
- 2) Foreign
- 3) Alien

Here's a closer look at those **3** classifications:

A. Domestic

Domestic insurance companies are ones that are incorporated and domiciled in California.

B. Foreign

Foreign companies are ones formed under the laws of any other state in the U.S.

C. Alien

Alien companies are formed and originate in another country outside of the U.S.

An **excess and surplus lines insurer** writes standard coverages in a state where the insurer is unlicensed.

A **standard market insurer** is an insurer who offers rates to insureds who have average or better than average loss exposure.

No matter the classification, all insurance companies in California must have a **certificate of authority**, issued by the Commissioner, to be admitted to transact insurance. It is a **violation** to act as an insurer without a certificate of authority. A public offense punishable **by imprisonment not exceeding one year** or by **fine** not exceeding **\$100,000** or both.

An **Admitted Insurer** has a certificate of authority and is permitted to do business and appoint agents in the state of California.

All authorized insurance companies have to:

- File detailed annual financial reports
- Pay all fees and expenses of the DOI examiners
- Contribute to appropriate insurance guaranty funds
- Agree to abide by all insurance Laws and Regulations
- Produce insurance business through licensed producers/agents

Note: If someone violates the requirement for a certificate of authority, they could face penalties of:

- Imprisonment in state prison, or in a county jail for up to **1** year
- A fine of up to **\$100,000**
- All of the above

An **Nonadmitted Insurer** is one that does not have a certificate of authority and is not permitted to appoint agents in the state of

California. A surplus lines broker is specially licensed to represent unauthorized insurers.

An insurer is considered **insolvent** when it is unable to meet its obligations when they are due. An impairment in "paid-in" capital is also considered grounds for the classification of insolvency. Further, an insurer cannot escape the condition of insolvency by being able to provide for all its liabilities and for reinsurance of all outstanding risks. An insurer must also be possessed of additional assets equivalent to such aggregate "paid-in capital" or "capital paid in" required by this code after making provision for all such liabilities and for such reinsurance.

Paid in capital is defined as the value of an insurer's assets in excess of its liabilities, expenses, taxes, debt and reinsurance.

If an insurer or agency you are involved with is found to be insolvent, the insurance commissioner, without any court order needed, can take possession of books and property. It is a misdemeanor to refuse to deliver any books records or assets once a seizure order has been executed. A violation subjects you to a fine of up to \$1,000 and imprisonment up to one year or BOTH!

Surplus Lines Broker

You might assume that "nonadmitted or unauthorized insurer" is simply the exact opposite of an authorized insurer, but it isn't. An unauthorized insurer isn't allowed to transact normal kinds of insurance, and so they deal with Surplus Lines brokers. A List of

Eligible Surplus Lines Insurers (LESLI), can be found on the California Department of Insurance website.

Surplus Lines brokers handle insurance for very high risks and non-standard coverages. For example, if someone wanted to insure a shipment of volatile chemicals, it would be difficult for them to insure such a high risk through the normal insurance market. The person would then contact a Surplus Lines broker, possibly working through his existing agent, who would arrange insurance through an unauthorized insurer.

It is important to note that there is an absence of “binding authority” when placing business through an excess and surplus lines broker.

4. Distribution Systems

Companies may further be classified by their marketing or distribution systems, such as:

- A. Direct Writers** (or Direct Response), companies that market by mail, phone, and /or the internet with their own employees.
- B. Exclusive** or Captive Agency, companies whose agents represent only one company.
- C. Independent Agency** -- agents represent and are appointed with several companies.
- D. Managing General Agent** (MGA), any person, firm, association, corporation, or partnership who manages all/part of an insurer's business. MGAs act as an agent and can underwrite up to 5 % of the insurer's annual policyholder surplus and may adjust or pays claims in excess of an amount determined by the

Commissioner as well as negotiate reinsurance on the insurer's behalf.

E. Home Service, also known as “debit” companies, sell small face amount policies and “industrial” insurance.

Insurers divide their company in major departments organized by function and include;

- Actuarial; responsible for data analysis, loss predictions, mortality and morbidity, premium determination
- Underwriting; determines standards for risks, evaluates applicant information, approve, decline, and rate risks
- Claims; investigation and settlement of claims
- Administration; policy issue, billings, commissions
- Investments; responsible for investment return for the insurer
- Marketing; sales, advertising, promotion and recruiting, training agents

The structure of insurance companies varies:

Stock Companies: Sell shares of stock to raise money necessary to operate. Stockholders own the company. Policyholders do not participate in dividends.

Mutual Companies: Policyholders contribute capital and become the owners. Their policies are participating in that they allow policyholders to participate in company profits. **De-mutualization** is the process whereby a mutual insurer becomes a stock company,

Fraternal organizations are described as any **benefits society** (without capital stock) conducted solely for the benefit of its members and their beneficiaries and not for profit.

Lloyds of London: Not really insurance companies, rather an insurance exchange where wealthy individuals agree be responsible for losses but also share in company profits.

Reciprocal and Risk Retention Group: A **Risk retention Group** is a form of insurer owned by policyholders who gather together to “self-insure” all or a portion of their risk, e.g., a group of doctors covering their own claims. In a **Reciprocal Group**, subscribers or members share insurance responsibilities and losses with other members but are managed by an attorney in fact. USAA is one example. Your consumers should know that coverage through these groups carries certain risks: They may not be subject to all insurance laws; nor do they qualify for state guaranty fund protection. In essence, the ability for these entities to pay claims is based solely on their present or reasonably anticipated financial condition.

5. Fraud and Prevention

The Department of Insurance, Division of Enforcement, has created the Fraud Division to enforce the provisions of the Code and to identify and **combat insurance fraud**. The business of insurance involves many transactions that have the potential for abuse and illegal activities. This division is intended to permit the full utilization of the department so that they may more effectively investigate and discover insurance frauds, halt fraudulent activities, and assist and receive assistance from federal, state, local and administrative law enforcement agencies in the prosecution of persons who are parties in insurance frauds.

Note: Preventing all types of insurance fraud significantly reduces the cost of insurance premiums.

The following statement is required on all claims forms in California:
"Any person who knowingly presents false or fraudulent claims for the payment of a loss is guilty of a crime and may be subject to fines and confinement in state prison."

Note: An insured signing a fraudulent claim form may be found guilty of perjury.

It is unlawful to do any of the following:

- Make or cause to be made a knowingly false or fraudulent material statement or material representation for the purpose of obtaining or denying any compensation
- Present or cause to be presented a knowingly false or fraudulent written or oral material statement in support of, or in opposition to, a claim for compensation for the purpose of obtaining or denying any compensation
- Knowingly assist, abet, conspire with, or solicit a person in an unlawful act under this section.

Anyone who commits fraud can be punished in one or more of the following ways:

- Imprisonment in a county jail for one year
- Imprisonment in the state prison, for two, three, or five years,

- Required to pay a fine that could be as high as **\$150,000** or required to pay a fine that's double the value of the fraud (whichever is higher)
- Required to pay restitution for any necessary medical evaluations or treatment services
- Possibly required to pay for the costs of the investigation

Note: Anyone who has had a prior felony conviction will also receive an extra **2**-years for each prior conviction in addition to one of the penalties mentioned above.

A. The National Automobile Theft Bureau

Every insurer in California is required to report covered automobiles involved in theft and salvage total losses, including the vehicle identification number to the National Automobile Theft Bureau (NATB) or a similar organization engaged in automobile loss prevention.

B. The Arson Information Reporting System

The **Arson Information Reporting System** was created to permit insurers, law enforcement agencies, fire investigative agencies, and district attorneys to deposit arson case information in a common database within the Department of Justice.

C. Fraud and Workers Compensation

When an insurer or rating organization knows or reasonably believes it knows the identity of a person or entity whom it has reason to believe committed a fraudulent act relating to a

workers' compensation insurance claim or insurance policy, including any application, the insurer, or agent authorized by an insurer to act on its behalf, or rating organization shall notify the local district attorney's office and the Fraud Division of the Department of Insurance.

D. Insurance Claims Analysis Bureau

An insurance claims analysis bureau performs the following functions:

- Collect and compile information and data from members or subscribers concerning insurance claims.
- Disseminate information to members or subscribers relating to insurance claims for the purpose of preventing and suppressing insurance fraud.
- Promote training and education to further insurer investigation, suppression, and prosecution of insurance fraud.
- Provide, without fee or charge, to the Commissioner, all California data and information contained in the records of the insurance claims analysis bureau in furtherance of the prevention and prosecution of insurance fraud.

6. Insurer Takeover

Whenever it appears to the commissioner that an insurer refuses to submit reports or meet prescribed deadlines, submit to an examination or where irreparable loss and injury to the property and business of an insurer has occurred or may occur unless the commissioner so act immediately, the commissioner, without notice and before applying to the court for any order, can take possession of the property, business,

books, records and accounts of the insurer, and of the offices and premises occupied by it for the transaction of its business, and retain possession subject to the order of the court.

Where there is sufficient time, the commissioner can also petition the court to act as a **conservator** for the insurer.

7. Insurer Discrimination

No admitted insurer, licensed to issue any policy of insurance covered by this chapter, shall **fail or refuse to accept an application**, issue or cancel a policy or charge a higher premium for reasons related to marital status, sex, race, color, religion, national origin, or ancestry; nor shall sex, race, color, religion, national origin, or ancestry.

Applications for insurance shall not carry any identification, or any requirement thereof, of the applicant's race, color, religion, national origin, or ancestry. A question on birthplace, however, can be used only to identify the applicant and not to discriminate against the applicant.

8. Insurer Privacy Protection Privacy Protection.

There are several significant acts of legislation agents should know affecting the privacy of consumer information supplied to financial institutions: 20-17

- 1. The Gramm-Leach-Bliley Act (1999)** concerns consumer financial privacy and financial safeguards: **Financial Privacy** -
- Requires financial institution to provide each consumer with a privacy notice explaining what information is collected about the consumer, where the information is used and how it is protected. Any changes must be disclosed. Prohibits the sharing of nonpublic information with a non-affiliated third party unless consumers are given an opportunity to opt-out.
Financial Safeguards -- Requires financial institutions to

develop a written security plan describing how the company is prepared for and plans to protect consumer nonpublic information, even if the consumer is no longer with the financial institution.

2. The California Financial Information Privacy Act (2003)

adds to the financial privacy provisions of Gramm-Leach Bliley by requiring that consumers **opt-in** PRIOR to any sharing of nonpublic information among financial institution non-affiliates. Consumers can **opt-out** for any sharing of information among affiliates of the financial institution.

3. Insurance Information and Privacy Protection Act (2003)

provides that personally identifiable information supplied to an insurance agent or broker in order to apply for insurance must be protected. Agents must provide consumers with a **Privacy Notice** explaining how and with whom this information will be shared and the consumer right to **opt-out** from having personal information shared.

Section PC 21

MARKETING & TRADE PRACTICES

Objectives

This unit will cover the Code and Ethics concerning the selling of insurance products in California. The purpose of Regulation concerning the Marketing of Insurance products is to ensure that all insurance companies act in good faith, abstain from deception and that they treat all members of the public with honesty and fairness in all insurance matters. While this is common sense in all business practices, there are several concepts and regulations that are particular to the insurance business.

1. Illegal and Unfair Practices

Insurance products are regulated to make sure that all members of the public are treated with honesty and fairness. Obviously, that's business ethics 101, but there are regulations specific to the insurance industry that could end up on the final exam.

With regard to the marketing or claims handling of insurance products, the following are defined as unfair methods of competition and unfair and deceptive acts or practices:

A. Misrepresentation

Misrepresentation means any of the following:

- Misrepresenting the terms of a policy, its dividends, the financial condition of an insurer, or making any misrepresentation to any policyholder insured in any company in order to induce them to lapse, forfeit, or surrender their insurance
- Making untrue or misleading statements
- Entering into any agreement to commit any act resulting in unreasonable restraint, or monopoly in the business of insurance
- Publishing or circulating false statements of financial condition in order to deceive
- Making false entries or willfully omitting any material facts in order to deceive
- Making or allowing any unfair discrimination
- Stating that the named insurer is a member of the California Insurance Guarantee Association, or stating that the insurer is insured against insolvency
- Canceling or refusing to renew a policy in violation of the code

B. Premiums

There are **3** main illegal practices regarding premiums:

- 1) **Commingling** means company money is mixed with the customer's money or the agent's money.
- 2) **Overcharging premiums** involves overcharging the insured and then keeping the excess.
- 3) **Charging premiums for unapplied coverage** means a producer accepts premium payments for coverage that isn't in effect.

C. The insurance License

It's illegal to transact insurance without a license, and it's illegal to obtain a license fraudulently. It's also illegal to sell insurance that's outside the scope of the license you have. If a producer is licensed to sell Property and Casualty insurance, they can't transact a Life insurance policy. So, just to reiterate:

- It's illegal to transact insurance without a license
- It's illegal to obtain a license fraudulently
- It's illegal to sell insurance outside the scope of your license

D. Rebating

Rebating means you use a sales inducement to get a prospective customer to buy an insurance policy. This could involve guaranteeing a dividend, splitting commissions with the client, or paying premiums for the client.

E. Illegal Inducement

This is a nice way of saying bribing somebody. It could mean giving gifts to prospective clients, offering them money, or even buying them nice dinners. Offering special contracts or changes to a contract or policy is also illegal, as well as offering prospective clients foot massages or a free phrenological assessment. Illegal, illegal, illegal.

F. Concealment

Concealment involves intentionally withholding facts or information to gain an advantage in an insurance transaction.

G. Twisting

Twisting means any situation where the truth is twisted or bent to get someone to drop an existing policy for a new policy. For example, if a producer could get a commission by convincing a client to drop their existing life policy, which takes care of all their needs, for a new policy they might not necessary need, the producer is engaging in twisting.

H. Defamation

The official definition of defamation is the malicious discrediting or slandering of an insurance company or its agents. Basically, it's saying/writing/impling something mean that could hurt a company/individual's reputation or cost them money. For example: "Buy from us, because unlike our competitors, we don't reek of day old cheese!" Usually it's harsher than that, but you get the general idea.

I. Controlled Business

You can't get a license just to write controlled business, which means you're only selling to friends and family. You can write some controlled business, but there are guidelines regarding controlled business:

- In a **2**-year period no more than twice the amount of a producer's premiums can be from controlled business
- A producer can't have twice the amount of controlled Life and Health policies, than they have for noncontrolled premiums

J. Free Insurance

This would fall under “inducement,” but the CIC specifies that Free Insurance is a no-no. Basically, someone would offer free insurance as a benefit of buying an annuity or a property. Agents/producers/insurers aren’t allowed to do this.

Note: The prohibitions of free insurance doesn’t include insurance written in connection with newspaper subscriptions or general circulation. It also doesn’t include insurance issued to credit unions or members of credit unions.

2. Misrepresenting Policy Provisions

It’s considered a misrepresentation of policy provisions if an insurance company or producer:

- Fails to disclose policy benefits during a claim
- Denies a claim because the insured fails to exhibit property without proof of demand
- Denies a claim because the insured didn’t act within time frames that weren’t in the policy
- Requires a release beyond the scope of claim for the payment of the claim
- Issues payment checks for partial settlement that releases the insurance company of it’s total liability
- Makes payments to the insured that requires reimbursement if the company doesn’t tell the insured about that policy

3. Unfair Claims Settlement practices

The following are considered specific unfair claim settlement practices. An insurance company can’t:

- Misrepresent facts or policy provisions

- Fail to respond promptly to a claim
- Fail to properly investigate a claim
- Refuse to pay a claim without an investigation
- Fail to affirm or deny coverage after Proof of Loss is provided
- Refuse to act in good faith when payment is reasonably clear
- Fail to offer reasonable settlement amounts, forcing the insured to resort to litigation or arbitration
- Delay processing a claim with excessive paperwork
- Delay settlement under one coverage as leverage to effect the settlement under another coverage for that policy
- Deny a claim without providing the insured with a clear explanation
- Discriminate against claimants who are represented by a public adjuster
- Fail to honor checks paid to claimants
- Fail to pay a claim promptly after settlement
- Fail to promptly deliver a release or settlement document to the insured or claimant
- Delay or add to the cost of Property/Casualty appraisals
- Fail to make a good faith effort to settle and force the insured into a Property and Casualty appraisal
- Settle directly with a claimant who's represented by an attorney without the attorney's consent
- Delaying the payment or provision of hospital, medical, or surgical benefits for services provided with respect to acquired immune deficiency syndrome or AIDS-related complex for more than **60** days after the insurer has received a claim for those benefits, where the delay in claim payment

is for the purpose of investigating whether the condition preexisted the coverage.

Note: This **60**-day period doesn't include any time during which the insurer is awaiting a response for relevant medical information from a health care provider.

3. Prompt, Fair, and Equitable Settlements Definitions

Claimant

The claimant is any person who asserts a right of recovery under a surety bond, an attorney, any person authorized by operation of law to represent the claimant.

Proof of claim

means any evidence or documentation in the possession of the insurer, whether as a result of its having been submitted by the claimant or obtained by the insurer in the course of its investigation, that provides any evidence of the claim and that reasonably supports the magnitude or the amount of the claimed loss.

D. File and Record Documentation

Every licensee's claim files shall be subject to examination by the Commissioner or by his or her duly appointed designees. These files shall contain all documents, notes and work papers (including copies of all correspondence) which reasonably pertain to each claim in such detail that pertinent events and the dates of the events can be reconstructed and the licensee's actions pertaining to the claim can be determined.

E. Duties upon Receipt of Communications

Upon receiving any written or oral inquiry from the Department of Insurance concerning a claim, every licensee shall immediately, but in no event more than twenty-one (21) calendar days of receipt of that inquiry, furnish the Department of Insurance with a complete written response based on the facts as then known by the licensee. A complete written response addresses all issues raised by the Department of Insurance in its inquiry and includes copies of any documentation and claim files requested.

Upon receiving any communication from a claimant, regarding a claim, that reasonably suggests that a response is expected, every licensee shall immediately, but in no event more than fifteen (15) calendar days after receipt of that communication, furnish the claimant with a complete response based on the facts as then known by the licensee. This subsection shall not apply to require communication with a claimant subsequent to receipt by the licensee of a notice of legal action by that claimant.

4. Standards for Prompt, Fair and Equitable Settlements

These are the standards for prompt, fair, and equitable settlements by insurance companies.

No insurer shall discriminate in its claims settlement practices based upon the claimant's:

- Age
- Race
- Gender
- Income

- Religion
- Language
- Sexual orientation
- Ancestry
- National origin
- Physical disability
- Address or location

After receiving proof of claim, every insurer has to:

- Accept or deny the claim as quickly as possible, and no later than **40** calendar days
- Notify the claimant if more time is required to determine whether a claim is going to be accepted or denied, either partially or wholly. The claimant needs to be notified every 30 days if more time is needed
- Settle the claim by making a reasonable offer—insurers can't make an offer that's unfair or unreasonably low

Note: If someone thinks they have received an offer that's too low, they can file a complaint with the Commissioner. The Commissioner shall consider any admissible evidence offered in determining whether or not a settlement offer is unreasonably low.

- Pay any approved claims no later than **30** calendar days

5. Insurance Information and Privacy Protection Act

An insurance institution or agent has to provide a notice of information practices to all applicants or policyholders in connection with insurance transactions as provided below:

- At the **time of the delivery** of the insurance policy when personal information is collected only from the applicant, an insured under the policy, or from public records
- At the **time of the collection** of personal information is initiated when personal information is collected from a source other than the applicant, an insured under the policy, or public records.

The written notice has to include the following:

- Whether personal information may be collected from persons other than the individual or individuals proposed for coverage
- The types of personal information that may be collected and the types of sources and investigative techniques that may be used to collect such information
- The types of disclosures and the circumstances under which the disclosures may be made without prior authorization
- A description of the rights established and the manner in which the rights may be exercised.
- That information obtained from a report prepared by an insurance-support organization may be retained by the insurance-support organization and disclosed to other persons

Disclosure forms must be:

- In plain language
- Dated
- Include the nature of information, as well as to whom it may be disclosed
- The name of the agent or insurer
- How long the authorization is valid.

Penalties for violation could include a fine of up to **\$50,000** and any court awarded damages.

Note: In California, marketing life, annuities, or disability to seniors who are **65** years or older, has specific regulations. Policies have to include a **30**-day free look period, a written comparison of any existing health coverage, and the person has to receive advice concerning HICAP's free services to seniors (the Health Insurance Counseling and Advocacy Program).

6. The Insurance License

It is illegal to sell any insurance product without an official state-granted license to do so. Also, selling insurance that is outside the scope of one's license is illegal. If an agent is licensed to sell Automobile and Home insurance, they cannot sell or write a Health insurance policy without being licensed for that line. It is also illegal to obtain any insurance license by fraudulent means.

Every licensee shall prominently affix or be printed on business cards, written price quotations for insurance products, and print advertisements distributed exclusively in this state for insurance products, its license number in type, the same size as any indicated telephone number, address, or fax number, as well as the word "insurance".

If someone violates these rules, the person could receive a fine of up to:

- **\$200** for the first offense

- **\$500** for the second offense
- **\$1,000** for the third offense, or any other offenses afterwards

Note: The penalty can't exceed **\$1,000** for any one offense.

7. Unfair Discrimination

Insurance companies can't deny insurance coverage based solely on the basis of race, religion, or national origin. Coverage also can't be denied because of a physical or mental disability.

Law and regulations regarding unfair discrimination state that:

- Insurance companies have to treat all applicants equally
- Insurance companies can discriminate as long as the discrimination is based on **Risk Selection and Sound Actuarial Principles**

Note: **Risk Selection and Sound Actuarial Principles** are methods for determining whether a person or a group of people are desirable insurance risks. This takes into account their age, occupation, gender, lifestyle, and history, but it also looks at a statistical model of certain demographics. Actuarial principles help companies deduce how much money in claims they could end up spending on claims based on morbidity rates, mortality rates, etc.

Companies are allowed to use the following characteristics only if those characteristics increase the risk of insurance:

- Age
- Sex
- Marital status
- Race

- Creed
- National origin
- Ancestry
- Lawful occupation
- Change of occupation
- Change of domicile
- Previous insurance rejection
- Cancellations/nonrenewals of insurance
- A previous lack of insurance

8. HIV

California has established mandatory and uniform minimum standards for insurers to avoid making or permitting unfair distinctions between individuals of the same class in the underwriting of life or disability income insurance for the risks of acquired immune deficiency syndrome (AIDS) and AIDS-related conditions (ARC), for assessing AIDS and ARC risks for determining insurability which are deemed to be sufficiently reliable to be used for life and disability income insurance risk classification and underwriting purposes, and to require the maintenance of strict confidentiality of personal information obtained through testing as well as require informed consent before any insurer tests for HIV.

9. Commissions and Fees

Only licensed producers can receive commissions or fees, or any other valuable considerations from insurance transactions. It's illegal for anyone who isn't licensed to accept a commission. Someone can accept renewals and deferred commissions if they were licensed at the time of the sale.

A service fee is a charge the insurance producer makes that isn't part of premium payments.

Note: Service fees aren't allowed in Personal lines of insurance: Auto, Property, and Liability.

Service fees can be charged in Commercial lines of insurance if the producer provided additional services above and beyond customary practice. In these instances, the producer would have to provide a written explanation for the charge.

You can't accept compensation from the insurance company unless you have done the following, prior to the insured's purchase of a policy:

- Obtained the insured's documented acknowledgement
- Disclosed the amount of reimbursement or provided a reasonable estimate of what that reimbursement might be
- Disclosed the nature of the work that will be done on behalf of the insured

10. Advertising

False advertising is illegal. Here are some guidelines concerning advertising:

- Advertising has to be clear and not misleading
- If a company advertises their assets, those assets have to match the last verified statement filed with the Commissioner
- You can't infer or suggest you're an insurer unless you're an insurer

- All advertising has to be true and accurate no matter what form it's in: media, newspapers, magazines, online, and etc.

Note: Advertisements for term life insurance aimed at people who are **55** years or older will:

- Clearly and prominently distinguish basic life insurance benefits from supplemental benefits such as accidental death benefits
- Prominently disclose any limitations, exceptions, or reductions affecting each benefit
- Prominently disclose any condition affecting the policy or certificate holder's continued insurability. If term coverage terminates at a stated age, or at the end of any designated period, that fact and the specified age or designated period shall be disclosed
- Prominently disclose any change in benefits resulting from the aging of the insured, policy duration, or any other factor
- Prominently disclose any change in premium resulting from the aging of the insured, policy duration, or any other factor. If the insurer retains any right to modify premiums in the future, that fact shall be disclosed

A. Internet Advertising

A person licensed in this state as an insurance agent or broker, who advertises on the Internet, and transacts insurance in this state, must identify all of the following information on the Internet:

- Name as it appears on his or her insurance license, and any fictitious name approved by the commissioner
- The state of his or her domicile and principal place of business

- License number

If someone who advertises on the Internet does any of the following, the California Code considers them to be “transacting” insurance:

- Gives an insurance premium quote to a California resident
- Accepts an application for coverage from a California resident
- Communicates with a California resident regarding terms of an agreement to provide insurance or an insurance policy

11. Fiduciary Responsibilities

Producers have certain financial responsibilities. If they receive premium payments on behalf of an insurance company, they have to report the exact amount of the payment and records must be kept on all received/refunded premiums.

Any refunded or returned premium has to be delivered promptly to the insured.

If the producer accepts a premium payment, they have to provide the insured with a receipt for the payment of premium no later than the next business day.

The producer has to deposit premium payments within **7** days of receipt, and if the payment is a check that's made out to the insurance company, the producer has to forward the check directly to the insurance company.

Note: Insurance producers have to keep client records for Property and Casualty insurance for **3** years past the policy's expiration.

If premiums are paid in cash, the insured has to get a receipt, which includes:

- The date
- The name of the agent/producer
- The name of the policyowner/insured
- The amount received
- The insurance company's name
- The policy number

Okay, so some of that is ultra-obvious. Don't roll your eyes at us, we're just being thorough.

Note: Just a quick aside—if there are extra charges relating to someone's policy or application, the insured needs an explanation in writing for those charges.

12. Policy Retention

Policy retention benefits everyone. A producer who keeps an open line of communication with his/her clients will have the opportunity for more sales, as well as be able to provide the maximum protection for that client.

It benefits the client because they always have the insurance protection they need. And, obviously, if a producer has a lot of

happy clients, this is going to benefit the producer and the insurer financially.

Section PC 22

CALIFORNIA INSURANCE GUARANTEE FUND

Objectives

Guarantee associations are the safety nets of the insurance industry. This unit includes:

- What are Guarantee Associations?
- The California Life and Health Guarantee Association
- The California Insurance Guarantee Association (CIGA)

1. What are Guarantee Associations?

Guarantee associations protect the public from insolvent insurance companies. “Insolvent” means an individual or company can’t pay their debt. The company might even be going through bankruptcy. The Commissioner determines if a company is insolvent, which means the company can’t fulfill any future financial obligation.

Here’s the core of the issue: just because a company becomes insolvent doesn’t mean it can stop paying claims. If an insurance company becomes insolvent, and then its clients experience covered losses, those clients still have settlements coming to them.

Obviously, once a company is bankrupt, it doesn't really have the money to pay insureds' claims. Guarantee associations pay insurance claims that an insolvent company isn't able to pay. This protects claimants and policyowners.

Any insurance company that wants to do business in California is required to belong to one or both of the following guarantee associations:

A. California Life and Health Guarantee Association

The **California Life and Health Guarantee Association** is under the Commissioner's authority, and protects annuity policyholders, beneficiaries, and payees of Life and Health policies.

The California Life and Health Guarantee Association guarantees any payments of benefits and continued coverage if an insurance company becomes insolvent. This association guarantees the following:

- **80 %** of contractual limitations
- Up to **\$250,000** for Life insurance Death benefits
- Up to **\$100,000** for cash surrender value
- Up to **\$100,000** for the present value of annuities
- Up to **\$200,000** for Health benefits

Note: The maximum amount an individual can receive for all policies is **\$250,000**. The maximum amount a firm or corporation can receive for all policies is **\$5 million**.

The **California Life and Health Guarantee Association**

doesn't cover:

- Variable Life or Variable annuities that aren't guaranteed by the insurer
- Risks the policyholder accepted
- Any part of the policy that's reinsured
- Policies issued by a health care service contract
- Anyone that's self-funded or uninsured
- Parts of a policy subject to dividends or experience credits
- Policies issued by an insurer that doesn't have a Certificate of Authority in California
- Any coverage issued by the California Medical Insurance Pool

B. California Insurance Guarantee Association for Property and Casualty

The **California Insurance Guarantee Association for Property and Casualty** protects Property and Casualty policyowners from insolvent insurance companies.

Every California insurance company that transacts Property and Casualty insurance has to be a member of the California Insurance Guarantee Association for Property and Casualty.

The limits of coverage ***per policy*** for all Fire and Casualty (excluding Workers Compensation) are:

- A minimum of **\$100**
- A maximum of **\$500,000**

The California Insurance Guarantee Association for Property and Casualty pays claims for most types of Property and Casualty policies, including Workers Compensation.

Alert!

There is no limit on Workers Compensation claims. The California Insurance Guarantee Association for Property and Casualty doesn't put any limits on Workers Compensation claims. We're drawing attention to this fact, because we've seen this actual question on the test.

Claims are paid if they are filed within **30** days of a company becoming insolvent. Once the Commissioner receives notification that a company is insolvent, the Commissioner notifies the CIGA within **3** days.

The Commissioner could request that the policyowners also be informed of the insolvency and their rights regarding the insolvency. Claims are paid up to **\$500,000**.

Note: Before a company can receive a Certificate of Authority in California, they have to belong to one or both of the CIGA. They won't be able to transact insurance business or appoint any producers until they've done so.