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Continuing Education Self-Study Course

Nuts & Bolts of P & C Insurance

630560 3 Credit Hours

The Nuts and Bolts of Property & Casualty Insurance
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The Nuts and Bolts of Property & Casualty Insurance

Agents who represent property and casualty companies (*referred to as P&C*) are in a position to greatly help consumers. Young or old, single or married, it is important to properly protect oneself against financial loss. This certainly includes losses from automobile accidents or home losses due to fire and theft.

Insurance companies are an important part of society and the economy. Insurance companies are **financial intermediaries,** which mean that they obtain money from one source and redirect it to another. Banks, savings and loan associations, as well as insurance companies, basically collect small sums of money from their clients and policyholders, pool the money, and then lend larger sums to and/or invest larger sums into other entities. Of course, not all financial intermediaries operate in this exact manner. Consumer and sales finance companies generally obtain large sums of money in the commercial paper market and then lend it in smaller sums to individuals and businesses. Even so, the basic formula is the same either way; there is merely a difference in the direction of the money.

As we know, business capital is in short supply. For that reason, there is a need for efficient collectors and distributors of capital because there is a demand for business capital.

There are many economic aspects to insurance involving our society. Many areas of business, besides that of available business capital, could not exist as it is today without the aid of insurance. As a result, the benefits of insurance for society outweigh the cost involved.

Many industries take more than one form. This is also true for insurers. In the United States insurers are either privately owned or ran by a government entity.

Within both, the privately owned and the government run insurers, there are additional sub-categories. For example, a company may be a **proprietary** or a **cooperative company.** There is a general difference between a proprietary and cooperative company. Proprietary insurers are organized and operated for profit. Cooperative insurers are formed and operated to provide insurance at cost to its members.

This is an oversimplification to some degree. For example, a proprietary insurer may be formed and operated by another business to obtain their insurance at cost. In this situation, the subsidiary insurance company is called a ***captive insurer.*** They may be formed as an alternative to self insurance.

I. Risk

As we know, insurance is bought to offset the risk, which exposes a person(s) to losses resulting from **perils.** The term **"risk"** is often interchanged with the terms **hazard** and **loss.** Risk is generally considered to be the uncertain potential for loss. There are varying degrees of risk; risk is usually not desired.

In basic terms, insurance is the transfer of risk from one entity to another. An insurance policy transfers the threat of financial loss from the policyholder to the insurance company. Of course, if insurance were merely risk transfer, then insurance regulation would simply address this issue. However, insurance deals with much more than risk.

An **insurable exposure** is one for which insurance may be purchased. That determination is the function of the analysts and the underwriters employed by insurance companies.

The ability to predict probabilities, a necessary part of predicting risk and loss, requires the use of the **"law of large numbers."** No insurance company can afford to insure a type of loss that will likely happen to large numbers of people in a single occurrence.

The words, **"chance of loss,"** are often used in place of the word or term **"risk."** However, they may not always mean exactly the same thing. The **chance of loss** is often stated as a percentage since it often expresses mathematical probabilities of probable numbers and severity of losses out of a given number of exposures. To put this in simpler terms, if a person flips a coin, there is the 50/50 chance that heads will land face-up. This may be stated as 50/50, 1/2 or 50%. So it is with **chance of loss.** The probable number of losses is the numerator and the number of exposures is the denominator.

When insurance companies figure their chances of loss, it is a serious undertaking. To miscalculate such chances could cause the company serious financial losses. This is true regardless of the type of policy involved.

Chance of loss is also the basis upon which rates or premiums are established by the insurance companies. A degree of accuracy is absolutely necessary.

Insurance protection brings about another factor: morale and moral hazards. While similar, each type of hazard is actually distinct. A morale hazard involves human carelessness or irresponsibility, rather than an intentional act. This might occur because an individual or a business was aware that they had insurance protection, so their actions were not well thought out. Moral hazard (no "e" at the end), on the other hand, involves an intentional human act. Moral hazards include such things as arson for profit and other types of fraud. Both types of hazards include humans and their actions.

Again, insurance is purchased to offset the risks we are exposed to, whether that risk involves our homes, cars, health or lives. Insurance underwriters and analysts rely on specific risk numbers to offset their chance of loss. Using a gambling term, one might say that insurance companies *"play the numbers."* It has frequently been said that insurance companies are the best scorekeepers there are. They are more likely to know the possibilities of either loss or gain than anyone else.

The **"law of large numbers"** is related to the degree of risk. Of course, insurance agents and insurance agencies also play the "numbers" game. Most professionals are well aware of how many times they must hear "no" before the "yes" comes along. Without becoming involved in the complicated mathematics, the law of large numbers basically states: ***the greater the number of similar units exposed to a similar loss, the more accurate the loss predictions based on that data will be.*** The law of large numbers may also be called the **law of probability.** Of course, the law of large numbers is not really a "law" at all. It is an entire branch of mathematics.

For instance, with life insurance, statistics are readily available to the insurance companies. The statistics show the probability of death according to sex, ages and even professions.

In the 17th century, European mathematicians were putting together crude mortality tables. They discovered that the percentage of female and male deaths among each year's births tended toward a constant if sufficient numbers of births were tabulated. It was not until the 19th century that Simeon Denis Poisson named this principle the **"law of large numbers."**

In its simplest form, risk (exposure to danger or adversity) is easy enough to understand, but becomes more complex when it is applied to the insurance field. The insurance industry tends to tie risk and the possibility of financial loss together. The chances and types of risk may be divided into categories. There are basically two types of risk:

(1) fundamental risk and particular risk and

(2) pure and speculative risk.

While fundamental and particular risks are linked together as are pure and speculative risk, each one is specific and separate. A **fundamental risk** is a type of risk to which society in general (or at least a large number of people) is exposed to in a single occurrence. A **particular risk** is one to which relatively few people are exposed to in a single occurrence. Sometimes it can be very difficult to make a distinction between the two types of risk. A recession is a risk to a large portion of society, so that would be a fundamental risk, whereas investors who contribute to a specific project are involved in a particular risk because only those investors are exposed to that particular loss.

Some types of risk seem to have properties of both fundamental and particular risk. This may especially be true when it comes to disability insurance. Particular risks, since they involve small numbers of people, are easier to insure.

Pure risk is a chance of financial loss that does not offer a chance of financial gain simultaneously. On the other hand, a **speculative risk** does offer the chance of both financial loss and financial gain at the same time.

Obviously, it is a financial loss when a person's car is damaged in an accident. If no accident occurs, the car owner does not receive any financial gain. **Pure loss** is at times described as a loss or no loss situation. There is never any gain with pure risks.

With speculative risks, the person involved is taking some type of action that purposely exposes them to the possibility of a loss. There are two elements involved in speculative risks:

1. There is a chance for gain as well as loss,
2. The individual usually creates a speculative risk for themselves by their own intentional actions.

There are many types of speculative risks including such things as gambling and some forms of investing. Between pure and speculative risks, pure risks are more easily insurable. In most insurance matters, those risks with a low frequency and high severity lend themselves best to insurance coverage.

When it comes to insurance policies, many people have heard the saying ***"What the big print giveth, the little print taketh away."*** In actuality, this saying is ***not*** true. Most states have laws requiring that "conditions" and/or "exclusions" be in type at least as large and clear as the statements of coverage. In some cases, the type must be larger or in boldface type.

Unfortunately, an agent would have a difficult time convincing a policyholder whose claim has been denied that this is true. Few policyholders ever actually read their policies. The insured often first realizes that their policy does not cover **everything** when a claim is denied. It is at that point that an insurance agent or an insurance company is typically accused of "hiding the details."

All coverage under any insurance contract is subject to some type of limitations. It is very important that insurance agents outline those limitations (of course, we may have had the occasion where, after fully covering the limitations in a policy, the client says "so this covers every thing?").

The term "risk" may be used in many different ways. **Simply put, risk means *exposure to danger or adversity.*** When investments are involved, risk is generally defined as uncertainly concerning loss. The two key words here are ***"uncertainty"*** and ***"loss."*** It is important to understand that risk is connected to the uncertainty, ***not*** to the loss.

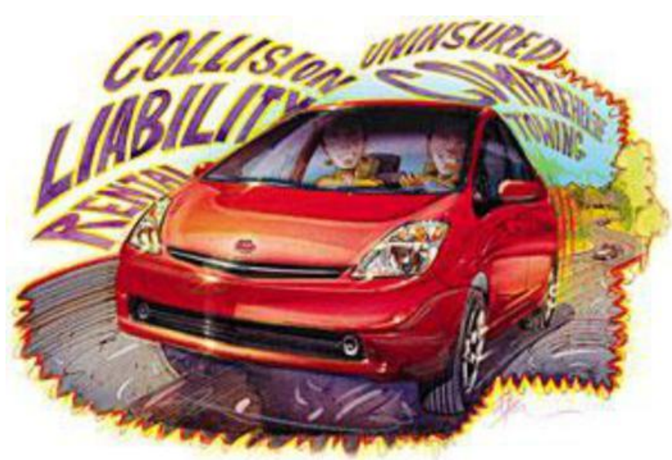
As we know, the basic function of insurance is to handle risk. The accuracy with which losses may be predicted is the measure or degree of risk.

There is some amount of social risk as well as financial risk. Generally speaking, most people try to avoid most risks in their lives. For example, the average person would not cross a street in heavy traffic. Past such daily risk avoidance, however, fear of risk has an economic price. Risk may discourage investors and can affect how financial resources are placed. Poor areas of cities often experience this. As an agent, you may find that your companies do not like to place insurance in certain areas that experience high rates of claims.

Insurance does not completely eliminate risk because achieving an infinite number of exposure units is not possible. One may always expect some deviation of actual results from expected results. Surely, statistics, upon which the predictions are based, can never be perfect either. Even if the statistics used for predictions were absolutely accurate, there is no reason to believe that tomorrow's losses will exactly duplicate yesterday's losses. As a result, there will always be uncertainties in predicting insurance losses.

II. Auto Insurance

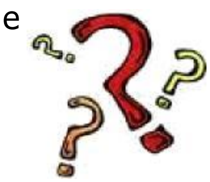
It is a simple fact of life that all drivers cannot be trusted to do the "right" thing. Many states mandate that drivers carry minimum amounts of liability insurance in order to guarantee compensation if they are at fault for an accident. Be that as it may, it is best to carry personal insurance and not count on the other guy to do so.



An **insurance policy** is a contract between the insured and the insurance company. The insured pays a **"premium,"** which is the price or cost of the policy. The insurance company agrees to pay for the insured's losses resulting from events, which the policy covers. Fire, burglary or a car collision would be examples that would be covered under a property and casualty policy. Policies typically have what is called a **"policy limit."** That means there is a limit to the amount of money the insurance policy will pay on a loss.

If a driver causes an accident, or is somehow shown to be at fault, it will not matter how large or small his or her policy is. Damages will be awarded according to many factors, but not that one. For example, if he or she has a judgment levied against them for $100,000 and his or her liability policy has a $25,000 limit, he or she will still be required to pay the full amount awarded. People have lost their homes, savings and everything else they own due to being under-insured. Therefore, a larger insurance policy not only assures compensation for those who are wronged, but it also protects *the driver* from the financial consequences.

Whether the policy is for property and casualty or life and health, insurance policies seldom (if ever) covers every possible kind of loss. If an insured is concerned about a specific cause of a loss, questions should be asked to be sure it is covered under their policy.



Many insurance contracts or policies contain **"deductibles."** A deductible is a specified amount of money that the insured must pay on a claim **before** the insurance company will pay anything. Usually, the deductible is per claim or per accident, so it may apply as often as a claim or accident occurs. Losses under the deductible amount simply come out of the insured's pocket. The higher the deductible, the lower the premium cost for the policy.

It is human nature to want an insurance policy to return the premiums paid in. As a result, a common complaint of consumers involves high deductibles. However, the sensible way to buy insurance is to construct the policy so that large losses are covered. Most people can handle the smaller ones themselves.

Of course, the term, "smaller claims," may mean different figures to different people. It is necessary to understand that one household may be able to handle a $1000 loss themselves while another household may have difficulty coming up with $250.

Automobile coverage is actually six different types of coverage. Which components that will be required by law will vary from state to state. The six parts include:

1. Bodily injury liability insurance,
2. Property damage liability insurance,
3. Collision insurance,
4. Comprehensive insurance,
5. Medical payments insurance
6. Uninsured motorists' coverage.

The first one, **bodily injury liability insurance,** covers someone else who is hurt or even killed.

The second one, **property damage liability insurance,** usually concerns the other driver's car which is damaged in an accident. It can, however, also include other types of property such as structures, fences, sign posts, and so on.

Both bodily injury and property damage liability coverage will pay for legal defense if claims or lawsuits are brought against the policy-owner. This is very important since a legal defense can be extremely expensive. Usually, both of these components have policy limits for which damages will be paid.

The question that commonly comes up is what situations are covered and what situations are not covered? While state laws do vary, generally any situation in which the car is being driven by the policy-owner, members of their family living in the same household, or anyone who has the owner's permission to drive the car would be covered. As well as variances in state laws, policies may also vary to some degree. In some policies, any person who has a "reasonable belief" that he or she has permission would be covered. This might involve the friend who drives the car because the owner is intoxicated. Certainly a thief would not be covered. In some states, only the licensed owner of the vehicle and his or her spouse may give permission to others to drive the car while in other states, any driver listed on the policy may allow another to drive the car.

The third element of a policy, **collision insurance,** covers the car when it is damaged as a result of colliding with another car or object. This particular component applies only to the car itself. It does ***not*** cover whatever the car actually hit.

The fourth one, **comprehensive insurance,** gives coverage for damages that were ***not*** the result of a collision. That might include damages from a windstorm, theft or fire, to name a few.

The fifth one, **medical payments insurance,** pays the doctor and hospital bills and, if necessary, funeral expenses for the policyowner and members of his/her family living in the same household, regardless of who caused the accident.

It is important to realize that liability insurance will ***not*** pay for injuries sustained by the policyowner and members of his or her family living in the same household. That is because liability coverage refers only to third party claims. *The policyholder and family members are first parties in the contract (policy). The insurer is the second party to the contract or policy.*

TO SUM UP: the **first party** is the policyowner, the **second party** is the insurance company and the **third party** is the other driver.

The medical payments insurance covers any passengers riding in the car. That would include someone else's car being driven by the policyowner and covered family members as long as they had permission to drive the car. Medical payments insurance would also cover pedestrians that were injured.

Premium rates for automobile insurance are higher in cities and suburbs. That is because that is where most of the cars are and, as a result, most of the accidents occur. Nevertheless, rates are on the rise everywhere.

There are many reasons why auto insurance premiums are going up. For one thing, today's new cars are increasingly more complex and more expensive to repair. Another factor, which any rush hour driver can verify, is the steadily increasing number of vehicles on our roads. As roads become more congested, more accidents are bound to happen. In rush hour traffic one accident often involves more than two cars as chain reactions occur.

Theft takes a heavy toll on automobile insurance as well. In many cities it is out of control.

Medical costs also play a major role in the soaring costs of auto insurance. The cost of medical care can be extremely high, especially if someone else is paying for it.

Certainly a factor in the rising premiums is the cost of litigation and settlements. There is more litigation now than ever before. In addition, settlements in injury cases tend to be much higher these days. Sometimes, poorly written no-fault laws actually encourage litigation rather than discourage it.

Also a factor is the cars chosen. More and more buyers have gone to smaller cars and sports vehicles. These types of cars are more likely to be involved in collision and injury claims than are larger cars.

Personal Injury Protection (PIP) is a broader form of medical payments and it may vary from state to state. PIP may cover, as well as medical payments, such things as lost wages and the cost of replacing services normally performed by the injured person (such as cooking). Personal injury protection (PIP) is sometimes called **no-fault coverage** because it is required in states that have no-fault laws. Also, this coverage is usually available in states that do not have no-fault laws.

The sixth part, **uninsured motorists' coverage,** pays for injuries caused by a driver who has no insurance coverage. In many states, this type of coverage is mandatory.

Each of these six types of automobile coverage has its own separate premium. The total cost of the policy is the sum of all the components. It is not always necessary to have all six components in the total auto package. Some of the parts are mandated by state law.

For many people, legal contracts can be intimidating. Breaking down a policy into its separate parts is often the first step to understanding the policy. As can be seen by the previous six components, an automobile policy is not nearly as complicated as many believe.

The problem is simply that few people ever actually read the policy which they have purchased. This is true not only of auto policies, but rather of insurance policies in general. Most consumers rely upon their agent to explain the policy, which they have purchased. The agent must hope that his or her explanation was clearly understood and then remembered.

Reading the Policy:

An auto policy is usually broken down into three standard parts:

(1) the declarations page,

(2) the insuring agreement, and

(3) the conditions of the policy.

The **declarations page** is where the policy-owner's name will be stated along with the autos covered, the time period of coverage (January first through July first, for example) and the premium amount. Also listed is the description of the coverage provided (from the six components previously reviewed) and the dollar limits.

The **insuring agreement** is the main part of the policy. Policy terms or definitions will be stated. Perhaps most importantly, the benefits given in exchange for the premium will be stated. Who is covered under the policy will also be stated. This can be essential information if the policyowner is in the habit of loaning out his car. Sometimes this may tie in to the listed definitions or policy terms. For example, a "relative" may be defined as any person who is related to those listed on the declarations page as named insured **and** *living in the same household.*

Exclusions will also be listed. Exclusion is a provision in the policy which denies coverage for specified perils, persons, properties or locations.

The third part in an auto policy, the **conditions of the policy,** describes the policyowner's responsibilities when a claim occurs. It may state how much time is allowed to report the claim and the types of proof of loss that will be required by the insurance company.

This portion of the contract will usually list the conditions under which a policy may be canceled. The policyholder may cancel their coverage at any time, but the insurer must follow set procedures. Certainly non-payment of premium is an obvious reason for which the insurance company may cancel the policy. Also, they may cancel the policy if the policyholder deliberately concealed or misrepresented any facts when applying for the coverage. If this were the case, the company could refuse to pay any losses that occurred.

It is probably not surprising that the most serious legal risk in driving is that of injuring or killing another person. Liability is, as a result, the most expensive type of coverage. Many states require by law that liability insurance be carried. By and large, it is considered wise to buy higher liability insurance limits than the law requires since state mandated requirements are often too low to give adequate protection.

If the policyowner or any other driver covered under their policy is found to be responsible for an accident that injures another person, they may be held liable for his or her medical bills (hospital and doctors), rehabilitative care and therapy, long-term nursing care and perhaps even the injured person's lost wages. Often there may be additional cash rewards given for pain and suffering. Consumer publications often recommend at least $100,000 of bodily injury protection per person and $300,000 per accident. The cost of such protection will depend upon the insurance company and the amount of risk the insured represents.

Many people purchase what is called **umbrella policies.** If a person has over $300,000 in assets, many professionals do recommend that such a liability policy be considered. As the name suggests, an umbrella policy is a policy, which is carried **over** all other liability insurance. It comes into play only when other coverage is exhausted. Most standard policies go up to a $300,000 limit. However, it is possible to purchase policies with limits as high as $400,000 or even $500,000. Generally, an umbrella policy can be bought from the same company that insures the policyowners home and automobiles.

Consumers look to their agent for suggestions when buying insurance. Recommending the proper coverage is often more a matter of "fact finding" than anything else. As questions are asked and answers are given, the customer will often recognize their own needs as the facts are written down in front of them. The "fact finding" should always be written down and then filed with the client's files at the agency office for future reference. The **Family Automobile Policy** (often referred to as a **FAP**) has several parts to it:

1. Part I consists of *Coverage A*, bodily injury liability and *Coverage B*, property damage liability. Under this coverage, the insurer agrees to pay to third parties money to cover any damages for which the insured is legally obligated due to bodily injury or property damage arising out of ownership, maintenance or use of an automobile.
2. Under Part II, *Coverage C*, the insurer agrees to pay all reasonable and necessary medical expenses to the insured, their relatives and other persons as a result of an accident involving an owned car or a non-owned car while being operated by the named insured, a resident of the household or any other licensed driver who was operating the vehicle with the permission of the insured.
3. Part III, which are *Coverages D through I*, provide protection against loss resulting from physical damage to an owned or non-owned automobile.
4. Part IV is *Coverage K*, the insurer agrees to pay a stated accidental death benefit in case of the death of the named insured resulting from bodily injury sustained while occupying or by being struck by a motor vehicle, providing that death occurs within 90 days of the accident.

Each part of the **Family Automobile Policy (FAP)** contains its own recovery limitations, definitions and exclusions. Coverage under a FAP will vary from contract to contract and among insurers not using standard bureau forms. These are generally limited policies available in the marketplace at a lower cost. As a result, the FAP owned by one person may differ from that owned by another.

Some states have what is called "no-fault" laws. In such states, each driver's own insurance policy reimburses their medical claims and loss of wages, even if the other person was technically at fault. Even if a driver lives in a no-fault state, professionals still recommend that larger liability policies be carried, because one can still be sued for pain and suffering in most cases.

Rates vary greatly from company to company. Of course, rates are also based on one's personal driving history (the number of tickets received and so forth). Although there may be "standard" policies, there is no such thing as a "standard" price. It is always wise to price shop. According to one leading survey, 73 percent of drivers simply purchased a policy with the first company they contacted, without doing any price comparison at all. Only 8 percent compared the rates of four companies or more.

Many insurance experts recommend that consumers consider purchasing their policies from independent agents, since they often carry multiple companies. Of course, this is no guarantee that the agent will suggest the lowest priced policy. Besides, as agents, we are often aware that price is not the only indicator that should be considered. Insurance agents are usually most aware of which companies do the best job when it comes to claim payments.

Women often state that they dislike shopping for car insurance because they feel that they are "out of their element." There is no basis for such feelings. One need not know the mechanics of a car in order to decide upon an auto policy.

Car insurance is probably one of the most basic types of insurance. If the policyholder causes an accident, he or she wants their policy to cover the cost of the other person's injuries, damage to his or her car or property, legal costs and any pain and suffering damages that might be awarded. Policyholders also want their own costs covered. This would include injuries or losses suffered by passengers. Additionally, he or she may want theft, towing, auto rental (while theirs is being repaired) and loss of earnings as a result of injuries.

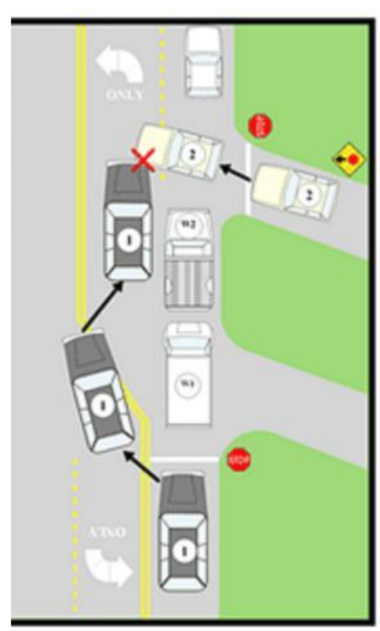
III. Liability Insurance

Auto liability coverage is for bodily injury. Many policyholders misjudge the amount of liability needed. It is common for too little to be carried. Liability for bodily injury is absolutely necessary. It covers losses incurred by pedestrians, passengers and other drivers due to the negligence of the policyowner or those covered under his or her policy.

Liability is probably one of the most important aspects in an auto policy. The potential for liability claims are especially great these days. Liability covers the injuries or deaths of other people and damage to their property when the policyholder is deemed responsible for the loss. It protects the policyholder's own assets as well, because if he or she did not have liability protection, he or she would have to liquidate their own assets to pay the costs of a judgment.

There are **single-limit polices,** which spell out the maximum amount the insurance company will pay for each accident. How the money is paid out is not set, so the company will pay any combination of personal injury and property damage, not to exceed policy limitations. Single-limit policies are the most flexible form of liability coverage.

There are also **split-limit policies,** which sets specific ceilings on each segment of coverage. In other words, only up to a set amount will be paid for personal injury, property damage, or pain-and-suffering. This is usually stated in the policy as 100-300-50, for example. It would mean the insurance company would pay up to $100,000 for the injuries of <u>one</u> person (including medical bills, loss of earnings, death and pain-and-suffering awards); up to $300,000 for the injuries of <u>two or more</u> people; and up to $50,000 for property damage. Damage occurring to one's own vehicle or property would not be included. If judgments were awarded that were higher than the insurance contract covered, those balances would have to come out of the policyholder's own pocket.



Liability insurance also covers the cost of investigating the accident and settling the claim. If the case goes to court, the company will provide an attorney, paying his fees. The policy often pays any reasonable expenses the policyholder might incur in getting to court, including loss of wages. It is important that the policy also cover anyone who drives the policyholder's car <u>*with their permission*</u>. Policies will not generally cover any car that was rented out or entered into a race (regardless of whether it is a legal or illegal race).

Some states set minimum amounts of liability insurance that must be carried; others do not. Anyone with substantial assets should carry an **umbrella policy** of up to $1 million or more for liability judgments. These days, $1 million is not excessive in view of past court awards.

No matter how much liability insurance is personally carried, it covers only the "*other guy*." It is not intended to cover the policyowner's own personal costs if they are injured. The policyowner would need to collect from the other driver's insurance company (and hope that he/she was adequately insured). Of course, if the other driver is under-insured the policyholder can attempt to collect damages from them personally. However, if they have no collectable assets, they may have little ability to collect damages. Since such a situation is clearly not just or fair, this is often an argument for the establishment of no-fault laws (where a driver can, in effect, insure themselves).

There are several ways to judge the amount of liability needed:

1. Protecting one's own assets means buying enough insurance to cover the highest judgments that might be assessed. The richer a person is, the more liability is needed. A policyholder who owns substantial property or assets is much more likely to be sued than is a person who has nothing.
2. Protecting oneself is often a wise buy. By this, we mean carrying insurance to cover one's own losses due to an uninsured motorist or an under-insured motorist. Generally, it is only possible to buy as much coverage for oneself as is purchased to cover the other person. If a $20,000 cap is on the policy for the other driver, there will also be a $20,000 cap on the policyowner.
3. Protecting the injured is not only a legal requirement in some states, but certainly a social and moral obligation as well. When a driver causes injury to another person, they have an obligation to pay for it. That requires an adequate amount of insurance even if the policyowner does not have assets to protect. Higher liability limits may not even be much more expensive. Certainly it is worth inquiring about.

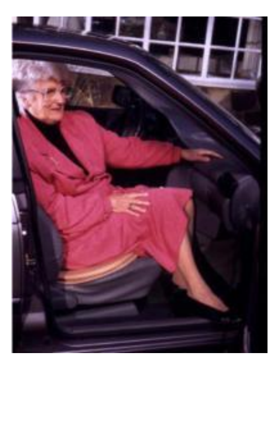
Arguably, all insurance is property insurance to some degree. The buyers wish to protect themselves against loss of property already accumulated or loss of property to be earned (as is the case for life insurance). Nevertheless, the concept of property insurance is restricted to losses resulting from causes other than life, disability or death.

Property Damage:

As the name indicates, liability coverage covers damage done to someone's property. While that is most often a car or other vehicle, it may be any type of property such as fences, a gasoline pump at a filling station or even a building. However, the amount carried is usually figured on the cost of replacing a car. Since cars do vary greatly in price, the amount covered may vary greatly from policy to policy.

Medical Payments:

Medical auto insurance covers reasonable medical and funeral expenses for the insured and anyone riding with the



insured, even if the accident is not his or her fault. Typically, the limits are fairly low, because the policy is relying on judgments to cover larger injuries. This would also cover anyone driving the policyholder's car *with their permission*. The car does not have to be in motion for this type of coverage to be used. For example, if your Grandma Jean is getting into your car and stumbles, hurting her ankle, your medical insurance would pay her doctor bills (up to the limits of the policy). Some policies double the coverage available if seat belts were worn at the time of the injury.

Some medical policies will not pay if the policyholder's regular health insurance will cover the cost of medical treatment. However, they will fill in the gaps left by any deductibles or coinsurances that apply.

Medical payments pick up the tab for hospital and doctor bills of anyone injured in the policyowner's car, without regard to who caused the accident. It also covers the policyowner's family if they are hurt as pedestrians or while riding in another vehicle.

Generally, this would even include such things as a bus or taxi. This type of coverage also covers a person who was injured while getting into or out of a stationary vehicle. Sometimes medical coverage offers fewer benefits than the policyowner may realize. If regular major medical health insurance benefits exist medical bills are already covered. If the auto insurance will pay only those bills not covered by the regular major medical policy, the actual payments may be limited to deductibles and co-payments. In no-fault states, medical payments are generally a part of the basic auto-insurance policy.

If the injured person is on Medicare due to age or disability, Medicare will require the auto insurance to cover the bills. Usually, the bills are still sent to Medicare first, but reimbursement is expected from the auto insurance.

Personal Injury Protection (PIP) :

In no-fault states, **personal injury protection** is required by law. The policyowner is covered for:

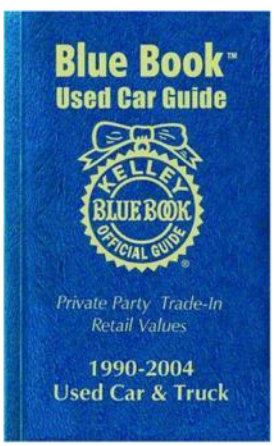
- their own medical bills up to a specified limit,
- part of lost wages,
- funeral expenses and,
- in some states, replacement services (such as house cleaning when the wife is injured).

Obviously, state laws vary, so collectable amounts also vary. There may be no ceiling or there may be a relatively low ceiling for specific benefits. There are also definite limits set on what doctors and therapists may charge.

Collision:

Collision pays for the repair of the policyholder's car if it is damaged in an accident or other mishap. This is true even if the accident is the policyholder's fault. If the car is ruined beyond reasonable repair limits, the insurance company will generally give the policyholder its **cash value.** This is sometimes called "totaling the car out." This figure is generally arrived at by taking the cost of the car and deducting depreciation. The theory is that the policyholder will be able to replace it with a car of like value.

Collision coverage is usually required by lenders for new unpaid for vehicles. The lender wants to be sure they will receive their money in the event that the car is totaled. In that case, the insurance money would be needed to repay the loan.



Typically, collision insurance covers the fair market value of the vehicle, which is usually determined by the book value, minus the cost of making repairs, minus a charge for unusually high mileage. As a result, this type of coverage is often not a good buy for old or already damaged cars.

When a loan is taken out to purchase an automobile, the lending institution typically requires that collision insurance be carried. Most people want to insure new cars for collision, because it would be a major loss if the vehicle were destroyed. Many professionals do not recommend carrying collision insurance on old cars. The cost of the insurance often does not warrant it because the vehicle is worth so little.

Collision policies typically have a deductible in the contract. A **deductible** is the amount of the repair bill (paid before the insurance company steps in) that would be the policyholder's responsibility. The actual amount can vary widely; however, the larger the deductible, the smaller the premium cost.

Collision coverage covers repairs to the policyowner's vehicle no matter who caused the accident. The price of this type of coverage will depend upon such factors as the size of the deductible and where the policyowner lives. If the accident is not the fault of the policyowner, the insurer may arrange for the deductible to be paid by the other driver or the other driver's insurance company.

Comprehensive Coverage:

Comprehensive insurance covers theft and damage from vandalism, fire, projectiles (that golf ball that goes through the windshield), animals, flood, explosions and other perils. Sometimes it also includes towing costs and other incidental bills. It will not pay for the normal wear-and-tear that a car receives. Comprehensive coverage will not pay for mechanical breakdowns.

Comprehensive does not always have deductibles, but the premium cost will be less if there is. The insurance company will not pay more than a car's value. Therefore, if the car is old and does not have much value, comprehensive coverage is probably not worthwhile to purchase.

Comprehensive coverage is considered to be essential for new cars. This type of coverage pays for damage to the vehicle from such things as fire, flood, vandalism, theft, rocks thrown on the freeway, etc. This coverage normally contains deductibles which might range from $50 to $500. As always, the higher the deductible, the lower the insurance premiums.

Comprehensive insurance covers the vehicle's fair market value which normally declines with time. Comprehensive tends to be cheaper than collision insurance.

Uninsured and Under-Insured Motorists:

In many states, uninsured motorist coverage is required by law. This type of insurance pays the cost of the policyowner's own injuries if they are hit by:

- An uninsured driver who is at fault,
- An at-fault driver whose small insurance policy won't cover all the damages, or
- A hit and run accident.

More and more consumers are now carrying uninsured motorist coverage. This type of insurance pays for whatever damages occur for bodily injury, and sometimes property damage, when the policyholder would have been legally entitled to receive it from the other driver, had he or she carried insurance, or a hit-and-run driver (where the other driver is not identified).

Generally, this coverage also covers lost wages. In some states, the driver might even be reimbursed for damage to the vehicle.
Uninsured and under-insured motorist coverage covers more perils than does the other types of coverage. It might even be possible to collect for pain-and-suffering. If the policyowner does not have disability insurance it may serve to fill this gap.

Many states allow individuals to buy as much insurance to protect themselves as they buy to protect the other guy. In no-fault states, uninsured motorist coverage kicks in when the policyowner is injured badly enough to sue. The policyowner can collect from this policy on top of their no-fault, personal injury protection. Some people prefer to carry adequate life, health and disability insurance rather than uninsured motorist protection. In some situations, uninsured motorist coverage isn't necessary.

Towing and Service/Rental Car Reimbursement:

Most professionals feel towing and service/rental car reimbursement benefits are a matter of personal preference. The premium cost is generally affordable, although sometimes coverage may be duplicated if the policyowner belongs to an auto club. Certainly, duplication of benefits should be avoided whenever possible.

Wage Loss and Substitute Services:

This type of coverage is required in no-fault states and often included in other polices as well. Wage loss and substitute services benefits will pay at least part of one's lost income because of an injury. It will also cover the services that are associated with the accident, such as child care.

Setting Auto Insurance Rates:

Not everyone pays the same for auto insurance. Insurance companies set their rates according to statistics that have been collected. Those that fall in groups with higher accident rates pay more for their insurance than those who fall in groups that experience lower incidence of accidents. Those groups are generally referred to as **risk groups.** Of course, personal irresponsibility will push individual rates higher, as well. There are several factors when determining the cost of auto insurance:

- **Age:** single individuals who are under the age of 25 often pay higher rates. Sometimes the rate can be lowered if the driver is on his/her parent's policy.
- **Marital Status:** once a person marries, especially if he/she is under 25, rates are often lower for auto insurance. Statistics show that marriage is a factor in safety. Some companies put widowed and divorced persons into higher-risk categories, which, of course, mean higher insurance rates. Young women tend to pay lower rates than young men; single women pay less than single men. With most companies, this can continue up to the age of 65. Overall, statistics show that women have fewer accidents than men.

- **Residence:** since insurance companies are excellent scorekeepers, it will not surprise an agent to learn that statistics are even kept in relation to accidents and location. As a result of these statistics, men and women pay lower auto insurance rates when they live in less populated areas. Even within the same city, one zip code area will often pay less than another zip code area. Those who live in rural areas typically pay less than those who live in cities; people who live in smaller cities are charged lower rates overall than are those who live in larger cities.
- **Occupation:** some occupations are considered to pose higher risks. Some experts charge that there is no rational statistical information regarding automobile accidents and occupation. Nevertheless, there are still insurance companies who do rate drivers using occupation as one of the elements. Often, those who work in occupations that deal with alcohol are charged more. This would include bartenders and cocktail waitresses. Some say this is because they make less believable witnesses if the insurance company decides to fight the claim in court. Occupation may also play a part in one's insurance rates if he/she is employed in an occupation that the insurance company dislikes financially. By this we mean an occupation that is known for not paying bills. Certainly, it is unjust to be charged higher

rates based on the actions of others, but the consumer often is not aware that this even played a part in the premium rates charged.

> **Driving Record:** few would argue that this should not play a part in calculating insurance rates. Safe drivers *should* get better rates than unsafe drivers. How insurance companies use driving records can vary widely from company to company.

> **Use:** the more a car is used, the higher rates often are. This is not surprising since higher use means higher exposure to other drivers and conditions.

> **Other Drivers:** even if the policyholder is a safe driver, he/she may have a member of their family that is not. If he/she drives the policyholder's car, their rates may be higher as a result. Policyholders often see their rates go up when their teenage children begin to drive.

> **Type of Car:** some types of cars cost more to insure. There can be several reasons for this, including the likelihood of it being stolen. The cost to insure inexpensive, low-priced cars is often less.

> **Merit Rating:** A few states have banned rates based on personal characteristics, such as sex and age. These states have attempted to link automobile rates directly to personal performance and responsibility. Of course, if an accident occurs, rates can go up sharply. Because merit-rating does not penalize the responsible person who just happens to be in a high risk group, it is considered a fairer way of charging premiums.

No-Fault Insurance:

Some states are **no-fault** insurance states. These states usually require that **personal injury protection** (referred to as **PIP**) be purchased by car owners. Under this system, victims of accidents are theoretically compensated more swiftly and justly. That is because payment is not based on "proving fault". Proving fault in an automobile accident can easily take two or more years. No-fault states provide immediate payment of medical bills and loss of income to the victims. For poorer citizens, no-fault states may work very well since they do not have to settle for whatever they can get in order to pay the bills that are due immediately. If the other driver is well off, he/she could feasibly delay payment in those states in which fault must be proven. Under no-fault insurance, financial ability is not an element because each person's own insurance company pays promptly for any medical bills and loss of earnings that result from the accident. *However, it must be noted that the bills will only be paid up to the limits of the policy.*

Not all no-fault states have set their laws up well, but in those that have, the lawyers may be cut out completely in small cases because limits are set on who can sue. Certainly, this does not appeal to everyone, especially these days when many people prefer to sue for pain and suffering, even in small cases. Some states require that there be $2,500 worth of medical injuries before there can be a lawsuit. In those states, the number of auto cases has dropped dramatically and insurance costs have been contained. However, some states have the dollar point as low as $500 which, by some estimates, has actually escalated small cases (bills are extended in order to reach the $500 mark) that would not have ordinarily reached that high in medical bills. In these states, there has been no evidence of cost containment. Most industry experts feel that good solid no-fault laws will be hard to come by in most states because the legislatures who must pass the laws are primarily made up of lawyers. Good no-fault laws often cut out the lawyers and their resulting fees.

No-fault is a system in which the driver's own insurance pays for the losses regardless of who caused the accident. It is generally felt that such a system keeps down the cost of insurance premiums since it eliminates much of the legal costs associated with proving blame.

"Fault" states must establish blame, as the name implies. Whoever is at fault must pay for the damages or losses brought on by the accident. Of course, the driver at fault may not necessarily have insurance (even in states which require it). Even if the driver at fault does have insurance, the amount carried may not be adequate in all cases. The insured driver may, of course, sue for a larger amount.

As stated, in "no-fault" states, each driver's own insurance company covers their losses. Even if the accident was totally the driver's fault, their insurance will still pay. No-fault coverage generally has a ceiling on their payments. If the limit is set too low, the injured driver may find the losses are far greater than the coverage provided by their policy. Even in a no-fault state, a driver may go to court and try for a pain-and-suffering award. In such a situation, fault must be proven.

In either type of state, the insurer will investigate the accident, handle the settlement negotiations, give legal council and pay any judgments against the driver *up to* the limits of the policy.

In states that do not have no-fault laws, the person who caused the accident (and his or her insurance company) is liable for the losses resulting from the accident. Sometimes, in order to collect from the person who was at fault (the person who caused the accident), it is necessary to sue and establish in court that the accident was their fault.

Lawsuits can be very time consuming. In some states it takes several years for a civil case to come to court. Obviously, medical care cannot be delayed that long! Many families have suffered severe financial difficulty as a result of medical bills and loss of income.

Lawsuits are also expensive. As much as one third to one half (plus costs) may go to the attorney. The basic idea of no-fault laws are to get accident victims' bills paid promptly regardless of who caused the accident. Another benefit is lowered insurance premiums since the number of lawsuits are reduced dramatically, which saves hundreds of dollars in legal fees. More of the premium dollars go towards losses instead of into litigation expenses.

IV. Insuring One's Home

It is not always possible for people to buy their own homes. For that reason, most people rent for a period of time.

Renter's Insurance:

Most insurance specialists recommend that a tenant insure their possessions. If the landlord has insurance, it will only be on the structure and not the tenant's possessions. The tenant will also want liability insurance, in case a visitor hurts themselves while on the premises. Depending upon the circumstances, the landlord might be responsible for injuries relating to the structure itself, but injuries relating to the actions of the tenant may not be covered by the landlord's policy. For example, if one of the children left their roller skates on the sidewalk, causing a fall, the liability would rest with the tenant rather than the landlord.

A tenant's policy is similar to a homeowner's coverage, but without coverage for the structure itself. It is important to purchase enough insurance to cover at least the cash value of the contents. Many renters prefer to purchase replacement value, so that their belongings could be replaced at today's costs. **Cash value** is the current retail price less depreciation. **Replacement value** is the actual cost of replacement at current retail prices. Rental insurance is fairly inexpensive; nevertheless, most renters are under-insured or are not insured at all.

Homeowner's Insurance:

Few people are able to simply walk into home ownership. For most, it is a difficult journey of saving and doing without. It would be most foolish to leave such a purchase uninsured.

Property Insurance covers damage to or theft of the insured's possessions. **Casualty insurance** (also called **Liability insurance**) pays for the insureds legal responsibility to other people for property damage or bodily injury losses. Automobile and homeowner's policies typically cover *BOTH* property and liability coverage.

Homeowner policies are designed to protect owners and tenants from loss or damage to their property and also to provide protection against liability claims. The point of homeowner insurance is to protect an individual's home and the contents within it. Some people are natural gamblers willing to play the odds that their home will never be damaged or destroyed and that their belongings will never experience a loss. The problem is, should they loose that bet, it could wipe out everything they own. It makes more sense to spend a few dollars for the sake of safety.

The policies generally have two sections:

(1) property exposures and

(2) liability exposures.

Often consumers believe that an item mentioned in their policy receives complete coverage. This is not necessarily the case. For example, if a diamond ring is covered against theft in a homeowners policy, that does not necessarily mean it will also be covered should the diamond drop out of its setting and become lost. These are the types of things that need to be fully explained to the insured. A **"floater"** may possibly be added to the homeowner's policy to include the loss of the stone. A floater is a separate policy or addition, which may be added to the original policy. It is often called an **"endorsement."** Floaters may also be used to raise the dollar limits in policies. Many homeowner policies would cover the theft of a ring only up to $1,000 or $2,000. An endorsement or floater could increase the amount of coverage.

Often floaters or endorsements provide **"all-risk"** coverage. In other words, they insure against all risks, except for specific exclusions which are listed in the policy.

The first section, **property exposures,** may cover such things as the structure or dwelling itself, other structures on the property, personal property and loss of their use during repair. Additionally, there may be coverage for such things as debris removal, fire department charges, trees, shrubs and other plants, theft of credit cards, property removal and reasonable repairs following a loss.

Replacement cost means the amount it would cost to have the house repaired or rebuilt; it does ***not*** refer to market value. In some situations, replacement cost might actually equal the market value, but this is not always the case. In fact, older homes often require more money to rebuild than the market value would have been. It is important that the insurance agent consider this when insuring an older home whose market value is below replacement costs.

As building costs rise, it is important that each property/casualty agent maintain a relationship with his clients and continue to update their policies. A policy should never fall below 80 percent of the replacement cost.

Agents know that consumers often hesitate to increase the premium amount of their policies (even when it makes sense). However, when the simple concept of replacement value is explained, most consumers prefer to be covered adequately. Placing a higher deductible on the policy might be an option that allows adequate coverage while keeping premiums reasonable. With higher deductibles, the consumer will be responsible for more of the smaller losses, but the major loss (the house itself) will still be covered by insurance.

The second section, **liability exposures,** covers personal liability and medical payments to others. It may also include coverage for claim expenses, damage to the property of others and first-aid expenses.

Homeowner's insurance is often the broadest coverage most people will ever buy. It literally covers the roof over their heads and the shirts on their backs. In addition, it covers their legal liability to others. Yet, the average consumer generally never even attempts to understand what they are buying.

A standard homeowner's policy does ***not*** cover many types of natural disasters. Separate coverage is needed for floods and earthquakes. In many cases, a separate policy will also be needed for those who wish to be covered for hurricane damage.

For the consumer to keep up with changing times and values, it is necessary to constantly update their coverage. It is generally considered unnecessary to insure the actual value of the land since it cannot be stolen or damaged in the same way that the structures upon it may be.

Most professionals recommend that "replacement value" be the determining factor in the amount of coverage needed. Replacement value is often different than "market value". Market value is the amount the homeowner could sell their home for. Replacement value is the amount of money it would take to rebuild the home should that be necessary. In areas where the housing market is depressed, for example, a home may only sell for $90,000 but rebuilding it could easily cost $135,000. Determining the cost of rebuilding often requires an appraisal.

Some insurance companies calculate replacement cost by multiplying the square footage of a house by the square foot construction costs for new homes in the homeowner's area. By doing so, an appraisal probably would not be necessary. The construction cost is often supplied by the local builders association. Most property and casualty agents can supply this information. It is imperative that an agent know and communicate to customers that it cost far more to rebuild a home than it is to build a new one. For that reason, it is important to insure a home to its replacement value (ITV).

Once the replacement cost is known, the policy should cover no less than 80 percent of the total replacement value.

TO SUM UP:

Replacement Value is what it would cost to replace a structure with a building of like kind and quality.

Actual Cash Value is replacement value less depreciation for its use and age.

Market Value is the dollar amount that the homeowners could sell their home for.

While the standard homeowner's policy may automatically put replacement value on the structure, it is not unusual for it to put only actual cash value on its contents. Therefore, your clients will appreciate an exact explanation of which they have in advance of a claim.

Insurance companies typically will not pay replacement value on claims unless coverage for at least ***80 percent*** of the total replacement value of the home is carried. If 80% of the total replacement value is in place, that usually qualifies as full replacement value. The reason that 80% would be considered full replacement is simply because few homes **totally** burn down. Generally, 80% would be more than enough to rebuild the home.

When a homeowner carries less than 80% of the total replacement value on their home, this will affect other claims. When a loss occurs the insurer will likely give the greater of two amounts:

1. a percentage of the total loss based on the percentage amount of coverage carried. For example, if 60 percent of replacement value is in place, then 60 percent of the loss would be covered for things such as storm damage, theft and so forth.
2. the actual cash value, which would be its replacement value **minus** depreciation for age and wear.

Either way the actual replacement value will not be paid, if less than 80 % of the total replacement value is carried.

Inflation is part of our lives and this is also true when it comes to our homes. As inflation rises, so should the amount of coverage carried on our homes. Labor costs are often one of the largest factors to be considered. A homeowner's policy should be reviewed yearly and updated, if necessary.

Many insurers offer policies, which include an inflation guard clause. These policies automatically increase their coverage by a specified percentage amount at specified time intervals. Of course, the premiums increase as well.

Even if an inflation guard is included in the policy, it still should be reviewed yearly. The percentage increase in the inflation guard may not equal the percentage rate of inflation. In other words, inflation may be taking away more than the inflation guard is adding. The opposite could also happen, as well. The inflation guard could be adding more than inflation is taking away. In that case, the homeowner would be paying for more coverage than is actually needed.

Another thing to remember is that an inflation guard will not reflect any improvements made. The only way to make sure that the amount of insurance carried reflects current values is to have yearly reviews.

The amount of insurance the lien holder (usually a bank) requires is not an accurate indicator of current values. The institution that holds the mortgage is only concerned with protecting its own interests (the loan). Therefore, as the mortgage is paid down, the banks interest decreases and the homeowners interests increases. Eventually, the mortgage would be paid off. At that point, the loaning institution has no further interest at all, but the homeowner has a very large stake in continuing to keep the property insured.

The mortgage lender usually requires that the home be covered by **"fire and allied coverage"** insurance. This means that the structures would be insured against just about anything that might damage it. That might include such risks as windstorms, tornadoes and even riots.

Homeowners insurance is a combination or package policy. What it contains depends upon the needs and desires of the homeowner. Each insurance company may have slightly different policies, but they all follow the same broad outline.

The homeowner's series consists of several forms which are numbered in sequence. There are different types of homeowner's policies. The consumer can buy separate coverage for fire, wind, miscellaneous hazards, theft and personal liability, or they can simply buy a policy that covers all of these in one package. Homeowner's insurance comes in three basic types. *Each type is progressively more expensive.*

1. **Basic Form:** this protects one's home against fire, smoke, lightning, windstorm, hail, vandalism, theft, explosions, riots, vehicles, aircraft, and broken glass (windows).
2. **Broad Form:** This is the most widely purchased form of homeowner’s policy. This type covers everything covered in the *basic form, plus* damage caused from falling objects, the weight of snow or ice, building collapses, broken steam or hot water heating systems, heaters, plumbing, frozen pipes, heating or air conditioning systems or appliances and injury from faulty electrical wiring. It does not cover damage to pavements (such as sidewalks or driveways), fences, patios or damage to pools from freezing, thawing or water. It is important to note that even though the *broad form* covers damage caused from broken steam pipes, it does not cover the cost of actually replacing the pipes themselves.
3. **Comprehensive form:** this form covers all conceivable perils, except flood, earthquake, war, nuclear attack and anything specifically excluded in the policy. It is very, very important to read the policy and know what is specifically excluded.

Any one of the three forms will cover one's house, although they generally do not apply to structures which have been built for occupancy by more than two families (such as fourplexes) or farm buildings and related structures. Farmers usually get a farm owner's policy that is specially designed for their purposes. Homeowner's insurance generally *will* also cover detached garages, sheds or other structures as long as they are not leased out to other individuals. A homeowner's policy generally has limitations on buildings used for business (sometimes not covering them at all). *Therefore, a person who uses their home as the location for their business (as is often true for independent agents) should be sure to purchase insurance that specifically covers an in-home business.*

Section 1 of Form #1 (HO-1) :

This type is called **HO-1**, **Form 1**, or the **"basic form."** This coverage is the cheapest to buy. The basic policy is usually called an HO-1. It generally covers the house and its contents against ***eleven*** different perils which range from fire to broken glass. Since there are so many flaws in such limited coverage, many companies have quit offering the HO-1 as a "stand-alone" policy.

The basic form lists four coverages:

(1) Coverage A - the dwelling

(2) Coverage B - all other structures, such as garages

(3) Coverage C - unscheduled personal property

(4) Coverage D - additional living expense.

The basic form also lists four supplementary coverages including coverage for debris removal and fire department service charge.

The HO-1 insures against direct loss to the property and interests covered if caused by any of the groups of listed perils.

Covered perils may vary, but the eleven common ones include:

(1) fire and lightning,

(2) removal,

(3) windstorm or hail,

(4) explosion,

(5) riot or civil commotion,

(6) vehicles,

(7) aircraft,

(8) smoke,

(9) vandalism or malicious mischief,

(5) breakage of glass, and

(6) theft.

It is sometimes possible to have as little as eight or nine risks covered (rather than eleven). Generally such things as vandalism or glass breakage are left out.

The form will list the exclusions and conditions which apply to Form #1.

Section II of Form #1 consists of:

> Coverage E which is personal liability and

> Coverage F which is medical payments to others.

Also in Section II of Form #1 will be exclusions which apply only to this section along with five supplementary coverages including damage to property of others.

Form #2 (HO-2) :

This type of coverage is called **HO-2, Form 2,** or the **"broad form."** This coverage costs a little more than the HO-1 plan because it gives more benefits.

The broad homeowner's policy is typically called an HO-2. It covers the house and its contents against specific losses. Coverage often included in the HO-2 includes freezing of plumbing, heating and air-conditioning systems and domestic appliances.

Section I of HO-2 contains the basic coverages, supplementary coverages, additional exclusions and conditions that are identical to those found in Section I of HO-1. The difference between HO-1 and HO-2 lies in the perils listed. HO-2 insures against loss resulting from *18* listed perils rather than 11 listed perils as in HO-1. The first 11 of the 18 are the same as in HO-1.

The additional perils include:

(1) falling objects

(2) weight of ice, snow or sleet

(3) collapse of buildings

(4) damage resulting from steam or hot water heating systems

(5) accidental discharge or overflow of water or steam

(6) freezing of plumbing, heating and air-conditioning systems and domestic appliances and

(7) accidental injury from electrical currents artificially generated to electrical appliances.

Section II OF HO-2 is identical to Section II of HO-1.

Form #3 (HO-3) :

Called the **HO-3**, **Form 3**, or the **"Special Form,"** this plan offers more coverage than either the HO-1 or the HO-2 does.

The special homeowner's policy is called an HO-3. It covers the house for all perils except those explicitly excluded by the policy. On personal property such as, clothing and household furniture, it covers loss or damage from the same risks as listed in HO-2.

However, on the house itself, the policyowner is protected from all risks except those which are specifically excluded. Some companies offer similar coverage for specified personal property. The HO-3 is identical to the HO-2 except that coverages A, B and D are insured against all risks or perils. Coverage C, which is unscheduled personal property, is insured against all 18 listed perils in HO-2 with the exception of breakage of glass.

Under HO-2, in order to receive compensation for loss under coverages A, B and D, the insured (policyholder) must prove that the loss was the result of a listed peril. Under HO-3, the insurer (insurance company) must prove that a certain peril is specifically excluded in order to deny payment.

HO-3 also provides the insured with coverage against a wider variety of perils than does HO-2. In other words, if something causes damage, the policy will cover **unless** the peril is specifically excluded. If a homeowner spills paint in their house, the HO-3 would cover the loss (if not specifically excluded). The loss would not be covered under the HO-2 because it is not one of the listed perils. Of course, the HO-3 is more expensive than the HO-2.

Different insurance companies may have different conditions, so it is always important for the insurance agent to fully understand the policy he/she is writing. It is equally important for the consumer to do so. Some points for both the consumer and the agent to look for include:

- **Detached buildings,** including garages, tool sheds or guest houses, are often covered only up to a specified limit, such as ten percent of the policy's face value. If buildings would cost more than that to replace, it may be necessary to increase that portion of the policy.
- If the home is left **empty for 30 or more** consecutive days before the loss occurs, one's protection against vandalism and broken glass may not apply. This becomes an important point for retired individuals who winter elsewhere.
- **Due diligence** is required in some areas. Damages resulting from freezing pipes, heating systems and air-conditioning systems that

occur while the homeowner is away may not be covered if due diligence was not exercised in the maintenance of heating sources or the draining of unused pipes.

> **Income loss from a home business** during a disaster is not likely to be covered.

> Should the homeowner **rent out his or her home** to another person, the insurance company may refuse to renew the policy.

> While the homeowner's home is being repaired, there may be coverage for **motel bills and restaurants** for amounts that exceed normal living expenses. Of course, the policy will pay only up to the limits within the contract.

> Depending upon the contract, there may be coverage for **debris removal.** Usually the policy will cover up to 5 percent of the total coverage.

> There is usually a limit on coverage for **plants, trees and other landscaping.** The homeowner will need to check his/her particular policy, but a limit of $250 to $500 is normal. Many policies offer no coverage at all; especially if they were run over by anyone who lives in the home.

> Seldom is there any coverage for **gutters, TV antennas, fences or awnings** unless the house collapses.

Rates for fire insurance within the policy will vary depending upon the amount of fireproof materials in the home and the efficiency rating of the local fire department. Such things as sprinklers, fire alarms and fire extinguishers often help lower the cost of coverage.

As is true with so many types of insurance, rates are often lower if the premiums are paid annually rather than quarterly. Some insurance companies offer an additional savings if the premiums are paid for three years at a time.

Water damage caused by sewer backups, rain, ground water, or flood is typically excluded. Rain damage may be covered if the house was first damaged by wind or hail, which allowed the rain to enter. The water damage caused by firemen fighting a blaze *is* generally covered. For those homes located in areas where floods are a danger, flood insurance is available through the government as long as the community has met the conditions for coverage. Earthquake insurance is available as a rider through the company that insures the home.

In an attempt to upgrade some communities, people are finding homes in high-risk urban areas, which have been made available to them at very low interest rates. This can sometimes pose an insurance problem if companies are not willing to insure homes in those areas. There is help through the federally backed **Fair Access to Insurance Requirements (FAIR)** plan. An inspector will visit the house or apartment to see if it meets minimal safety standards and is structurally sound. If the structure meets the requirements, coverage is provided from an insurance pool. Coverage may also be available if repairs are in progress to bring the building up to required levels.

Form #4 (HO-4) :

Called **HO-4**, **Form 4,** or **"renters insurance,"** this type generally covers around 17 or 18 risks to personal property. The HO-4 may be known as renters or tenants coverage. It may also be called the Contents Broad Form. It applies only to the contents of the house. It is identical to the HO - 2 except that losses to the structure itself are not covered. The perils would include fire and lightning, windstorm or hail, explosion, riot or civil commotion, vehicles, aircraft, smoke, vandalism or malicious mischief, glass breakage that is part of a building, storm doors or windows and theft.

Form #5 (HO-5) :

Form #5 is **The Comprehensive Form** or the **HO-5.** The HO-5 is identical to the HO-3 except that all risk protection is extended to coverage C (unscheduled personal property). This form provides broader coverage than does the HO-3 and, consequently, is more expensive than the HO-3.

Form #6 (HO-6) :

This form is usually referred to simply as **The Condominium Unit Owners Form.** The **HO-6** was introduced in 1974 expressly for the unique needs of condominium unit owners who were exposed to risks similar to those of renters. HO-6 is a reproduction of HO-4 except for two changes which were necessary for the policies to be appropriate for condominium owners.

1. One change allows $1,000 of coverage for damage to additions and alterations made by the unit owners within the unit.
2. The other change provides that the addition and alterations coverage will be excess insurance over any insurance owned by the condominium association that covers the same property.

The HO-6 may also have coverage for additional losses by use of endorsements.

Various endorsements are generally available (for an added cost) which will extend the coverage of homeowners policies. For example, the **"Inflation Guard Endorsement"** increases on a quarterly basis the limits of liability of Section I of HO-1, HO-2, HO-3 and HO-5 by a fixed percentage amount. The idea is to guard against inflation.

Some insurances offer an **inflation guard.** This automatically increases the homeowner's coverage (generally by 1 percent or more) every three months. Of course, the premium rate will be higher, but it is often worthwhile since it guards against inflation. Agents often prefer adding inflation guards because it takes away some of the trouble of constantly rechecking policies that are already in effect. It is important to understand, however, that inflation guards may not always reflect the actual increases in building costs, allowing the amount insured to drop below the 80% mark. Even with an inflation guard, the wise agent will still check back with his/her clients at least every two years and preferably every year.

Endorsements are also used to cover valuable personal property for higher amounts than provided for in the basic policy. An endorsement may be used to increase limits of recovery for money and securities. There is a credit card endorsement which protects the insured from losses resulting from stolen or lost credit cards. Such endorsements give flexibility to the homeowner forms and, as stated, may also be attached to the HO -6.

Form #8 (HO-8) :

Coverage designed for older homes is called **HO-8.** It is identical to the HO-1 except losses under the *10* perils (fire and lightning, windstorm or hail, explosion, riot or civil commotion, vehicles, aircraft, smoke, vandalism or malicious mischief, breakage of glass) are settled on an **ACV (Actual Cash Value)** basis in contrast to a **replacement cost basis.**

V. Exceptions

There are exceptions in the homeowner policy. Policies will vary from company to company and from state to state. However, there tends to be similar types of non-covered or limited coverage clauses:

- A separate structure on the property that is used for business purposes or that is rented out.
- Losses due to a power failure from a source outside of the home.
- Water damage, including floods, tides, sewer back-ups and seepage from ground water. However, water damage from firefighter's hoses or due to a leaking roof (which allows rain in) would generally be covered.

- Losses due to neglect.
- Damage deliberately caused by the owner(s).
- Earthquake, except by special rider.
- Ice or snow damage to such things as awnings, fences, patios and swimming pools.
- Vandalism to houses left empty more than 30 days.
- Frozen or burst pipes in a house left unoccupied without maintaining the heat or draining the pipes.
- Damage from settling or cracking structures.
- War.
- Normal wear and tear.
- Damage done by birds, rodents, insects or the owner's pet(s). However, some types of damage may be covered to porches or other minor collapses.
- Smoke damage from nearby factories or agricultural smudging.
- Claims containing fraud or misrepresentation of the facts are never covered.
- A continuous leak from plumbing, heating or air conditioning systems. Only sudden leaks would be covered.
- Nuclear explosions are not generally covered. It is hard to imagine anyone trying to put in a homeowner's claim following a nuclear explosion.

While liability coverage is recommended, it is important to understand what would not be covered:

- Employees and clients if the homeowner is running a home-based business. This is true for child care services also. Any type of a business ran out of the home needs separate business insurance to be fully protected.
- Aircraft.
- Injuries from boats and motor vehicles. Some types of small boats, golf carts or dirt bikes might be covered. The homeowner should specifically check their individual policy to be sure.
- Claims by one family member against another.
    - Damage against the policyowner's own property.
- Any disease that someone catches from the policyowner or covered members.

> Damage done by a leaking waterbed to rented property (unless a special rider was obtained to specifically cover it).

Homeowner's insurance insures against the loss of the home. It is important to buy coverage that will replace at least **80%** of the home's current replacement cost. Realize that the policy will only pay up to the limits imposed within the contract. If the cost of repairs or replacement is *less* than the limits imposed by the policy, the homeowner will receive only up to the costs incurred. If the cost of repairs or replacement is *more* than the limits imposed by the policy, the homeowner will be responsible for the balance.

VI. Natural Disasters

A standard homeowner's policy does *not* cover many types of natural disasters. Separate coverage is needed for floods and earthquakes. In many cases, a separate policy will also be needed for those who wish to be covered for hurricane damage.

Under flooding, there are many forms of water damage exclusions. Generally, it applies to tidal waves as well as such things as sewer water back-ups outside of the home. Water damage inside the home would be covered if it were due to a burst pipe or water tank.

Since most people do not need flood damage, it would be unnecessary to include the premiums for it in the standard policy. Since most people do not need such coverage, it stands to reason that only those who live in a high risk area will choose to buy the benefits. The result is what is called **"adverse selection."** In other words, only a small number of policyholders will be sharing a large risk. Both the private and government insurance coverages are part of the National Flood Insurance Program which is administered by the **Federal Emergency Management Agency (FEMA).**

When a disaster occurs, typical behavior follows. When the earthquake occurred in California in 1989, insurance adjusters were en route almost immediately. They came equipped with cellular phones (since most lines were damaged and, therefore, not operating), laptop computers and blank checks.

Mobile homes and recreational vehicles were used as makeshift claims processing centers. Checks were issued on the spot to policyholders to cover immediate necessities such as food, shelter and clothing. Of course, additional checks were written later on as damages were assessed.

Insurance companies that sell earthquake coverage have specialized teams with years of claims experience for responding to disasters. They take great pride in bringing immediate assistance to their policyholders.

Those Californians who did have earthquake insurance had bought it in addition to their standard homeowner policies. For most, it was in the form of an endorsement. As stated, an endorsement is an addition to the regular policy.

In California, each company located there must offer to sell earthquake insurance to its homeowner policyholders. The key word here is *"offer."* It is up to the individual whether or not to purchase it. Immediately following an earthquake, it is impossible to buy earthquake insurance. Generally, there is a moratorium on selling such coverage (ranging from 48 hours to 60 days) following the last aftershock that measures 5 points or more on the Richter Scale, which is the standard measure of an earthquake's severity. A moratorium is the legal permission to delay action, as in the selling of a specific type of insurance.

There are a couple of reasons for this moratorium:

1. to allow insurance companies time to determine their exact losses before assuming new risks;
2. to acknowledge the possibility of damaging aftershocks.

Additionally, it is felt that by delaying the availability of earthquake insurance following an earthquake, panic buying may be avoided. Usually disaster-type policies (bought in panic) do not stay on the books well. Panic buying is costly for insurance companies if the policies are dropped soon after purchase. Premium refunds generally do not cover the cost of underwriting and issuing the policy, as well as the costs associated in processing a cancellation.

Earthquake insurance tends to be expensive. There are variables involved, such as, Frame houses withstand an earthquake better than brick structures do. As a result, frame houses are much cheaper to insure. The location of the homeowner also has a great deal to do with the cost of the policy. In

California, where risk is relatively high, premium costs are much greater than in New York where risk is relatively low.

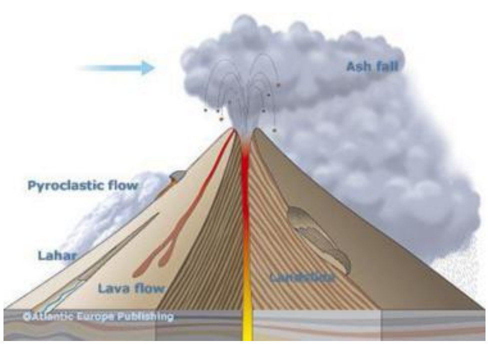
Deductibles for earthquake insurance are often expressed as a percentage rather than a dollar amount. For instance, instead of a $250 deductible, such a policy may have a deductible of 10% on the total policy value.

The high premium costs and deductible amounts simply reflect the risk involved. Consumers must realize that a major earthquake could bankrupt some insurance companies. It has been estimated by industry experts that a major earthquake in a populated area could run up to $60-billion or more in damages. The cost is high because, even though only a small number of people carry earthquake insurance, the disaster affects nearly all types of insurances. Claims affect auto, fire, business interruption, worker's compensation, life, health and disability.

For insurance companies to meet all the claims that would occur, they would need to sell hundreds of millions of dollars worth of stocks, bonds, real estate and a multitude of other investments immediately. As a result, thefinancial markets would also be heavily affected. It would also leave the insurance industry without the capital necessary to meet future claims.

Another reason that earthquake insurance is high will not surprise you: relatively few people buy it. Since a low number of policyholders are sharing the risk, the cost is high. If the cost were to be shared by many, then premiums would be lower. One of the underlying principles of insurance is the spreading out of risk among many.

Volcanoes:



Washington state created a specified area of concern on May 18th, 1980 when Mt. St. Helens erupted with a series of explosions. Previously, neither insurance companies nor consumers thought much about volcano insurance. Because nobody considered such coverage to be necessary in the United States, there was much confusion as to whether or not the disaster was covered in Washington resident's policies.

Traditional homeowner policies had specifically excluded "volcanic eruptions," but simplified versions of the homeowner policy did not list that exclusion. In the end, about $27-million was paid in claims for damage caused by the eruption of Mt. St. Helens. The claims were covered under "explosions" in most cases. Generally, standard policies now list volcanic eruptions as a covered peril.

Hurricanes and Tornadoes:

Luckily, most people do not need to contend with hurricanes and tornadoes. Windstorms are covered in standard insurance contracts, which is the only peril likely to hit the majority of homeowners. However, if one lives in an area of the United States that is vulnerable to hurricanes or tornadoes, extra protection may be necessary.

Standard coverage is typically ***unavailable*** to homeowners who live in a high risk area. There are special coverages for people who are at risk for such hazards as floods and hurricanes. There are beach and windstorm insurance plans in seven states along the Atlantic and Gulf Coasts.

As with everything, there are two sides to special insurance coverages. There is an increasing tendency to build expensive structures in areas that are extremely vulnerable to hurricanes. There is increasing controversy over allowing people to build such expensive homes in areas that are high risk. For example, Hurricane Alicia, which was just a medium-sized storm, struck Galveston in 1983. The claims that resulted totaled $155 million. There was only $87.5-million in premiums that the Texas Catastrophe Property Insurance Association had collected in its 10 years of existence.

Due to such occurrences, the insurance industry has pushed for stringent federal standards to protect property against hazards. The model is usually the National Flood Insurance Program.

VII. Personal

Homeowners are generally aware that their belongings are covered under most homeowner policies. What they often do not understand is just *how* they are covered. Usually belongings are insured for up to 50 percent of the coverage of the house. In other words, if the house is insured for $100,000, the contents would be covered for up to $50,000. For additional premium, it is usually possible to increase the coverage on personal property to 75 percent of the amount covering the home.

Belongings (called **personal property**) may be insured for either their **"actual cash value"** or for their **"replacement value."** As you know, actual cash value is the replacement cost of an item ***less*** depreciation for its age or use. Replacement value covers the current cost of replacing the item or items.

Policies which pay **"replacement value"** cost more. Usually they run about 10 to 15 percent more than those which pay only **"actual cash value."** However, should a claim occur, replacement value more than pays for itself. Even when replacement value is in the policy, most insurers (insurance companies) usually have the option of repairing the item or replacing it, rather than paying the insured the money (for the insured to replace it themselves).

When a home's contents are destroyed or stolen, one of the most difficult jobs can be making an inventory of what is missing or destroyed. Most insurance companies provide, upon request, inventory forms to their policyholders. It is not really necessary to use specific forms. Any type of list will be useful when claims occur. The list or inventory should be listed by rooms (of the house) and include each article and its description, when it was purchased and what the purchase price was. Certainly, it is wise to also keep receipts of the purchase. Most insurers are going to request some type of proof that the item was owned in order to settle the claim. This list or inventory would also be helpful to the police should a burglary occur.

It is important to realize that such an inventory will be of little use should it be burned up in the fire that also destroyed the house. Therefore, once the list is made, a copy should be given to the insurance agent to be placed in the policyholder's files. Another copy should be placed in the insured's safety deposit box or given to another family member. A third copy may be kept at home for reference. When changes are made, it is important to update all copies at least once a year or as things are replaced, sold or purchased.

This type of inventory is an ongoing affair. As items are replaced, sold or added to, changes in the list must be made. Many people make an initial list, but never think to update it as changes occur.

Many professionals recommend that pictures or a video be used rather than making a list. Actually, both are useful. Pictures are certainly better proof of ownership, but do not give price and date information. A combination of the two works well.

The recommended procedures are:

- photograph each room,
- take separate pictures of important items within the room,
- list the items within the room remembering such things as drapes, rugs and wall decorations,
- list the contents of closets and drawers (12 pairs of slacks, etc.) Clothing can be very expensive to replace. Any item that is unusually expensive should probably be photographed. This might include such things as matched luggage or a designer dress.
- the serial numbers on appliances should be listed along with the purchase date and price paid.
- On large items, such as major appliances and pieces of furniture, include any necessary details. A sofa that is an 1800's antique has much more value than a sofa made of pine last year.
- As stated, when each item was purchased and how much was paid for it is very important. Obviously this is not necessary for every single item, but certainly for all major items.
- Keeping the list updated is simply a matter of adding in the receipts for new purchases and removing items no longer owned.

Umbrella Insurance:

Umbrella policies are often needed by individuals with relatively large asset bases. An umbrella policy covers liability judgments that exceed the limits of the auto and homeowner's policies (usually $300,000). Umbrella policies are generally priced according to the number of cars owned. Costs might range from $75 to $200 or more per year.

Even for the homeowner, it is necessary to insure personal property (just as renters do). In basic, broad and comprehensive policies, personal property is typically covered at 50 percent of the coverage carried on the home. In other words, if the home is insured for $100,000, personal property would then be insured for $50,000. It is important to understand, however, that the belongings in the home are not normally insured at full replacement cost. Rather, most policies take the current retail costs and deduct value according to how old the item is. Only a policy that insures at **replacement value** would actually replace the item at current rates. Not all insurance companies offer replacement value on a structure's contents.

When personal property is removed from the home, insured values are affected. Usually, it is covered for up to 10% of the total policy amount on basic and broad form coverage; some basic and broad policies and comprehensive form will continue to insure up to the 50% level. There are a few policies that will cover the property up to 100% anywhere in the world, but the average person is unlikely to purchase this. The property of a house-guest or resident employee, such as a baby-sitter, is only covered up to 10% even though the property is on the premises.

Theft insurance sections have some special aspects, which can vary from company to company. Each policy should be checked for the following:

> If you have **basic form** insurance, you are usually not covered for *"mysterious disappearance."* This means that an item or items are missing, but the homeowner is not able to prove theft

was responsible for the disappearance (maybe her child loaned the article out to a friend). Under **broad or comprehensive forms,** the loss would generally be covered.

- Checks and credit cards which are stolen are generally ***not*** covered by a homeowner's policy.
- Homeowner policies ***will*** generally pay for property stolen from a safe deposit box or storage warehouse.
- If an addition is being added to one's home, theft of the building materials is ***not*** covered.
- **Basic and broad form** policies will ***not*** pay for gems which disappeared from their settings, unless theft can specifically be proven. Usually such a loss is not considered to be theft since it is more likely that the stone simply fell out of the ring.
- Unless forced entry can be proven, homeowner policies will ***not*** normally cover theft from unattended automobiles, boats or trailers.
- Property lost in the mail is ***not*** covered by a homeowner's policy.

Many personal items are either ***not*** covered at all by a homeowner's policy or, if they are covered, the loss would generally only be covered up to specified policy limits. Such things as motorbikes, golf carts, pets, aircraft, paintings, sculpture, and business samples are not covered (unless specifically covered within the policy). Most policies will only cover up to $100 for lost cash, coin collections, and bullion. Only up to $500 is generally covered for securities, deeds, stamp collections, jewelry, watches, furs and gems. Some policies put a $1,000 limit on silverware and guns. If a person has specific items they would like covered by their homeowner's policy, they would want to purchase a **floater** in the amount of coverage needed. **Floaters** traditionally insure against all risks, not just those listed in the homeowner's policy. There can be additional clauses besides the ones we just listed that would exclude coverage for personal belongings.

Every person should keep a list of all household and personal belongings. When each item was purchased should be listed as well as the price paid. Claims adjusters are not likely to simply take the policyholder's word when it comes to replacing items. Any item of special value should be appraised. In addition, it is wise to take pictures of household items to verify the article's existence and quality. The inventory, appraisals and pictures should be kept in a safe deposit box or a fire-proof safe. When the insurance policy is purchased, many experts recommend that copies of inventories, appraisals and pictures be given to the insurance agent for his or her files.

VIII. Homeowner's Liability Insurance

We live in an age where liability insurance is absolutely necessary. **Liability insurance** protects the policyowner in case he/she is sued for property damage or personal injury. Few policies contain less than $25,000 in liability coverage, and amounts may be written as high as desired. The more financial assets one owns, the higher the liability insurance carried should be (there is more to gain in a lawsuit from someone who has a lot versus someone who has little).

Liability insurance ***never*** pays if the property or personal loss was caused by an intentional act, unless the person who did the damage was under the age of thirteen. The loss must be the result of *unintentional* actions or conditions. Some state laws hold parents responsible for the malicious acts of their children. Therefore, if a child burns down a public building, such as a school, the parents may be financially responsible. Insurance policies often state a dollar limit and it is important to know what that dollar limit is.Liability insurance provides protection for the actions of one's family and pets, whether on the insured's property or a neighbor's. Without a rider to cover additional members, policies generally only cover people under the age of twenty-one who live in the policyowner's home; the actions of domestic employees while working for the insured; and the actions of people using the insured's property for non-business purposes. Lately, polices are also covering injuries committed by one family member upon another. Not all policies will do so, so again it is important to know what is and is not covered.

The insurance company will handle all negotiations for an out-of-court settlement; defend the insured in court; pay for any bail bonds or interest on judgments which the insured wants to contest and might reimburse (depending upon the policy) the insured for any loss of income due to court appearances. Claims for bodily injury and property damage will only be paid up to policy limits. The insured is responsible for paying claims that go above their policy limits, so it is very important to purchase adequate liability coverage.

For the insurance agent, it is very important to realize that most business activities are ***not*** covered under the standard liability policy. Therefore, if your insurance office is in your home and one of your clients falls on your property, receiving an injury, your homeowner's policy will ***not*** pay. It is possible to have business activities covered, but your policy must specifically do so through a rider. Let's look at what a standard liability policy will ***not*** cover:

> Business activities, unless a rider has been purchased that specifically does so.

> Boats larger than a specified size, when off premises.

> Vehicles licensed to operate on public highways, racing cars and aircraft.

Some items will be covered, although they may cause premiums to rise. Included in this would be any additional property purchased that would normally be covered. Your homeowner's liability would also cover the actions of a building contractor and his workers while working on the insured property. Unattached campers, boats and trailers are covered as are dune buggies and lawnmowers, as long as they are on the premises.

A common claim on liability policies are dog bites. The liability policy will cover the insured's dog should he/she bite someone. However, if it happens more than once, the policy may be canceled by the insurance company. Some breeds of dogs will not be accepted at all by insurance companies. The breeds often include German Shepherds, Pit Bulls and Doberman Pinschers, but may also include other large dog breeds. If the policyowner has one of the excluded breeds, either the policy will be totally denied or the policy will state that losses caused by the dog are excluded. In some states, a second bite by the dog may be cause for **punitive damages**, which is an extra sum that must be paid to the injured party. If one owns a dog that has bitten someone once, it is important to check with the insurance agent or the insurance company to find out what laws apply in that particular state.

Some policyowners chose to pay a little more for their liability insurance and include coverage for medical bills for minor injuries caused to visitors while on the insured's property. The basic protection usually pays a benefit of only $500 per person, but it is possible to purchase higher limits. This protection pays regardless of who was at fault for the injury, but only to non-related people who do not live on the premises.

If one has major assets, most experts recommend that an **umbrella policy** be purchased. An umbrella policy insures all liability losses above the limits of one's regular insurance policies. These polices are not terribly expensive and are usually written for amounts up to $1 million.

IX. Premium Rates

There are about 3,500 insurance companies selling property and casualty home and auto insurance in the United States. While the type of insurance company may vary, they all sell in two basic ways:

1. directly to the general population through the mail or
2. indirectly using a middle man (insurance agent).

Locating and measuring loss exposures requires detailed information searches which must be done in an organized manner. Many sources are utilized. Financial records are one important source. The balance sheet of a business is always an excellent source of information as well. A systematic study of each asset will often help to locate loss exposures. Such things as asset location, replacement costs, utility values, and the perils and hazards to which they are exposed are all considered.

Also involved in any risk analysis is the process of setting premium rates. An insurance rate is the cost for one unit of insurance. The premium is basically the rate multiplied by the number of units purchased. It is similar in concept to unit pricing at the local grocery store. A box of food may be priced at $4.25 for the total package, but the unit price is what the cost is for a given measure whether that unit of measure happens to be an ounce, a pound, or whatever. By comparing the "unit price," the consumer may determine the best buy. A box of rice costing $4.25 may actually be the best buy over a box costing $3.00 if the unit price is less per pound.

In other words, $1.50 per pound is always less than $1.75 per pound no matter what size or shape the package may be.

A unit of insurance is generally $1,000 of coverage. As with the package of rice, the cost of one's insurance is based upon the rate, not the size of the policy. Rates are given for every type of car and driver and for each geographical area of each state.

The rate for any given policyholder depends upon numerous rates. Surcharges and discounts may be considered penalties and rewards given by the insurance company to their policyholders. These penalties and rewards are based upon the kind of risk that the policyholder represents.

Typically, rates are set along three basic guidelines:

1. To make enough money to cover all their policyholders claims and pay the company's overhead expenses. If a company is publicly held, they must also pay a profit (hopefully) to their shareholders.
2. To charge higher rates to drivers who file more costly claims and lower rates to drivers whose claims occur less often and/or who have smaller claims.
3. To stay competitive with other insurers in the markets which they think will be the most profitable

Another factor in rates will be based, to some degree, on which state they are set in. The insurer must follow the regulations of each individual state. The rate for a particular car and driver could change from state to state.

When determining a driver's rate, one of the first things which will be considered is the amount of risk the driver represents. Such things as age is considered as well as factors such as the type of car driven, the number of miles driven and so forth. Although an underwriter (who determines the rate) may have some prejudices, statistical experience is primarily used. Many years of record keeping supports their judgments in establishing rates. A 21 year old with a sports car will pay a higher rate than will a 50 year old person who drives an economy car. The underwriter will feel the risk imposed by the 21 year old driver is much higher than the risk imposed by the 50 year old driver. Risks are usually stated in one of three ways:

1. preferred, which is low risk,
2. standard, which is average risk and
3. non-standard, which is high risk.

No section on risk analysis would be complete without an adequate definition of insurance. As previously stated, the often-used definition, the transfer of risk, is not totally accurate. A more fully expanded definition would be either the accumulation of a fund OR a transfer of risk, though not necessarily both. In addition, it must include a combination of a large number of separate, independent exposure units to make somewhat predictable the possible individual losses. The predictable loss is then shared proportionately by all units involved. This definition of insurance makes the point that both uncertainty is reduced and losses are shared. Both are important aspects of insurance.

Insurance policies allow an individual or a business to substitute a relatively small, defined premium cost for a possibly large, though uncertain, loss. The fortunate many that do not experience a loss will help to compensate the unfortunate few who do suffer a loss.

It is the *"cookie jar"* classic. Many people put cookies into the jar, but only a few will find themselves in need of removing cookies. A policyholder puts one cookie in, but may find themselves (due to a major loss of cookies at home) needing to replace the dozen lost. Having put one cookie into the jar enables the person to take out the dozen needed to replace their loss. The extra 11 cookies taken out came from others who also placed one cookie into the jar.

When a new policy of any type is received, the policyholder is wise to check it for errors. As the agent, you should mention this to your clients. If the policy goes to the agent first, that agent would certainly want to do the same. When an agent delivers a policy which contains errors, it makes the agent look as bad as the insurance company.

Insurance products of all kinds have developed a reputation (not always deserved) of being easily misunderstood. There are several factors involved in this concept. Certainly, it is a field with a variety of products, each often having their own methods or ways of laying out a policy. Some insurance fields, such as Medicare supplements, have attempted to standardize the product brochures. Other types of policies allow great variations. Often confusion arises from a lack of understanding or knowledge of insurance terms. However, many analysts feel a major problem is simply the preconceived idea held by the consumer that an insurance contract is *unreadable.* It is unfortunate that so many consumers believe, without ever trying, that they will not be able to read and understand their insurance policies.

The producer (insurance agent selling the product) is in an ideal position to dispel some of those outdated beliefs. The producer is usually the first, and perhaps the only person, who can act as an educator. Of course, to do so requires the agent to be educated himself. To be a successful educator, the agent must have a grasp of the basics of insurance principles and guidelines.

An insurance policy is the document containing the contract between the insured and the insurer (the policyowner and the insurance company). The length and complexity will vary with the type of contract and the complexity of coverage. Regardless of the length or complexity of the document, the policy will define the rights and duties of the contracting parties.

Insurance policies usually follow the same basic format which includes:

(1) declarations,
(2) insuring agreements,
(3) exclusions,
(4) conditions and miscellaneous provisions and
(5) definitions.

Some types of policies will follow this format precisely while others may consist of multiple parts which must be combined to make a complete contract. An automobile policy will tend to follow this format with easily recognizable parts. On the other hand, a homeowner's policy will consist of two parts which must be combined to make the complete contract.

DECLARATIONS are descriptive phrases which describe the subjects covered, persons insured, and premiums to be paid, period of coverage, policy limits and warranties made by the insured (the policyholder) regarding the nature of a hazard. The declarations usually appear as a separate form or as the first page of the policy. This section personalizes the policy to the specific policyholder.

INSURING AGREEMENTS are the coverages in an insurance policy which are broadly defined in the insuring agreements. Insuring agreements may sometimes also define important terms in the contract. In most policies, the insuring agreements appear immediately after the declarations.

EXCLUSIONS eliminate specific coverages. Exclusions may also be referred to as limitations in some types of policies. There may be many reasons why the insurer (insurance company) may use exclusions in a contract. They may wish to:

- maintain management of physical and/or moral hazards,
- eliminate duplicate coverages,
- eliminate coverages not generally needed
- eliminate or minimize uninsurable perils and
- eliminate specialized coverages that the insurer is not qualified, for whatever reason, to offer.

CONDITIONS AND MISCELLANEOUS PROVISIONS may be seen as the ground rules under which the contract operates. From a legal standpoint **"Conditions"** and **"Miscellaneous Provisions"** are distinct from one another. Even so, they usually appear together. Since insurance policies are conditional contracts, the conditions with which the insured must comply are listed here. They control the insurer's liability for covered losses by imposing obligations on both the insured and the insurer (the policyowner and the insurance company respectively). They may include such things as time limits for paying claims, alterations of the policy,
assignment, cancellation, fraud or optional settlements, to name just a few of the possible conditions.

DEFINITIONS are simply a list of terms and phrases with their fully defined meanings stated. Wherever those words or phrases appear in the policy, they are **printed in boldface type** to remind the reader that a specifically listed definition applies. Often endorsements and riders will appear in the same section as definitions. Any endorsements or riders or other forms supersede those of the preprinted policy to which they are attached.

Since endorsements and riders have been mentioned here, it should be noted how they are used:

ENDORSEMENTS AND RIDERS are often used when standards or preprinted policies do not entirely meet a specific situation. Modification of the standard or mass-printed policy is obtained by adding special provisions to the basic contract. The term **"endorsement"** is used in property and liability insurance. The term **"rider"** is used in life insurance contracts.

Endorsements and riders are used to complete a contract, alter coverage or change a policy that is in effect. Such as, a standard fire policy is not considered complete until the endorsement is added which describes the property which is to be covered.

A **peril** is defined as a cause of a potential loss. That loss may be due to a multiple of causes such as an accident, fire, explosion, flood, negligence or theft.

A peril is different than a hazard. A **hazard** is anything that increases the seriousness of a loss or increases the chances that a loss may occur. There are four types of recognized hazards:

- **Physical Hazards** which come from material, structural or operational features. A physical hazard is, as the name implies, something that exists physically.

> **Moral Hazards** involve people and their actions. Arson is a moral hazard because it involves the actions of a person or persons.

> **Morale Hazards** are different than moral hazards Note the difference in the spelling. Morale (with an "e" on the end) involves human carelessness or irresponsibility rather than an intentional act.

> **Legal Hazards** come as a result of court actions which increase the likelihood of a loss or increase the size of the loss itself. We live in an age of increasing lawsuits and this is a legal hazard

We recognize that authorities do not always use the same definitions for any given term. The terms **perils** and **hazards,** for example, are often interchanged from one policy to another and from one text to another. Even with these variations, most authorities consider:

> Perils to be the things that cause losses and

> Hazards to be the catalysts that bring about or increase perils.

X. The Insurance Policy Layout

Reading a policy is a difficult thing for the average consumer. Terms, such as **"replacement value"** and **"actual cash value,"** may not be understood. What is ***not*** covered may not be fully explained or not fully understood, if explained.

For example, many homeowners do not realize the limits within their policies even though it may have been explained to them by their agents. While policies certainly do vary, most companies have set limits on certain types of property:

> $200 on money, gold, silver, platinum, coins, bank notes and medals.

> $1,000 on securities, deeds, manuscripts, tickets, stamps and valuable financial papers (like letters of credit or evidence of debt).

> $1,000 on watercraft including their trailers, furnishings, equipment and outboard motors.

- $1,000 on trailers not used with watercraft.
- $1,000 on grave markers.
- $1,000 to $2,000 on jewelry, watches, furs and precious or semiprecious stones.
- $2,500 on silverware, gold ware, silver-plated or gold-plated ware and pewter ware.
- $2,500 on firearms

The limits listed apply to each category, not to each item within a category.

This list is not necessarily comprehensive. Many policies offer limited coverage for art, antiques and collectibles. Also, one must consider the general limits of the homeowner's policy. The limits set on the total contents of the house may be much too low for the value of those contents if not properly assessed.

Many homeowner policies carry endorsements to cover the additional value of the insureds possessions. An endorsement is a form attached to an insurance policy to add to or change its normal provisions. Floaters may also be used. Whereas an endorsement is an *addition* to a policy, a floater is a *separate policy* that will provide more insurance and can cover possessions against perils not listed in the homeowner's policy. Generally, floaters are **"all-risk"** policies that will cover against all perils, *except* those specifically excluded in the policy.

XI. Negligence Laws

All human activities can lead to situations where negligence is alleged against one party by another.

"No wonder you had an accident, Leroy, you weren't listening to me."

Negligence is the lack of proper care or attention to the matter at hand. It is the standard of the **reasonable and prudent man rule,** which was established as a criterion against which human activities are measured. This application applies equally to many things, including the operation and/or ownership of a motor vehicle.

In some state's laws, statutes and ordinances have been enacted which may alter and/or modify some of the common law concepts of the application of negligence. It is necessary for each agent to be specifically familiar with his/her state's provisions since they do vary from state to state.

There are basically three types of negligence laws:

(1) pure comparative negligence,
(2) modified comparative negligence and
(3) contributory negligence.

With **pure comparative negligence,** the policyowner can collect damages based upon the percentage of fault: what percentage was their fault and what percentage was the fault of the other driver.

States that have **modified comparative negligence laws** allow the driver to collect from the other driver's insurance only if the policyholder's percentage of fault was **less** than a specified percentage (often under 50 percent). In other words, a driver who was 40 percent at fault could collect damages from the other driver, but a driver who was 55 percent at fault could not. As you can see, the percentage of fault must be proven. It is often stated that those who prefer this method most are attorneys.

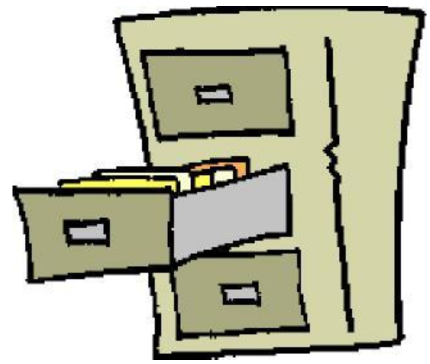
States that have **contributory negligence** allows a policyholder to collect damages only if they had no fault at all in the accident. Of course, their own insurance company would pay for the losses, but the other driver's company would not pay.
In such a situation, the type of coverage carried becomes very important. If no medical coverage is carried (some states do not require it) there will not be any coverage for the physical injuries of the driver or passengers. Even in a no-fault state, the driver could find themselves in court as a defendant. In most cases, no-fault laws cover only personal injuries.

XII. Loss-Adjustment Provisions

Everyone would prefer that losses not occur. Safety should always be the aim of every business and individual. Some precautions may actually lower a person's insurance premiums. As you might guess, insurance companies strongly advocate safety measures.

There is no way to prevent ***all*** insurance claims, but some types of losses certainly can be reduced. For example, every homeowner should inspect their home from the viewpoint of a thief. The more time consuming it is to break into a home, the more likely the thief is to pass up the house for an easier target.

Notice of Loss:

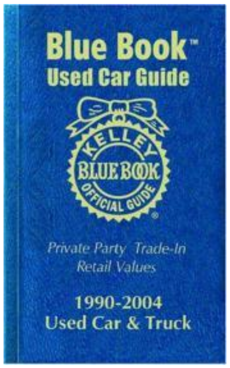


Unfortunately, no matter how careful an insured is, a loss may still occur. When any loss is reported to an insurance company, it is important that well-organized records be kept. Only copies should be mailed to an insurance company. Few require that the originals be sent. Original copies should be kept by the insured or policyowner.

Most liability insurance policies provide legal defense for their policyholders. That means the company will represent the policyholder if a claim is brought against them. To adequately defend a policyholder, it is important that the insurance company be given all information pertaining to the case including copies of any communications received from the opposing side.
Property and liability insurance claims are usually settled in branch offices or by independent adjusters. Home-office claim departments are usually responsible for claims administration. They operate as a personnel and records office, responsible for selection and supervision of adjusters and maintenance of adequate claims records. By keeping detailed records of the causes of each loss, underwriters and insurance engineers are able to develop loss prevention measures. Claims departments routinely work with police forces, detective agencies, special investigators and physicians to recover losses or reduce their severity.

Processing An Auto Claim:

When a claim is received, the first thing the company will do is to confirm that the policy was in effect at the time of loss. This is actually true for virtually all types of insurance policies. Secondly, the company will check to see if the issued policy covered the type of loss that occurred. Once these two things are confirmed, the company will assign the claim to a **"Claims Adjuster."** This person may work exclusively for one company or may work as an independent representing multiple companies. The job of the adjuster is to verify the loss and then determine the amount that the policyholder is entitled to claim under the policy.



Sometimes an adjuster may declare a vehicle a **"total loss,"** in which case the insurance company will pay the policyholder its book value rather than the cost of repairs. A standard auto policy will not pay to repair a vehicle if the repairs would cost more than the cash value of the car. The value of a car may be determined by consulting standard reference guides such as the **Blue Book** published by the *National Automobile Dealers Association* and/or by consulting local used car dealers.

The policyholder is entitled to the market price of their car. Sometimes it may be necessary to prove a higher value if the reference guides state a lower price. Records which might be useful in proving a higher value include mileage records, service history and affidavits from mechanics.

Some states have no-fault laws (refer to the section on **no-fault** laws). These states usually require that **personal injury protection (PIP)** be purchased by car owners.

Of course, not all states have no-fault laws. In states that do not have no-fault laws, the person who caused the accident is liable for the losses resulting from the accident. Many states require that liability insurance be carried to protect drivers from the negligent acts of others. Sometimes, in order to collect from the person who was at fault, it becomes necessary to sue and establish in court who was negligent.

There are basically three types of **negligence laws** (please refer to the section on Negligence Laws):

1. pure comparative negligence which bases what a policyowner can collect on the percentage of each person's (driver's) fault.

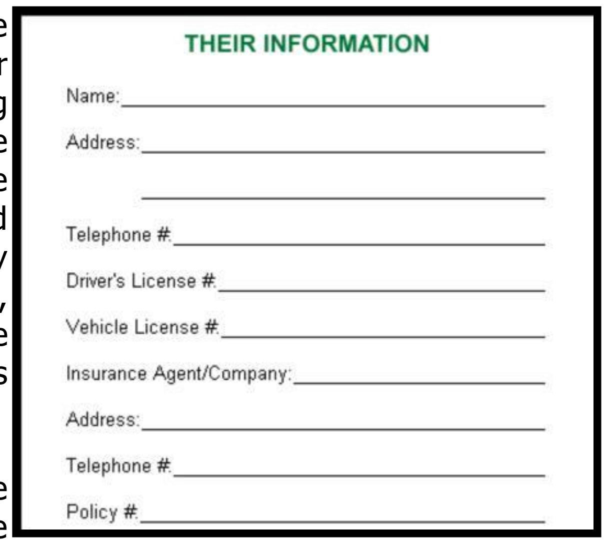
2. modified comparative negligence which allows the driver to collect from the other driver's insurance only if the other driver's liability in the accident was more than a specified percentage. Usually, that percentage is 50 percent.

0. contributory negligence which allows a policyholder to collect damages only if they had **no** fault at all in the accident. If the driver had any fault at all, then he or she must collect from their own insurance company.

If a policyholder is sued for more than their policy limits, the insurance company will still defend their client. Nevertheless, the company may suggest that the policyholder retain another attorney as well to protect the additional interests involved.

Losses of any kind should be reported immediately. This is true regardless of the type of policy. Fortunately, most consumers do not need to file auto claims. The average household will spend around $10,000 on auto insurance over a 10 year period, but file only one claim during that time for about $1,000.

Most people state that speed of claim service is important to them. Often the policyowner can help the system by simply providing complete information to their insurance company. Of course, the first step is the prompt reporting of any claim. Agents need to stress this to their clients. It certainly helps if the insured can provide the names, addresses, phone numbers, insurance companies, license numbers and registrations of the other drivers involved.


THEIR INFORMATION

Name: ____________________

Address: ____________________

____

Telephone #: ____________________

Driver's License #: ____________________

Vehicle License #: ____________________

Insurance Agent/Company: ____________________

Address: ____________________

Telephone #: ____________________

Policy #: ____________________

When a claim occurs that does not involve bodily injury, the insurer will usually arrange to have an appraiser or adjuster examine the damaged vehicle. An appraiser estimates the cost to repair the car; an adjuster also estimates the repair cost, but usually also has the authority to settle the claim.

A large part of the insurance policy will deal with the procedures for loss adjustment. Although policies will vary, generally a policy will contain provisions relating to:

- notice of loss,
- protection of property,
- inventory,
- evidence,
- proof of loss,
- assistance and cooperation,
- appraisal,
- abandonment and salvage,
- settlement options,
- time limits for paying claims,

- time limits for bringing lawsuits, and
- miscellaneous clauses.

As stated, policies will vary; not all policies will contain provisions on all twelve items. Which provisions are used often depend upon the type of policy. For example, life insurance policies normally have just two: proof of loss and settlement options.

For those who pay out numerous premiums and never make a claim, insurance must seem very costly. After all, an insurance policy is most valuable after a loss. Since no one has access to a crystal ball, we must all simply make the best choices we can with the facts available to us.

XIII. Glossary

ACTUAL CASH VALUE: the replacement cost of an item *less* depreciation for its age and/or use. Often it is referred to simply as ACV.

ADVERSE SELECTION: when only a small number of policyholders are sharing a large risk.

ALL-RISK COVERAGE: the insurance company promises to pay for losses from all risks, except for specific exclusions which are listed in the policy.

BASIC FORM OR HO-1: also called Form 1, it generally covers the house and its contents against any of eleven different perils, which range from fire to broken glass. The Basic Form is considered to be limited coverage.

BODILY INJURY LIABILITY INSURANCE: covers someone else (other than the policyholder) who is hurt, or perhaps even killed, in an accident.

BROAD FORM OR HO-2: also called Form 2, this coverage costs more than does the HO-1 because it gives more benefits. It covers the house and its contents against specific losses as stated in the individual policies. The difference between the HO-1 and the HO-2 lies in the perils listed. The HO-2 insures against loss resulting from 18 listed perils rather than 11 or less, as in the HO-1.

CHANCE OF LOSS: the long-run relative frequency of a loss. It is often expressed as a percentage, since it often expresses mathematical probabilities of probable numbers and severity of losses out of a given number of exposures.

COLLISION COVERAGE: usually required by the lender on new vehicles which have not yet been paid for. It applies only to the car itself. The lender wants to be sure they will receive their money in the event that the car is a complete loss, due to an accident. Collision coverage covers repairs to the policyowner's vehicle no matter who caused the accident. It usually covers the fair market value. (also see fair market value)

COMPREHENSIVE COVERAGE: this gives coverage for damages that were not the result of a collision, such as damage from fire, flood, theft, vandalism, rocks thrown from the roadway, and so on. It is considered to be essential for new cars and sometimes even for older vehicles. Comprehensive covers the vehicle's fair market value, which normally declines with passing time.

COMPREHENSIVE FORM OR HO-5: also called Form 5, It is the same as HO-3, except that all risk protection is extended to coverage C, unscheduled personal property.

CONDITIONS: the "ground rules" under which the contract operates. Insurance policies are *conditional* contracts. The conditions are those items which the policyowner must comply with in order for the policy to operate. They control the insurer's liability for covered losses by imposing obligations on both the insured and the insurer.

CONDOMINIUM UNIT OWNERS FORM OR HO-6: also called Form 6, it was introduced in 1974 expressly for the unique needs of condominium unit owners who were exposed to risks similar to those of renters. HO -6 is a reproduction of HO-4, except for two changes, which offer limited coverage for damage to additions and alterations and also provides that the extra coverage will be excess insurance over and above any offered by the condominium association.

CONTENTS BROAD FORM OR HO-4: also called Form 4, or renters or tenants insurance, this type covers around 17 or 18 risks to personal property. It applies only to the contents of the house, not to the structure itself (which would presumably be covered by the building's owner).

CONTRIBUTORY NEGLIGENCE: allows a policyowner to collect damages only if they had no fault at all in the accident. If the driver had any fault at all, then he or she must collect from their own insurance company.

COVERAGE A: covers the actual dwelling or house.

COVERAGE B: covers all structures, except the house.

COVERAGE C: covers all personal property.

COVERAGE D: covers the loss of use of damaged property.

DECLARATIONS: descriptive phrases which describe the subjects covered, persons insured, premiums to be paid, period of coverage, policy limits and warranties made by the insured regarding the nature of a hazard. The declarations personalize the policy.

DEDUCTIBLES: many types of policies contain various types of deductibles. It is the amount of the loss that must be assumed (paid) by the policyholder before anything will be paid (covered) by the insurance company. It may be expressed as a dollar amount, a percentage or as time not covered.

DEFINITIONS: See Policy Definitions.

ENDORSEMENTS: used in property and liability insurance, they allow a standard or preprinted policy to be modified to meet specific situations. **Riders** are used in life insurance policies to modify mass-printed standard forms. They are used to complete policies as well as to take away benefits. For example, a standard fire policy is not considered complete until the endorsement is added, which describes the property which is to be covered. Also see Riders.

ENDORSEMENTS AND RIDERS: Often used when standard or preprinted policies do not entirely meet a specific situation. Modifications of the standard or mass-printed policy are met by adding special provisions to the basic contract. The term, endorsement, is used in property and liability insurance and the term, rider, is used in life insurance policies.

EXCLUSIONS: these eliminate specific benefits or coverage. Exclusions may also be referred to as **limitations** in some types of policies.

FAIR MARKET VALUE: this is determined by the book values (for automobiles) minus the cost of making repairs, minus a charge for unusually high mileage, if applicable.

FAMILY AUTOMOBILE POLICY (FAP): this has several parts to it, which includes:

- Coverage A, bodily injury liability (Part 1)
- Coverage B, property damage liability (Part 1)
- Coverage C, reasonable & necessary medical expenses to the insured, their relatives and other persons injured (Part 2)
- Coverages D thru I, protection against loss resulting from physical damage to an automobile (Part 3)
- Coverage K, found in some though not all policies. The insurance company agrees to pay a stated accidental death benefit if the death was caused by bodily injury while occupying a vehicle or by being struck by an insured vehicle, providing that death occurs within 90 days of the actual accident. (Part 4)

Each part of the FAP contains its own recovery limitations, definitions and exclusions.

FIRE AND ALLIED COVERAGE INSURANCE: usually required by a mortgage lender, this means that the structures would be insured against just about everything that might damage it.

FIRST PARTY: In an insurance contract, the first party is the policyholder.

FRAUD: the deliberate attempt to steal or deceive. When applied to insurance policies, it often takes the form of applying for benefits that are not due.

FUNDAMENTAL RISK: a type of risk to which society in general (or at least a large number of people) is exposed to in a single occurrence. An example of this is a recession.

HAZARDS: the catalysts that bring about or increase perils (also see perils).

HOMEOWNER'S INSURANCE: a combination or package policy. The actual provisions contained in the policy will depend upon the needs and/or desires of the homeowner. A homeowner's policy contains a combination of several forms, in most cases. Homeowner polices are designed to protect owners and renters from loss or damage to their property and to provide protection against liability claims.

INFLATION GUARD CLAUSE: a clause in a policy which automatically increases the coverage by a specified percentage amount at specified time intervals. The premium typically increases as well. An inflation guard will not reflect any improvements made.

INSURANCE: the simplified term most often used is *the transfer of risk from one entity to another.* A more complete definition would be: either the accumulation of a fund or a transfer of a risk, though not necessarily both. It must include a combination of a large number of separate, independent exposure units to make possible individual losses somewhat predictable. The predictable loss is then shared proportionately by all units involved. The definition of insurance should point out that together uncertainty is reduced and losses are shared.

INSURANCE POLICY: the document containing the contract between the insured and the insurer (the policyowner and the insurance company respectively).

INSURANCE RATE: the cost for one unit of insurance. Typically, a unit of insurance is $1,000 of coverage, although this can vary.

INSURED: the policyholder, generally speaking.

INSURER: the insurance company.

INSURING AGREEMENTS: the coverages in an insurance policy, which are broadly defined in the insuring agreements. They may sometimes define important terms in the contract. These usually appear immediately after the declarations. Also see Declarations.

LAW OF LARGE NUMBERS: relates to the degree of risk. It may also be referred to as the Law Of Averages or the Law Of Probability. Without becoming involved in the complicated mathematics, basically it states that the greater the number of similar units exposed to a similar loss, the more accurate the loss predictions based on that specific data will be.

LEGAL HAZARDS: these hazards come as the result of court actions which increase the likelihood of a loss or increase the size of the loss itself.

LIABILITY: the state of being responsible or under obligation. Liability insurance covers a person's responsibility or obligation to another due to a loss. Liability insurance is the most expensive type of coverage.

MARKET VALUE: this is the dollar amount that the homeowner could sell their home for. It is not necessarily the same as the amount of money required to rebuild the home, should a loss (such as a fire) occur.

MEDICAL PAYMENTS INSURANCE: this pays, as the name implies, the doctor and hospital bills and, if necessary, funeral expenses for the policyowner and members of his or her family who live in the same household, regardless of who caused the accident. It will also cover any passengers in the car being driven and even pedestrians.

MODIFIED COMPARATIVE NEGLIGENCE: bases what a policyowner can collect on the percentage of each person's (driver's) fault.

MORAL HAZARDS: this involves people and their actions. Arson is an example of a moral hazard because it involves the deliberate actions of a person or persons. [Also see Morale (with an "e" on the end) Hazards.]

MORALE HAZARDS: this involves human carelessness or irresponsibility, rather than an intentional act. (Also see Moral Hazards.)

MORATORIUM: the legal permission to delay action. This generally applies to such things as the selling of earthquake insurance immediately following the final aftershocks of an earthquake. By allowing a moratorium on the sale of earthquake insurance (following such an occurrence), it allows insurance companies to determine their exact losses before assuming new risks. It also acknowledges the possibility of additional and damaging aftershocks, which could result in additional losses for the insurance companies.

NATIONAL FLOOD INSURANCE PROGRAM: this is administered by the Federal Emergency Management Agency (FEMA). Both the private and government flood insurance coverages are part of this program.

NEGLIGENCE: the lack of proper care or attention; carelessness.

NO-FAULT: a system in which the driver's own coverage pays for the losses regardless of who actually caused the accident. It is due to this fact that it is referred to as "no-fault."

OLDER HOME FORM OR HO-8: also called Form 8, it is identical to HO-1, except losses under the 10 listed perils are settled on an Actual Cash Value (ACV) basis rather than on a replacement cost basis.

PARTICULAR RISK: a risk to which relatively few people are exposed to in a single occurrence. Particular Risk and a Fundamental Risk have much in common. The main difference is the number of people exposed to the risk itself.

PARTIES: There are several parties involved in insurance:

- The first party is the policyowner.
- The second party is the insurance company.
- The third party is the other driver.

PERILS: perils are the things that cause losses, such as fire, floods, explosions or negligence. Also see Hazards.

PERSONAL-INJURY PROTECTION: Often referred to as PIP, it is required by law in some states. It covers:

- the policy owner’s own medical bills up to a specified limit
- funeral expenses
- replacement services in some states.

PHYSICAL HAZARDS: these come from material, structural or operational features. A physical hazard is, as the name implies, something that exists physically.

POLICY DEFINITIONS: a list of terms and phrases with their fully defined meanings stated. Wherever those words or phrases appear in the policy, they are printed in bold-face type to remind the reader that a specifically listed definition applies.

POLICY LIMIT: contained in most policies, it means there is a limit to the amount of money the insurance company (policy) will pay out on a covered loss.

PRODUCER: the insurance agent who is selling the product.

PROPERTY DAMAGE LIABILITY INSURANCE: this is usually the other driver's car which is damaged in an accident. It can, however, also include other types of property, such as sign posts, fences or structures.

PURE COMPARATIVE NEGLIGENCE: this bases what a policyowner can collect on the percentage of each person's (driver's) fault.

PURE RISK: this is a chance of financial loss which does not offer any chance of financial gain simultaneously. Also see Speculative Risk.

RENTER'S INSURANCE: known as HO-4, Form 4 or Contents Broad Form, it covers only the personal property in a house; it does not cover the structure itself. It is identical to the HO-2, except that losses to the structure itself are not covered.

REPLACEMENT VALUE: the current cost of replacing an item or items that are lost, stolen or destroyed.

RIDERS: used in life insurance policies, they are used when standard or preprinted policies do not entirely meet specific situations. Modifications of the standard or mass-printed policy is obtained by adding special provisions to the basic contract. Also see Endorsements.

RISK: simply put, is exposure to danger or adversity. For investments, risk is generally defined as uncertainty concerning loss. Risk is always connected to the *uncertainty* rather than to the loss itself. Also see Pure and Speculative Risk and Fundamental and Particular Risk.

SECOND PARTY: In an insurance policy, the second party is the insurance company.

SPECIAL FORM OR HO-3: also called Form 3, this plan offers still more coverage than either the HO-1 or the HO-2. It covers the house for all perils except those explicitly excluded by the policy. On personal property, it covers loss or damage from the same risks listed in the HO-2, but on the house itself, the policyowner is protected from all risks except any specifically excluded in the policy.

SPECULATIVE RISK: a risk which does offer the chance of both financial loss and financial gain at the same time. This is true in many types of investments; either a loss or a gain may be realized. A speculative risk is often created by the actions of the individual.

TENANTS COVERAGE: this is more commonly called "renters insurance" or HO-4. See Renter's Insurance or Contents Broad Form.

THIRD PARTY: In an automobile insurance policy, the third party is the other driver.

TOTAL LOSS: when the cost of an auto repair following an accident is higher than the value of the vehicle itself. A standard auto policy will not pay to repair a vehicle if the repairs would cost more than the cash value of the car.

UMBRELLA INSURANCE: often needed by individuals with relatively large asset bases. An Umbrella policy covers liability judgments that exceed the limits of the auto and homeowner's policies.

UNINSURED AND/OR UNDER-INSURED MOTORISTS: this type of coverage pays the cost of the policyowner's own injuries if they are hit by:

- an uninsured driver who is at fault for the accident.
- an at-fault driver whose small insurance policy will not cover all the damages incurred
- a hit-and-run accident.

This type of coverage may also cover lost wages and, in some states, damages to the vehicle.