Property and Casualty Basics

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Property and Casualty Insurance

Property Insurance is relatively simple to define. It is insurance that indemnifies a person with an interest in physical property for its loss or the loss of its income-producing abilities.

The following types of insurance are generally considered to be property insurance:

Dwelling **Homeowners** **Farm**

Commercial Property **Business Owners' Policy**

Inland Marine **Ocean Marine** *(not covered in detail in this course)*

Equipment Breakdown

Casualty Insurance is more difficult to define because it includes a wide variety of basically unrelated insurance products. It is that type of insurance that is primarily concerned with the *legal liability* for losses caused by injury to persons or damage to the property of others. It covers the risk of financial loss as a result of our actions toward others. ***Insurance for liability includes both personal and business liability.*** Although insurance against the liability risk is an important casualty coverage, there are many other types of insurance that have historically been classified as casualty.

The following types of insurance are generally considered to be casualty insurance:

Aviation *(not covered in this course)*

Auto (Personal and Commercial)

Crime

Workers' Compensation

Bonds

Personal (Homeowners)

Business Liability (Commercial General Liability)

Umbrella (Personal and Commercial)

The following chapter consists of terms and concepts for insurance, specifically property and casualty insurance. Personal lines insurance is property and casualty insurance, non-commercial. To clarify briefly, property is 'my stuff,' casualty is the cost for my liability for damage to you and/or your stuff. ("Stuff" being a technical term.) My auto policy is a personal lines policy consisting of a property portion that will repair my vehicle and a casualty portion which will pay to a third party if I am liable for injury or damage to their property. We start with a few generic terms…

I. **An Insurance Contract** — is the application, the policy, and any riders and endorsements.

II. **Riders and endorsements** are added to a policy and broaden or restrict coverage. Riders are on life and disability policies and endorsements are on property and casualty policies.

- An endorsement may also mean a signature.

III. **The policy** itself consists of the declarations page and the **coverage forms**. An insurance policy is assembled with a combination of various standard forms, including a declarations page, coverage form, and endorsements. A causes of loss form may also required. Together these forms explain the coverage term, the insurance policy limits, the amount of coverage, exclusions and other limitations of coverage, and the duties and responsibilities of the insured in the event of a loss.

IV. **Coverage Form** — one of the primary standardized insurance forms used to construct an insurance contract. The coverage form generally contains the insuring agreement, coverage conditions, exclusions, and policy definitions.

V. **Insuring Agreement** — that portion of the insurance policy in which the insurer promises to make payment to or on behalf of the insured. Also known as the heart of the contract. Often, insuring agreements outline a broad scope of coverage, which is then narrowed by exclusions and definitions.

VI. **Exclusion** — are items, perils. or property that are not covered. An auto policy will tell you for example that you are covered in any car anywhere. The exclusions limits or withdraws coverage for delivery, driving paying passengers, etc.

VII. **Causes of Loss Forms** — Insurance Services Office, Inc. (ISO), commercial property insurance forms that establish and define the causes of loss (or perils) for which coverage is provided. A causes of loss form is combined with one or more coverage forms, the commercial property conditions form, the common policy conditions form, and the declarations to make up an ISO commercial property policy. There are three causes of loss forms: the basic, broad, and special causes of loss forms. The basic and broad causes of loss forms are named perils forms; they provide coverage for loss from only the particular causes that are listed in the policy as covered. The special causes of loss form is an all-risks form; it provides coverage for loss from any cause except those that are specifically excluded.

1. **Insurance** is designed to transfer the financial impact of a loss from an individual or company to an insurance company. In exchange for the protection (agreement of indemnification) of the insurance company, an insured must pay premiums.

   "***Insurance is a contract whereby one undertakes to indemnify another or pay a specified amount upon determinable contingencies.***"

   - Property and Casualty Insurance Contracts are indemnification contracts. ***Indemnification*** means to restore a person to his or her original position before the loss, with no gain.

   - ***Property Insurance*** indemnifies a person or business who has an interest in physical property for the loss or the loss of income-producing abilities.

   - ***Casualty Insurance***, often referred to as ***Liability Insurance***, indemnifies for a wide variety of losses caused by an insured to a third party. Casualty Insurance includes Commercial Liability, Auto, Workers' Compensation, Crime, Surety (Bonds), etc.

   - ***Law of Large Numbers***… Risks are usually not considered insurable unless the insurance company has a large enough number of similar risks and a large enough base of previous loss experience to be able to accurately predict future losses. ***It is the law of large numbers that makes accurate predictions of group losses possible***. The larger the number of risks, the more predictable the number of losses becomes.

2. **Insurable Interest** is the potential for financial or economic loss in a person or in a loss of property. In order to purchase insurance, one must have an insurable interest in the subject of insurance. For example, you cannot insure a home unless you own the home. In property and casualty insurance, interest or ownership **must** exist **at the *time of the loss*.**

3. **The Policy Application** is a formal request to an insurance company to issue a policy based on its representations. ***Signatures of the producer and the insured are required***. The producer signs the application as a witness to the signatures.

   - ***In filling out the application, if an error occurs, a single line should be drawn through the error***. If the error is discovered before being sent to the insurance company, the producer should take the application back to the insured for the correction.

   - ***Neither the producer nor the company can make a change in an application without the written approval of the applicant***.

4. **Monoline vs. Package Policies…** One coverage policies are monoline policies and those with more than one line of coverage are package policies (a.k.a. multi-line policies). A Homeowners Policy covers the building(s) and the liability, known as a package policy. However, a Dwelling Policy covers just the building(s) and is considered a monoline policy.

5. **A Binder** (a.k.a. **unconditional receipt**) can be verbal or in writing and it provides **temporary-guaranteed** coverage prior to the issued policy. No premium is required for coverage to be in-force. Binders are good for a maximum of 90 days (may be extended with the **Commissioner's** written permission). ***The binder is in effect until the policy is issued***.

6. **Endorsements** are provisions added to a policy which broaden or restrict coverage or change a current provision. An endorsement is not valid unless signed by an executive officer of the company and must be attached to and made part of the policy.

   (Note: a rider is the same thing for life or disability policies.)

7. **Certificate of Insurance** represents ***proof that a policy and coverage exists***. A certificate will often list an outline of coverage or brief description of the coverage.

8. **Damages**

   A. **Compensatory Damage** (a.k.a. Actual Damage) is a term which encompasses specific and general damages. Compensatory damages are intended to compensate (pay or indemnify) someone for both the tangible and intangible elements of a loss.

   Specific Damages… If someone destroys your property or causes bodily injury which results in medical expenses, ***specific losses*** have occurred (the value of the property or the amount of the medical bills).

   B. **General Damages** is a broader term that may include a number of intangible elements which cannot be specifically measured in terms of dollar amounts, **such things as pain and suffering** for bodily injury.

   For example: due to a car accident, a person may suffer specific damages to their car, incur medical bills and general damages for pain and suffering. A court may award damages in all of these areas, thus, all such damages are "**compensatory**."

   C. **Special Damage** **(a.k.a. Consequential Damage)** is damage that is caused by an injury, but which is not a necessary result of the injury. Special damages should be distinguished from specific or general damages which are presumed to be directly caused by the injury. The distinction between special and general damages is NOT absolute by, but rather depends on, the circumstances of each case.

   For Example: In an action of failure to provide auto parts as agreed to in a contract, the general damages would be the price paid under the contract. Any claim for damages to the business's reputation for reliability or competence would be special damages.

   D. **Punitive Damage** is a form of ***punishment*** intended to serve as an example to others and to create disincentives that discourage certain behavior. Punitive damages are awarded in cases involving ***gross negligence*** or conduct which exposes members of the public to extreme hazards. ***Gross Negligence*** is willful and reckless misconduct. It is characterized by the lack of even the slightest degree of care.

Most insurance policies will NOT pay for punitive damages.

9. **Liability** means being legally responsible or negligent for someone else's loss. This is also known as **third-party coverage**. Most liability insurance claims result from an alleged violation of tort law, defined below.

Types of liability include Absolute, Strict, Vicarious (a.k.a. Imputed), and Negligence.

Strict and Absolute Liability both mean that someone can be **held liable without regard to fault or negligence.**

Strict liability is most commonly applied in product claims. If a claimant can prove that a product was defective and that the defect caused the injury, the manufacturer can be held strictly liable.

A. **Absolute liability** is imposed when conduct is so hazardous that public policy demands those engaging in it be held fully responsible for any resulting injuries or damages. **Absolute liability is where the claimant (third party) does not have to prove anything or that the insured was negligent for the loss**.

Examples of absolute liability would include anyone using explosives or keeping dangerous animals that could cause bodily injury or property damage. Workers' compensation laws impose a form of absolute liability because employers are held liable for employee's injuries and sicknesses, **regardless of fault**.

B. **Strict liability** is most commonly applied in product claims. If a claimant can prove that a product was defective and that the defect caused the injury, the manufacturer can be held strictly liable.

C. **Vicarious Liability** means that someone is liable for the actions of **another person,** *e.g., employers are liable for employees, parents are liable for their children.*

10. **Negligence** is the failure to use the ***proper care*** that is required to protect others from an unreasonable chance of harm. It is through negligence (generally ***a careless act***) that someone becomes responsible or legally liable for someone else's loss.

Legal liability is covered within the body of law called the Tort Law. A tort, from French for "wrong," is a civil wrong or wrongful act, whether intentional or accidental, from which injury occurs to another. Torts include all negligence cases as well as intentional wrongs which result in harm.

- **Civil Law** deals with disputes between individuals. (This will cost you.)
- **In Criminal law,** the government prosecutes an individual in the interest of society for violating laws written to protect the public. (This will put you in jail.) Criminal and dishonest acts of an insured are NOT covered under insurance policies.

A. A tort ***is a civil wrongdoing that violates the rights of another.*** A tort is an action that causes injury that, under law, means the victim is entitled to compensation. The person who commits the tort may be called a tortfeasor.

B. Four Elements of Negligence required in all cases of negligence are:

i. There must be a legal duty to act or not to act.
ii. There must be a breach of that duty.
iii. There ***must be resulting injury or damage.***
iv. The breach of duty must be the **proximate cause** of the injury or damage.

Proximate Cause exists when there is an uninterrupted chain of events resulting from the negligent act that causes the loss. The negligent act must have been the cause without which the accident would not have happened.

It is the key event in a chain of events that leads to a loss.

C. Defense against negligence can be as basic as the differing degree of care due to a person. It includes any of the following:

- ✓ failure to prove the four elements of negligence,
- ✓ assumptive risks – knowing 'something' could happen that may be dangerous, but you do it anyways,
- ✓ comparative fault – both parties are at fault. This may be 50/50, 75/25, etc.,
- ✓ intervening or superseding act – an event that changes the proximate cause of a loss to a later event.

The Prudent Person Rule is a theory that says you are negligent when you have failed to do what a prudent person would do in similar circumstances. ***It may consist of an act or a failure to act***. A **Degree of Care** is owed to most people.

The **degree of care** that must be exercised depends on the status of the person coming onto the insured's land.

Common law, which consists of past court decisions and is contrasted with **statutory law** or written law, such as statutes enacted by legislatures, recognizes four classes of persons with differing degrees of care due them:

Trespassers, Licensees, Invitees, and Children.

I. Trespasser - a person who comes onto the property without right and without consent of the owner or occupier. As a general rule, the land occupant has no duty to exercise care to protect the trespasser.

II. **Licensee** - a person who comes onto the property with the knowledge or toleration of the owner but for no purpose of, or benefit to, the owner (insured). This classification would include door-to-door salespeople or solicitors. An occupant has a ***degree of care*** to protect such individuals from harm.

III. **Invitee** - a person who has been invited onto the property for some purpose of the insured. This classification would include garbage collectors, mail carriers, and other delivery people. The occupant has a duty to warn invitees of any dangers or make them safe. Any condition (or **careless act**) that could cause harm to an invitee is a possible source of legal liability.

IV. **Children** - require the ***greatest degree of care*** by the occupant. Attractive Nuisance Doctrine means any condition or item on a premise that will draw children to investigate or use it, if used, the children will be treated as invitees. The owner may be held liable for any injury, even if the child trespassed. A key point is the attractive nuisance must be artificial, such as a swimming pool. Trees are considered landscaping, a treehouse on the other hand will draw children to investigate.

11.Underwriting

Underwriting is the process of selecting certain types of risks that have historically produced a profit and rejecting those risks that do not fit the underwriting criteria of the insurer. Good underwriting of risk selection normally produces a favorable loss ratio. This means the premium collected, less loss and expenses, produces a profit for the insurer.

Insurers must carefully underwrite all risks to avoid being the victim of ***adverse selection***. Adverse selection is selection against the insurance company. It is the tendency of insureds with a greater-than-average chance of loss to purchase insurance. Insurance is based on the ***law of large numbers***. By combining a large number of homogeneous units, the insurer is able to make predictions of possible loss. Using the law of large numbers, insurers are able to calculate their probable number of losses and adjust premium accordingly.

An acronym companies may use for the underwriting is **COPE**: **Construction, Occupancy, Protections, and Exposure.**

- ✓ **Construction** – Refers to frame, masonry, metal, brick veneer, fire resistive, etc. The better the construction the lower the fire rate. An older home may get a discount due to the age of the home and the fact that the materials are less likely to burn. *e.g., wood walls will burn but at a slower rate than particle board and glue.*
- ✓ **Occupancy**: Is the building owner occupied, 65% of the space rented out, for what is it used?
- ✓ **Protection**: Is there an alarm system, a sprinkler system, how close is the nearest fire hydrant as well as the nearest fire station?
- ✓ **Exposure** such as nearby buildings and their usage, the neighborhood in general, is it a business park, warehouses, or residential?

Generally, higher risk factors will result in higher premium rates and lower risk factors will drive premiums lower. Total premium is a blending of all factors for each policyholder. When the Office of the Commissioner analyzes risk calculations and rating plans, they determine whether or not the calculations and plans are "actuarially sound," *i.e., reasonable in light of the anticipated risks.* These rating plans can be simple, such as a rate per $1,000 of desired insurance coverage, or complex formulas that take into consideration multiple rates and factors.

Sources of Underwriting Information:

When the application comes to the insurance company, underwriters review it for its acceptability to the company. In addition to the application, the insurance company may also evaluate by using the following sources:

- Inspection Services;
- Department of Motor Vehicles;
- Industry Bureaus such as Automated Property Loss Underwriting System and C.L.U.E.;
- Financial information services such as Standard and Poor's; and
- ***Previous insurers and the company's own claim files.***

12.Rate Development: An insurance rate is the price per unit of insurance. Deciding the cost per unit is different in insurance than in any other business. Generally, when creating a product to sell, a business calculates the cost of raw materials, the cost to create the finished product including design, workmanship, transportation, etc. Insurance rates are based on what *might happen.*

A. Types of rate development depend on the product. Insurance companies look at various characteristics to determine the premium that an individual is charged. Auto insurance premiums are based on factors such as where you live, your age, and your driving record. Dwelling and Homeowners insurance premiums are based on factors such as where you live, the value of your home and its contents, type of construction of the home, previous losses, etc. A CGL policy will look at the classification of company, possible liability exposures, territory, and the limit of liability coverage. Each insurance company determines premiums differently since the rating plans differ.

B. Components: The four main components of P & C insurer rating manuals are rules, rate pages, rating algorithms, and underwriting guidelines. Insurance companies like to verify the expected premium will cover the expected losses and expenses as well as profit the company.

C. Basis: The calculation of premium is based on the amount of exposure a policy brings to the company. It is important that the basis for premium and exposure are on the same basis, *e.g., written, earned, or in-force.*

13. **Risk** is the uncertainty of loss. ***The purpose of insurance is to deal with the transfer of risk from the insured to the insurer.*** Without risk there is no need for insurance. Only ***pure risk*** is insurable. ***Pure risk*** means that only a chance of loss is present and no chance of gain.

14. **Hazard** - is anything that increases the chance of a loss. Types of hazards include:

   A. **Physical** - *dirty windshields, broken headlights, unattended candles, or paper next to an open flame.*

   B. **Morale** - carelessness of attitude or irresponsibility. *This would include failing to lock the front door of a house thinking that any loss would be covered by insurance.* ***A careless person is a morale hazard.***

      Hint: *The difference between morale and moral is the 'e' on the end. Look at the ale on the end of morale, a person who has had an ale or two is more careless than one who has not.*

   C. **Moral** - arises from people's habits and values… Dishonesty. *Examples of poor moral risks include intentionally setting a fire in order to collect the insurance, filing a false claim, excessive speeding tickets, or a poor credit report.* **A claimant may be charged with a Class "C" felony for filing a false claim**. **A dishonest person is a moral hazard.**

   D. **Legal** - arises from court actions which increase the likelihood or size of the loss. *For example, there is a growing tendency for people to file lawsuits and claim enormous sums for alleged damages.* All liability policies include 'Duty to Defend." *This can include attorney's fees, court costs, limited bail bond, appeal bond, etc.*

15. **Peril** is anything that causes a loss, *e.g., fire, wind, hail*. A property policy may have Named Perils where only the perils covered are named or Special Perils where the exclusions are named and all else is covered.

   A. **Named perils** are those policies where covered items are **only** those items that are specifically named. Basic form and Broad form peril policies are named peril policies.

      - Fire, lightning, and internal explosion are covered in a **Basic form policy**. Extended coverage adds the perils of REV C SHAW, riot, explosion, vehicle and volcano, civil commotion, smoke, hail, aircraft, and wind. Also covered are vandalism and malicious mischief.

      - **Broad form coverage** adds BIAFFECT: the perils of burglary (damage to the structure, not items missing), ice, accidental water damage (from inside, not flood), freezing, falling objects, electrical – sudden and accidental damage from artificially generated sources.

B. Open perils can be known as all perils, special form perils, or all risks of direct physical loss. These policies cover everything that is not specifically excluded in the policy.

Damage is caused when a hot water heater explodes. The peril is explosion, and the hazard is an un-serviced water heater. Most policies will pay for the ***damage caused by*** the water heater exploding but **will NOT pay for a new hot water heater**.

"Act of God"… an event arising out of natural causes with no human intervention which could not have been prevented by reasonable care. *For example: earthquake, flood, lightning, or strong winds.* ***Some "Acts of God" are covered and some are not***.

16. Fire is combustion accompanied by a visible light (a flame or glow).

- A ***friendly fire*** is intentionally set and remains within its container or intended limits.
- A ***hostile fire*** is one that escapes its intended limits.
- A fireplace holds a friendly fire. When a spark ignites nearby curtains, it starts a hostile fire.
- **Only hostile fires are covered under fire policies**.

17. **Theft** is any loss of property by stealing, including both robbery and burglary. Less obvious events also are covered when the circumstances at least show the likelihood that property was ***stolen and not merely misplaced***.

I. **Mysterious Disappearance** means that insured property was lost but there is no likelihood that the property was stolen. Mysterious Disappearance is **NOT** an insured peril. *Example: The insured cannot find one of their rings.*

II. **Burglary** is the breaking and entering into the premises of another with felonious intent**,** leaving ***visible signs of forcible entry or exit***.

  - Burglary is when no one is home, or the business is closed.

III. **Robbery** is the taking, ***by force or fear of force,*** of personal property of another.

  - Robbery happens when someone is home, or the business is open. Face-to-face confrontation.

18. Types of Loss can vary depending on the product. Property coverage deals with losses to an insured's property and the loss of use of that property. For example, the property policy will pay to repair or replace a home after a housefire, it will pay for the items inside that were destroyed or damaged, and it will pay for reasonable accommodations while the repairs are in progress. Casualty insurance is to protect an insured by paying to a third party if the insured is found to be legally liable in the event of a loss to the third party.

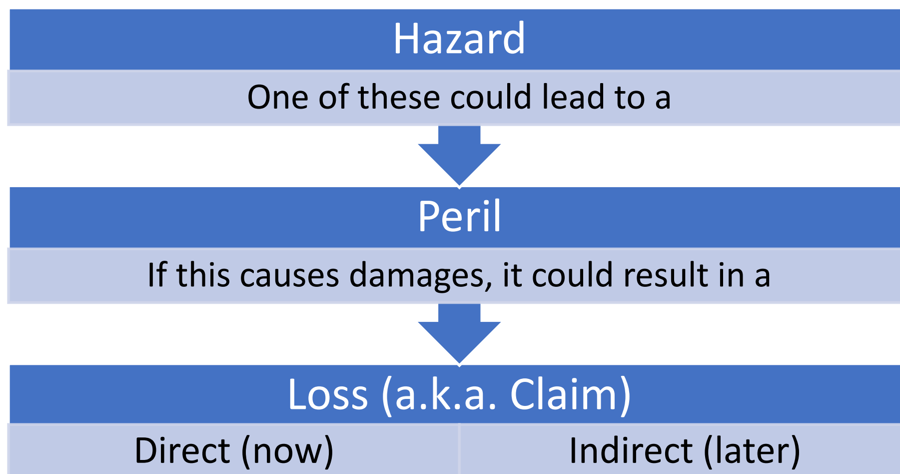
A. Direct Loss means actual physical damage, destruction, or loss of property. For example, a Homeowner's policy will cover direct fire damage to an insured's house including ***water damage from putting out a fire.***

I. **Proximate Cause:** Direct loss caused by a specific peril does not necessarily mean that the peril was the only factor damaging insured property. When a specific peril is the *proximate cause of a loss*, courts have held that the specific peril in question caused the loss. So, loss from water damage and firefighters breaking down the walls or doors is a ***direct loss caused by fire***. The water damage would not have happened if there were no fire.

II. **Concurrent causation** is when there are two separate causes for a peril, one is covered, and one is not. An earthquake causes the candle to tip over which causes a fire. Does the insurance policy cover this? Damage from the fire should be covered, structural damage from the earthquake won't be.

B. An Indirect Loss **(a.k.a. consequential loss)** is a loss which is a result of a direct loss and which occurs as a ***consequence of the direct loss***. An indirect loss usually involves ***money***, whether from loss of income, loss of business, or expenses for lodging and meals after a house fire. ***An indirect loss is paid only if the "direct loss" is caused by a covered peril***.

If I cannot stay in my home because of water damage from a flood, the water damage is NOT paid for if I do not have Flood Insurance and the hotel stay is NOT covered.

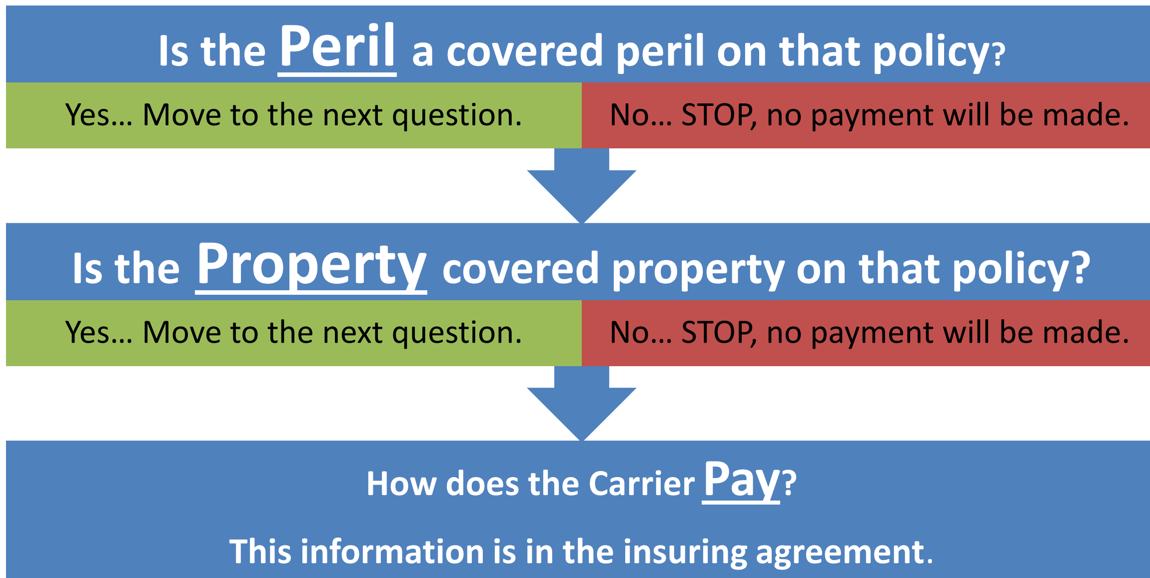


When you are asked how much will be paid for a loss, remember, it may be nothing. So… **PPP**.

When determining how much a company may pay for a claim, remember to check **the 3 P's**

Peril – Property – Pay

Peril – Property – Pay



A grease fire causes damage to the kitchen, how much does the carrier pay?

P - peril - fire is covered

P - property - my property is covered

P - pay - the insurer will pay to repair

The same fire caused smoke damage to my neighbor's home, how much does the carrier pay?

P - peril - smoke is a covered peril

P - property - this is not my property, no payment

The water from the firefighters putting out the blaze flooded the basement, how much will be paid?

P - peril - water damage from putting out a fire is covered

P - property - it is my property

P - pay - the insurer will pay to rebuild

Heavy rains caused the old sewer lines to fail and my basement flooded, how much will the carrier pay?

P - peril - flood is not a covered peril, no payment will be made.

19. **Loss Valuation** (a.k.a. ***loss settlement***): how does a company pay for a claim?

A. **Actual Cash Value (ACV)** means the cost of repairing the damage, minus reasonable **depreciation** (wear and tear, deterioration, and obsolescence). ****ACV=RC-Dep*****

- The replacement price paid for a 10-year-old sofa for example, would not cover the purchase price of a new one. In the event of a loss, the consumer will have to pay out the difference.

B. **Replacement Cost (RC)** means the current cost, at the time of loss, to repair or replace the damaged property with new materials of like kind and quality, **without** deduction for depreciation, but not more than the policy limit.

- This can be endorsed on a Dwelling or Homeowners policy. *A 10-year-old sofa destroyed by fire would be replaced with a new sofa, like for like. A 5-year-old laptop would be replaced with a new laptop of the same size, regardless of the initial price compared to today's price.*

C. **Functional Replacement Cost** means the current cost, at the time of loss, to repair or replace the damaged property with less costly materials and methods of construction, **without** deduction for depreciation and never more than the policy limits. This can be used instead of replacement cost and has a lower premium. This is used when the replacement with identical property is impossible or unnecessary due to age or technology. An older home may have lathe and plaster walls or curved cornices that cannot be replaced identically.

D. **Agreed Value**… Property is insured for a set value. The value is determined on the policy date, not at the time of the loss. This may be done with an appraisal. This is usually accomplished by ***scheduling*** a particular item on the policy. It is generally used to insure fine arts, jewelry, and furs.

E. **Valued Policy:** A policy that states that in the event of a total loss, a specific amount will be paid, and that is set as the limit of the policy. This term also applies in some states that have a valued policy law. In case of a total loss the company cannot dispute the amount to be paid under most circumstances except for the normal exceptions such as fraud, etc. and must, in the event of a total loss, pay the full value of the policy.

F. **(Fair) Market Value** is a concept which does not usually apply to insurance settlements. *Market value means the selling value of the property*. The (fair) market value on real property would not be a good indicator of the insurable value for fire insurance. In a down market, a home might sell for less than it cost to be rebuilt. Cars though are covered at fair market value, never wholesale.

G. **Salvage Value…** The **Salvage** Clause is a condition in a property policy that gives the insurance company the right to take title to property after payment of a total loss. **Salvage Value** is often referred to as the value of damaged property taken over by an insurer to reduce its loss. ***The insurance company will sell the damaged property.***

- Most insurers will ***offer the insured an option to purchase the salvage back from the insurer for what the insurance company might receive from a salvage yard.***

- For example, someone backs into my old 1992 Thunderbird and dents the front quarter panel. It will cost more to repair and repaint than the vehicle is worth. The insurance company pays the loss and totals the car. The car though, if a bit dented, is fine to drive and the consumer may buy the car back from the insurance company at salvage value. *Note: the vehicle will need a new registration and new license plates.*

20. Accident vs. Occurrence

An accident is an incident, sudden and unexpected, that results in bodily harm or property damage.

An Occurrence means an accident, including continuous or repeated exposure to the same harmful conditions, which results in bodily injury or property damage, which is neither expected nor intended by the insured. ***An occurrence does not have to be sudden and accidental. The covered loss could occur over days or even months.***

Most policies pay on an occurrence basis. 1 occurrence = 1 deductible, although if there are multiple claims from an accident or occurrence, there may be multiple deductibles. This would be in commercial policies.

21. Policy Provisions / Policy Structure (D.E.C.I.D.E.S.)

Declarations, **E**ndorsements, **C**onditions, **I**nsuring Agreement, **D**efinitions, **E**xclusions, **S**upplemental

A. **Declarations Page** contains the identity of the property covered, policy period, limits, deductible, premium, mortgagee, endorsements, and first named insured, etc. (Who, what, when, where…)

  - Who: Insurance Company, Producer, Insured
  - What: is the coverage for, what is the premium, what is the policy number, what are the endorsements
  - Where: policy territory
  - When: policy period

B. **Endorsements** are items in the policy that broaden or restrict coverage. *(e.g., earthquake coverage).* They are listed on the declarations page.

C. **Conditions** section describes the responsibilities and privileges of each party to the contract, such as cancellation or renewal rights, payment of claims, etc.

D. **Insuring Agreement**: "We will provide the insurance described in this policy in return for the premium and compliance with all applicable provisions of this policy." The insuring agreement is referred to as the **heart of the contract** and is the insurance company's **promise to pay**.

E. **Definitions** section shows the insurance company's uses of words and how it defines them *(e.g., "yours," "ours," "bodily injury," and "residence").*

F. **Exclusions** section eliminates coverage for certain perils and circumstances. Standard exclusions include wear and tear, earthquake, damage from flooding, or intentional acts of an insured.

G. **Supplemental or Additional Coverage** is coverage that supplements or adds to the existing policy by paying out more money above and beyond the policy limits. Your company has a 'duty to defend' which means they will supply attorneys to defend you if you are sued.

Keep in mind, this is only until the policy limits are paid out. Once that happens, duty to defend is over.

Additionally, supplemental payments can include:

- up to $250 for bail bonds
- premium on appeal bonds or bonds to release attachments
- prejudgment and post judgement interest
- $200+ per day for earnings lost to attend court at the company's request
- reasonable expenses incurred at the company's request

22.Policy Clauses

A. Insured vs. Named Insured vs. First Named Insured…

- An insured is anyone who may be covered by the insurance.
- Persons Insured includes the named insured and all residents of the same household who are relatives of the named insured by blood, marriage, or adoption, and anyone who is under 21 and in the care of any person insured.
- It also includes any loss caused by animals or watercraft owned by or in the care of the insured, except for any business uses.
- The *named insured* is the person, persons or business **actually named** as the named insured in the policy declarations. A *named insured* is responsible for meeting the ***conditions*** of the policy.
- Some commercial policies use the term ***first named insured*** since there could be many named insureds. For example, a commercial cancellation notice would be sent to the first named insured instead of all of the named insureds.

B. **The Policy Period** is the time period during which the policy is in effect. Fire policies have annual policy periods, and start at 12:01 A.M. Auto policies usually have six-month policy periods.

C. **Policy territory** is where the coverage is covering. An individual auto policy covers in the US, its territories and possessions, Puerto Rico, and Canada. A business auto policy will cover anywhere in the world for up to 30 days. A homeowner's policy covers the home, and it covers the personal possessions anywhere in the world.

D. Cancellation vs. Nonrenewal

I. **Cancellation** means coverage will terminate before the renewal date. A refund of premium will usually be due to the insured. Either the insured or the insurer may cancel the policy.

- The insured may cancel the policy at any time with a written notice or by returning the policy. A short rate refund (all unearned premium minus a service fee) must be given within 30 days.
- The insurer may only cancel with a valid reason and generally must give 30 days' notice prior to the cancelation (20 for auto). A pro rata refund (all unearned premium) must be given within 45 days.

II. **Nonrenewal** means that coverage will continue through the current policy term, but the insured will not be able to renew the coverage for another term.

III. **Notice of** cancelation and non-renewal from the insurer must include a reason – in clear and simple language. It must be sent to the named insured, the mortgage company, and the producer of record.

E. Deductible

E. Deductible is the amount that an insured pays first before the insurer pays. This can be a dollar amount or a percentage. A deductible is charged for direct property losses. **SIR or Self-Insured Retention** can be another term for deductible.

Deductibles are used by an insured to help control the amount of their premiums, and used by the insurance company to eliminate small claims.

I. **Per Occurrence** means an accident (***unintended, unforeseen, or unexpected event***), including continuous or repeated exposure to the same general harmful condition. One deductible is charged regardless of the number of claims.

II. **A Per Claim** deductible is charged for each claim in any one accident or occurrence. For example, a painter painting a house may cause damage to several cars from overspray. Each claim will require a separate deductible.

F. Other Insurance

III. **Primary vs. Excess Insurance**: Primary coverage pays first until its limits are exhausted. Excess coverage, usually, is triggered when the primary coverage is exhausted. Umbrella insurance is an example of a policy that will not pay until the underlying limits are paid out under another policy.

IV. **Nonconcurrency**: The condition created by two or more policies covering the same loss exposure that do not have identical inception and expiration dates. Nonconcurrency of an insured's umbrella policies and the liability policies required by the umbrella as underlying insurance is a problem because the nonconcurrent policy terms make it possible for a loss under an underlying policy's annual aggregate limit to use up part of the limit required by the umbrella and thus violate its underlying limits requirement.

V. **Contribution by Equal Shares**: A method of apportioning loss among multiple insurers. Under the contribution by equal shares apportionment method, the loss is shared equally among all the insurers that have valid insurance on the risk, up to the limit of liability of the insurer.

For example: a commercial building is insured for 5 million dollars with company A, 3 million with company B, and 2 million with company C. If a loss occurs, each policy will pay 1/3 of any covered loss up to that policies limit.

VI. **Pro Rata Share**: is a method of apportioning loss among multiple insurers. Under the Pro Rata Share apportionment method, the ***loss payment will be based to a fraction, according to the policies share of the whole.***

For example; a commercial building is insured for 5 million dollars with company A, 3 million with company B, and 2 million with company C for a total of 10 million in coverage. If a loss occurs, company A would pay 1/2 or 50% of any loss because they have 50% of the total coverage. Company B would pay 30% of any loss since they have 30% of the total coverage, etc.

23. Limits of Liability Casualty policies pay to a third party for BI and of PD up to the limit of the judgement that the insured is liable for or the policy limit, whichever amount is reached first. Supplemental costs are paid *in addition* to that limit until the limit is reached. At that point, the duty to defend may stop.

A. **Bodily Injury** (BI) means bodily harm, sickness, or disease, **including required care**, loss of services *(e.g., **wages, daycare, landscaping, housekeeping**, etc.),* and death that results to a third party for which the law holds the insured responsible.

B. **Property Damage** (PD) is the insured's liability for damage to the property of others or loss of use of other's property. (Note: Property insurance covers my property, Property Damage in Liability covers others property.)

C. **Personal Injury** includes false arrest, malicious prosecution, libel (in writing), slander (verbal), defamation of character, invasion of privacy, and wrongful eviction or entry. Personal Injury may be endorsed on your HO policy.

24. Variations in Writing Limits - Casualty Insurance may be written on a specific, scheduled, or blanket basis. The ***limit of liability*** means the maximum amount that the insurer is responsible to pay under an insurance contract. These limits are paid out on a first come first served basis and may include:

A. **(Combined) Single Limit** (CSL) - one figure shows the maximum the company will pay for all Bodily Injury (BI) and Property Damage (PD) liability arising from one occurrence, *e.g., $400,000.*

OR

B. Split Limit - three figures show the maximum the company will pay for liability resulting from one occurrence, with *sub limits*.

For example, 100/300/200 means there is a $100,000 Bodily Injury coverage limit for each person, a $300,000 Bodily Injury total coverage limit for the accident, and a $200,000 Property Damage coverage limit.

- Any number of persons can be paid but not more than $100,000 per person or $300,000 for all persons combined.
- Any set of numbers may be used; 25/50/10, 300/500/100, etc.

$100,000 /	$300,000 /	$200,000
Maximum per person for **Bodily Injury (BI)**	Maximum to all persons for **Bodily Injury (BI)**	Maximum for all **Property Damage (PD)**

C. Occurrence Limit is the maximum amount available per accident regardless of the how many people are injured, or the amount of property damaged. Single limit and Split limit are per occurrence, not per claim.

D. Per Claim is generally for commercial coverage and there will be a deductible for each claimant as opposed to one deductible for the entire occurrence**.**

E. Aggregate Limit is the maximum amount available for the policy period. A policy may have a CSL of $300,000 and a million-dollar aggregate.

25.Co-Insurance Clause

A. Definition of co-insurance is both the insurer and the insured cover the loss in proportionate amounts.

- This amount is based on the amount of insurance coverage an insured may choose to buy compared to the replacement cost.
- If a person buys ½ the amount needed the insurance company will pay ½ of any loss, up to the policy limits.
- *The amount needed is generally 80% of the full replacement cost.*
- *This means if the replacement cost is $100,000 a client could purchase $80,000 of insurance and be fully covered for any losses up to the policy limits. If there was a loss of $10,000 the policy pays $10,000. If there is a total loss of $100,000, the policy pays its limit or $80,000.*

B. Purpose of which encourages the insured to insure her property for its full value by imposing a penalty on indemnification amounts if the property is insured for less than a given percentage of its value (usually 80%).

Unless otherwise stated, expect an 80% coinsurance clause in any exam question.

C. The penalty is the fact that if the insured only carries a fraction of what is needed, the insurance only covers a fraction of the total loss. That fraction is determined by the amount of insurance carried compared to the full replacement value. If a client carries 80% of the replacement cost, the policy actually pays 100% of the loss up to the policy limits. If a client carries 50% of the amount required, the insurance company only pays 50% of the loss.

The amount required for the insured to carry is 80% of the total replacement cost.

D. Total loss will mean the policy pays up to the policy limits**, no more**. This may lower premiums for the consumer but if there is any loss, the company pays a fraction and the consumer pays the balance; this is considered to be the penalty.

E. Calculating **How much (What percentage) are they covered for?**

Step A

What is the amount of insurance they have?

Step B

What is the replacement cost?

80% of the total replacement cost is the amount of insurance needed, a.k.a. "Should be"

Step C

Is / Should Be = The proportionate amount paid.

Step D

The amount of the loss is multiplied by the proportionate amount paid to come up with how much the company will pay towards the loss.

For example: If a house has a $400,000 replacement cost and the policy has an 80% co-insurance clause, the insured would be expected to carry at least $320,000 of coverage. (80% of 400 is 320) As long as the amount of insurance is $320,000 or more, all losses up to the policy limit would be paid fully. **If the coverage is only $160,000 and a loss occurs, the policy will pay only one half of the loss (see below).**

Let's say the loss is $20,000:

A: $160,000 **is** the insured amount — $160,000 … **is** insured for

B: $400,000 is the replacement cost — -------------

($400,000 x 80%) = $320,000 — $320,000… **should be** insured for

$320,000 is the amount of insurance needed

C: $160,000/$320,000 = 1/2 or 50%

D: ½ x $20,000 (the loss) = $10,000

Subtract the deductible if one is shown

If the coverage is $160,000 and a **total loss** occurs, the policy *limit* of not more than $160,000 will be paid.

26.Specific, Scheduled, and Blanket Coverage

I. **Specific Coverage** provides a specific amount of insurance for specific types of property. A homeowner's policy has coverage A to replace the home, this is the policy amount. Additionally, coverage B or other structures is 10% of coverage A, coverage C which is for personal property and is 50% of coverage A, etc. A homeowner's policy may cover personal property for a **blanket limit** of $50,000; however, cash has a **specified** coverage limit of $200 total.

II. **Scheduled Coverage** is used to provide different amounts of insurance for different types of property. A homeowner policy will only cover the theft of a $5,000 ring for a **specified amount of $1,000**. By ***scheduling*** the ring for $5,000 on the policy [for additional premium], it would be covered for its proper and full amount.

III. **Blanket Coverage** provides a single amount of insurance that may apply to different types of property or even more than one location. It covers the structure as well as the personal property with one dollar amount. It can be more expensive to purchase than a conventional policy, but the coverage may be better for insuring more than one location. For example, insuring two homes for $200,000 each or insuring both for $400,000 total. You may have more money to repair or replace if there is a loss to one home as it is covered for $400,000.

27. Vacancy vs. Unoccupancy…

IV. **Vacancy** means the absence of people and property from a building.

V. **Unoccupied** means the absence of people only.

28.Named Insured Provisions

F. Insured vs. Named Insured vs. First Named Insured…

- An insured is anyone who may be covered by the insurance.
- Persons Insured include the named insured and all residents of the same household who are relatives of the named insured by blood, marriage, or adoption, and anyone who is under 21 and in the care of any person insured.
- It also includes any loss caused by animals or watercraft owned by or in the care of the insured, except for any business uses.
- The *named insured* is the person, persons or business **actually named** as the named insured in the policy declarations. A *named insured* is responsible for meeting the ***conditions*** of the policy.
- Some commercial policies use the term ***first named insured*** since there could be many named insureds. For example, a commercial cancellation notice would be sent to the first named insured instead of all of the named insureds.

G. Duties After a loss:

- Notice of Claim… Notify the insurer immediately after a loss.
- Protect the property from further damage.
- Submit a proof-of-loss and inventory of damages within **60 days**.
- Make the property available for inspection.
- Submit to an examination under oath, if required.
- Notify the police if a law has been broken.

The Settlement Clause states that the insurance company:

- Has ***30 days to tell the insured their intention*** of how they will pay for the loss. For example, the insurer has the **right to repair, replace or give a cash settlement under property claims.**
- Agrees to **pay the claim** within **60 days** ***after agreement*** with the insured, or a judgment is made by the court, or an appraisal is awarded.
- **Does not** need the insured’s approval to settle any liability claims.
- However, ***professional liability*** policies need the ***consent by the insured before settlement of a claim***.

H. **Assignment** is the transfer of the policy rights to someone other than the policyholder. *Assignment is valid only with the written consent of the insurance company.* For example, if a car is in the body shop due to an accident and the insurer will cover the cost, the insured has two options. They could pay the repair shop and submit the bill to the insurer to be reimbursed OR the insured could assign payment directly to the repair shop. The insured then would only have to pay for the deductible and the insurer would pay the shop the balance directly.

I. **Waiver of Rights:** A waiver is the voluntary surrender of a known right. When written in an insurance contract, it is considered an express waiver. A waiver of subrogation rights may be endorsed in some policies with an increase in premium. This limits the carrier from recouping any loss paid from an at fault third party, it also eliminates potential conflicts between an insured and their clients. *For example, subrogation is an express waiver of the insured's right to recover from a third party who is responsible for a loss after the company has paid for the loss. Some contracts, such as construction and lease contracts, may require a waiver of subrogation, that way the insurer may not seek compensation after a claim is paid, lowering delays in construction contracts, or maintaining tenant-landlord relations.*

29.Insurer Provisions

A. **Liberalization:** A clause in property and casualty insurance contracts which states "if we make a change which broadens coverage under this edition of our policy without additional premium charge, that change will automatically apply to your insurance as of the date we implement the change in your state." In other words, the insured won't have to start a new policy to get the better coverage, it is implemented immediately.

B. **Subrogation** is the transfer to the insurance company, by the insured, the insured's rights to recover against a third party when the insurance company has paid for the loss. The insurance company stands in the insured's place. Subrogation is ***very closely related to indemnification***.

C. **Claim Settlement Options** on a liability claim include repair, replace, or make a cash settlement. This payment could be a lump sum, made for a fixed period of time, made in a fixed amount until the money runs out, payment for life, or life with a minimum payment of a fixed period (e.g. 10 years) with a named beneficiary, or life with refund with a named beneficiary to receive the balance of the principle should the claimant die prior to receiving the full amount awarded. The interest paid out will always be taxable.

D. **Duty to Defend** is a supplemental coverage at no additional charge, the liability policy includes the duty to defend. It is the obligation of the insurance company to provide an insured with defense made to claims arising under a policy. It covers all legal costs relating to a lawsuit against covered items in the policy. This does not infer the obligation to pay. Duty to defend ends when the company has paid out the limit of the policy through judgements of settlements.

E. **Insurable Interest and Limit of Liability** means when more than one person has an insurable interest, the amount payable for loss will be no greater than the insured's interest at the time of loss, subject to the limit in the policy.

F. **The Policy Period** is the time period during which the policy is in effect. Fire policies have

annual policy periods and start at 12:01 A.M. Auto policies usually have six-month policy periods.

G. **Policy Territory** defines where the coverage extends. Read the policy to determine where coverage exists. The coverage territory in a Personal Auto Policy differs from the coverage territory in a Commercial Auto Policy.

H. **Appraisal** happens when the insurer gives a value for an item and the insured disagrees with it. If the amount cannot be agreed on, impartial appraisers may be called in and paid for by each party. If the two appraisers disagree on an amount a third appraiser, called an umpire, is hired by both the insurer and the insure. Their decision is one of the two existing amounts and is final. An informal procedure as no attorneys are involved and it is between the insurer and the insured.

I. **Arbitration** is similar to appraisal in that if there is a dispute on an amount to be paid or a dispute to the fact that it should be paid at all, each party calls in an arbitrator and they select a third one called an umpire. If an agreement cannot be reached between the first two, the umpire chooses and the best 2 out of 3 and that is the amount paid. Arbitration is a more formal process however, functioning like a court. You are not in court though with the attorney's costs and court costs. (Appraisal is for property, arbitration is for Bodily Injury.)

30.Third Party Provisions

A. **Standard Mortgage (Mortgagee) Clause** - Protects the interest of the financial institution against loss to real property caused by perils insured against. It also grants coverage even if the insured intentionally caused the loss. The institution can also provide a proof of loss or pay premiums in case the insured cannot or refuses to do so. They must also be advised if the contract has been cancelled or non-renewed by the insurer.

B. **Loss Payable Clause** - Very similar to the Mortgage or Mortgagee Clause. An insurance provision authorizing payment in the event of loss to a person or entity other than the named insured with an insurable interest in the covered chattel property (other than real estate). Loss payable clauses are common in all property policies in which the chattel property is financed through a finance institution.

E.g., a fire destroys a warehouse. The Mortgage clause states the bank is paid first for the structure loss; the loss payable clause covers the equipment.

C. **No Benefits to the Bailee** - A Bailee is the temporary holder of another's property. An insured's property insurance policy protects the insured and not a bailee of the insured's property. If the insured's property were destroyed by fire while at the dry cleaners, the insurance company would only protect the insured. If the dry cleaners are negligent the insurance company could pay the insured and subrogate against the dry cleaners.