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Chapter 1 – Uncertainty and Insurance

"History has demonstrated that the most notable winners usually encountered heart breaking obstacles before they triumphed. They won because they refused to become discouraged by their defeats." B.C. Forbes

Introduction

There is probably no country on earth that places greater importance on the right to own property than the United States. For most of us, the national yearning to own property translates into the "American Dream" of owning our own homes.

Since World War II, there has been a veritable explosion in the number of people who own and live in their own residential property. In recent years, despite inflated prices and high interest rates, many still have been fortunate enough to fulfill this desire. With the fulfillment comes risk, the potential of losing one's home due to physical destruction of the property. Homeowners Insurance is designed to mitigate the consequences of these losses. Before we focus on the specifics of the homeowner's coverage, we will focus the first three chapters on the basics of insurance. This will lay the foundation of better understanding of the manner in which homeowner's protection is designed.

In this chapter we will deal with the uncertainties of financial loss, techniques for treating Loss Exposures, benefits of insurance in society, the social costs of insurance and the various types of insurance.

Uncertainties of Financial Loss

A **financial loss** is a decrease in value arising out of an unexpected event.

Financial losses may result when property is either destroyed or damaged.

Loss Exposures

A **Loss Exposure** is a possibility of loss. A Loss Exposure exists if there is a possibility of loss occurring and if such an occurrence causes a financial loss. It is the possibility, not the certainty, of a financial loss that creates insecurity and the need for insurance.

Every Loss Exposure has three elements:

- X the item subject to loss
- X the perils or forces that may cause the loss
- X the potential financial impact of the loss

Example: *owning a home creates a Loss Exposure because all three elements are present. The house and its contents are subject to loss or damage by various perils including fire, wind and explosion.*

If such an event were to occur, obviously the cost of rebuilding or repairing would be a financial loss to the owner.

Types of Loss Exposures

Property Losses - Property consists of such items as buildings, furniture, equipment, merchandise, money, securities, valuable papers and works of art. Property can be destroyed, damaged, lost or stolen.

Property damage can also cause net income losses. All individuals, families and businesses must generate an excess of income over expenses in the long run.

A net income loss consists of either:

- X a reduction in income or revenue
- X an increase in expenses

Liability Losses - A Liability Loss Exposure occurs when some other individual sues an individual for alleged wrongdoing. Even if the suit is groundless, substantial legal fees for defense may be paid. The lawsuit may allege bodily injury, property damage, humiliation, libel, slander, loss of reputation and other forms of personal injury.

Personal Losses - Personal or human losses result from events such as death, disability and unemployment. While injury to members of the public is a Liability Loss Exposure, injury to members of the family itself is considered a Personal Loss Exposure. A personal loss to a family could cause a loss of income (death of the breadwinner).

Techniques for Treating Loss Exposures

When a family analyzes its Loss Exposures, it must decide how these Loss Exposures will be treated. The major techniques for treating Loss Exposures are:

- X avoidance
- X loss control
- X retention
- X transfer other than insurance
- X insurance

It is common for families to use more than one technique for each identified loss exposure. Insurance policies often include a form of retention, as well as, insurance. Insurance company underwriters sometimes require insureds to adopt safety measures as a condition of an insurance policy. Such safety measures are a form of loss control.

Avoidance - When feasible, avoidance is the most effective technique for treating Loss Exposures. Avoidance means a family avoids potential losses by choosing not to own certain property or engage in certain activities. This technique is not very realistic and the least used in preventing losses.

Loss Control - Losses can be controlled through:

1. Loss prevention (lowering the frequency of loss)
2. Loss reduction (lowering the severity of the losses that occur)
3. A combination of 1 and 2

Loss frequency refers to how often a loss occurs or how many losses occur during a given time period. **Loss Severity** refers to the size of the losses that have occurred or might occur in the future.

A good example of loss prevention would be to encourage insured's to drive defensively and wearing seat belts as an example of loss reduction. Seat belts cannot prevent an accident from occurring but it may lower the size of the loss, the extent of the injury and the resulting medical expenses and recovery time.

Unlike avoidance, loss control does not eliminate the possibility of loss. Some chance of loss remains although it may be minimized.

Retention - Retention means keeping or absorbing all or part of the financial impact of a loss. An example of retention would be a deductible on a Homeowners Policy. Retention is not merely a last resort. It can be the most cost-effective way to deal with high frequency (occurring often), low severity (not large) losses. The insured, in fact, agrees to self insure the first \$100, \$500 or \$1,000 of Loss Exposure.

Transfer Other-Than Insurance

Transfer other than insurance occurs when the Loss Exposure of one person is assumed by another, usually through a contract. An example of a contractual transfer of Loss Exposure would be a *hold harmless agreement*. A contract between a softball team and its sponsor would absolve the sponsor from any liability for injury. The sponsor has transferred its liability to the team itself. Such contracts shift responsibility for the financial consequences of a Loss Exposure to another party.

Insurance

Insurance is the most popular technique for treating Loss Exposures. The key elements are *transferring* the risk to an insurance company, thus *sharing* the risk with the company.

Transfer Loss Exposures - by transferring their Loss Exposures to insurance

companies, the insured exchange the possibility of a large loss for the certainty of a much smaller, periodic premium (the insured's payment for insurance coverage). The transfer is accomplished through insurance policies. An insurance policy is a contract that states the rights and duties of the insurance company and the insured.

Sharing the Cost of Losses - Sharing, like transfer, is another element of insurance. Each insured pays its insurance premium to the insurance company that "pools" the premiums into a loss fund.

Insureds who incur covered losses are paid from this fund. The total cost of losses is spread among all insureds. Insurance companies predict future losses and expenses to determine how large a pool of funds will be necessary. They can do this because of the law of large numbers, the foundation of insurance operations. The law of large numbers is a mathematical principle that states, when the number of similar, independent (not subject to the same loss event) exposure units (such as cars or houses) increases the relative occurrence of predictions about future outcomes (losses), based on these exposure units, also increases. This principle enables insurance companies to improve the predictability of losses by pooling a large number of similar independent exposure units.

If an insurance company insured only one person's home against fire, it would have as much uncertainty as that individual. It would also be unable to calculate an appropriate premium. The law of large numbers reduces the uncertainty and increases the accuracy with which the

insurance company can predict the number of fires in all the homes it insures.

The idea involves 2 distinct measures:

1. The probability of an event occurring
2. The uncertainty connected with the occurrence or non-occurrence of that event

Insurance is designed to reduce uncertainty by accepting Transfers of Loss Exposures and improving predictability through the law of large numbers. Insurance does not reduce the underlying probability of the event occurring. The probability of lightning striking a house is very small but the uncertainty to the homeowner is high. In these cases, the uncertainty is high because the number of exposure units is small.

The underlying probability of obtaining a "head" or a "tail" when flipping a coin is 50-50. If a coin is flipped 10 times, however, the result could be 3 heads and 7 tails. If the coin is flipped 10,000 times, the result could be 4,600 heads and 5,400 tails.

Although the underlying probability is the same, in the first case there were too few cases for the law of large numbers to reduce the uncertainty significantly. In the second case, the large number of coin tosses reduces the variance considerably.

Benefits of Insurance

Insurance provides many benefits to individuals. The most obvious benefits of insurance are that it provides payment for losses and reduces uncertainty. Less

obvious are some of the indirect benefits of those loss payments. Since insurers have a financial incentive to control losses, society has benefited from insurer's loss control activities. Insurance also helps provide credit and solve social problems. It enables people to satisfy legal requirements.

Payment for Losses

To *indemnify* is to restore a party who has had a loss to the same financial position that would have existed had no loss occurred. The primary role of insurance is to indemnify individuals, businesses and organizations that incur losses.

To recognize the value of payment of losses, consider what happens after a loss to people who have no insurance. Families burned out of their homes or apartments find themselves on the street, without money, clothes or a place to stay.

Insurance provides some measure of financial security despite these events by paying claims to indemnify insureds. Thus, insurance provides stability to individuals, families and businesses.

Reduction of Uncertainty

Individuals enjoy greatly reduced uncertainty because insurance provides financial compensation for covered losses. Some of a family's greatest financial concerns, such as death of the breadwinner or fire destroying the home, are almost completely eliminated through the transfer of the uncertainty of loss to an insurance company, thereby reducing anxiety and stress. We are not

referring to the emotional trauma of losing a loved one but rather the financial concern of such an event occurring.

Society as a whole experiences a reduction in uncertainty because insurers, using the law of large numbers, are better able to predict losses that individuals or businesses incur.

Loss Control

Insured losses require insurance companies to make claim payments. Loss control reduces the amount of money insurers must pay in claims. The result is reflected both in improved financial results and in reduced insurance costs to the consumer.

Insurance companies employ loss control representatives whose job is to help control the losses that might be suffered by insureds. These inspectors and engineers help insureds identify and evaluate Loss Exposures and re-recommend ways to minimize the frequency and severity of potential losses. The knowledge and experience gained from one insured are shared with insureds that face similar Loss Exposures.

Support for Credit

Before lending money, a lender wants assurance that the money will be repaid. When money is lent to purchase property, the lender usually acquires an interest in that property. The lender can repossess a car or foreclose on a house if the loan is not paid. A lender would have less recourse if the car, of course were destroyed, or if the worker were killed or disabled. Insurance

guarantees that the lender will be paid if the car or house is destroyed or if the borrower dies or becomes disabled.

Reduction of Social Burdens

Uncompensated accident victims can be a serious burden for society. Insurance helps to reduce such burdens by providing compensation for lost wages, medical expenses, and death benefits to survivors.

Satisfaction of Legal Requirements

Many legal requirements necessitate the purchase of insurance policies. In many states, owners of autos must prove they have auto liability insurance before they can register their autos.

Certain business relationships also depend upon the existence of insurance. Just as lenders often require insurance before granting a loan, building contractors usually receive construction contracts only if they can provide proof of Liability Insurance Protection in order to receive a contract for services.

Social Costs of Insurance

Insurance provides many benefits to society as a whole but these benefits are not cost free. Premiums must be charged in order to collect the money to make loss payments. Because there are expenses involved with operating an insurance company, the money collected for premiums is greater than the amount ultimately paid for losses.

Example: *an insurance company might use \$0.85 of every insurance dollar to pay*

claims, with \$0.15 absorbed by salaries, commissions and overhead expenses. In addition to these direct costs, society may bear certain other costs of insurance because it creates moral and morale hazards and perhaps because it encourages dependence on insurance.

Moral and Morale Hazards

To some extent, the existence of insurance actually encourages losses. Although insurers have an economic incentive to encourage loss control, insurance sometimes provides an economic incentive for insureds to have losses.

Moral Hazard - is a condition that exists when a person may intentionally try to cause a loss or may exaggerate a loss that has occurred. Nobody knows for sure how many building fires are started intentionally by people who would rather have the insurance money than the building.

More common are exaggerated or inflated claims. An insured may claim that four items were lost rather than the actual three or that the items were worth much more than their actual value. In liability situations, third party claimants often exaggerate their personal injuries and property damage, and sympathetic physicians, lawyers, auto body shops and contractors may support these exaggerations and drive up the cost of the claims.

Morale Hazard - is a condition that exists when a person is less careful because of the existence of insurance.

Morale hazard does not involve intent to cause or exaggerate a loss. Instead, the insured becomes careless about potential losses because insurance is available. Leaving the keys in an unlocked car or having oily rags placed near a furnace are examples of carelessness and morale hazards. The result is morale hazards cause additional losses that drive up the cost of insurance because of injuries and damages that could have been prevented.

Dependence on Insurance

There is some tendency in today's society to rely too heavily on insurance or to ask insurance to do things for which it was not designed. This tendency can have undesirable results.

Example: *liability lawsuits have been on the rise in recent years. One reason is that liability insurance sometimes pays large sums of money to a person who has been insured.*

Liability insurance is intended to protect people who may be responsible for injury to somebody else or damage to another's property. There is a growing tendency to look upon liability insurance as a pool of money available to anyone that has been injured or damaged, regardless of negligence.

Closely related are the problems associated with compulsory insurance, especially auto insurance. In order to assure a source of recovery for people, who are injured in auto accidents, drivers in many states are required to purchase insurance, even those with bad driving records.

This requirement may cause some of the costs of insuring these bad drivers to be included in the premium charged to good drivers.

Types of Insurance

The security needs of individuals center on the continuity of their income, the protection of their assets and the minimization of their liabilities. Life insurance replaces the income-earning potential lost through death or disability. Health insurance provides additional economic security through the payment of medical expenses. Protection of tangible assets is the function of Property Insurance. Liability insurance covers situations in which an individual or a business may incur financial responsibility for harm inflicted upon someone else. For this course, we will focus on Property and Liability Insurance.

Property Insurance

Property insurance covers *accidental losses* resulting from damage to the insured's property. The insured could be an individual insuring a home and its contents, known as personal property, or a business insuring its building, inventory and equipment. When the insured experiences a loss, such as fire damage to a home, the insured will deal directly with the insurance company in the settlement process.

Property insurance is often referred to as "fire" insurance, although it is much broader than fire insurance. The reason is found in U.S. insurance history. Prior to the 1950s there were three categories of insurers: life,

fire/marine, casualty and surety. Some large insurers still use these terms. When regulations enforced these separate categories, "casualty" insurers could write only property. Thus, property insurance and fire insurance become almost synonymous terms.

Many types of insurance are classified as Property Insurance. Crime or boiler and machinery insurance, were once considered casualty insurance and, therefore, developed distinct forms, language and insurance practice, some of which continue today.

Examples of Property Insurance are:

- X Fire and Allied Lines
- X Loss of Business Income
- X Crime
- X Ocean and Inland Marine
- X Auto Physical Damage

Fire and Allied Lines Insurance - generally covers property such as: buildings and contents at a fixed location or at locations described in the policy. The term *allied lines* refers to insurance against perils (causes of loss), usually written with (allied to) fire insurance such as windstorm, hail, smoke explosion, vandalism and other perils.

Loss of Business Income Insurance - formerly called Business Interruption Insurance, indemnifies a business for this loss of earnings as a result of a covered loss such as fire. If a business has a serious fire, it may have to close while repairs are being made. This loss of business income (or earnings) takes place over time. Loss of Business Income Insurance pays for what would have been earned during the period of business interruption caused by a covered peril.

Crime Insurance - covers money, securities, merchandise and other property from various causes of loss: burglary, robbery, theft and dishonest acts of employees. Crime Insurance is often part of a package policy such as the Homeowner's or Business-Owners Policies.

Ocean Marine Insurance - one of the oldest forms of insurance, covers ships and cargo against the "perils of the sea". Inland Marine Insurance was developed to provide coverage to cargo over land, rather than over the seas, and continues to provide transportation coverage. **Examples are metro truck cargo and mobile equipment coverages.**

Auto Physical Damage Insurance - is usually part of a policy that also covers Auto Liability. It covers loss or damage to the vehicle from collision, fire, theft or other perils.

Liability Insurance

Liability Insurance, unlike Property Insurance, can involve 3 parties: the insured, the insurance company and someone who is injured or whose property is damaged by the insured.

The insurance company pays the claimant *on behalf of the insured* if the insured is legally liable for injury or damage due to negligence.

Examples of Liability Insurance are:

- X Auto Liability
- X General Liability
- X Personal Liability
- X Professional Liability

Auto Liability Insurance - covers losses due to the insured's liability for bodily injury to others or damage to property of others caused by an auto accident. The legal costs of defending the insured are also covered. The various types of Auto Insurance Policies combine auto Liability Coverage with Auto Physical Damage Coverage; a form of property convenience and expense savings.

General Liability Insurance - covers liability for bodily injury and property damage arising from accidents on premises, business operations in progress, products, manufactured or sold and completed operations.

Personal Liability Insurance - like general liability insurance, provides broad liability coverage to individuals and families. Bodily injury and property damage liability claims alleging the insured's negligence arising from the insured's premises or activities are covered. **Examples:**

1. *Insured's dog bites a neighbor*
2. *Avon lady slips on icy steps*
3. *Insured's son, an amateur golfer, tees off and hits another golfer*

Professional Liability Insurance - is designed to provide liability coverage to professionals such as physicians, lawyers and accountants for errors and omissions arising out of their professional duties. Medical malpractice insurance is an example.

Chapter 1 - Review Questions

1. An unexpected decrease in value arising out of an event is:
 - A. Loss Exposure
 - B. Morale Hazard
 - C. Moral Hazard
 - D. Financial Loss
2. All of the following are types of loss exposure except:
 - A. Personal Losses
 - B. Property Losses
 - C. Educational Losses
 - D. Liability Losses
3. A technique for treating loss exposure would be:
 - A. disability quotes
 - B. retention
 - C. life insurance term policies
 - D. none of the above
4. When each insured pays his/her insurance premium, he/she is practicing what insurance principle?
 - A. peril
 - B. indemnity
 - C. transferring
 - D. sharing
5. A condition that exists when a person is less careful because of the existence of insurance is known as:
 - A. Morale Hazard
 - B. Moral Hazard
 - C. Peril
 - D. Loss Exposure

ANSWERS

1. D
2. C
3. B
4. C
5. A

Chapter 2 – Property Loss Exposures

"Ingenuity, plus courage, plus work, equals miracles." Bob Richards

Introduction

This chapter will explore the various components of Property Loss Exposures, with an emphasis on:

- X Types of property that may be exposed to loss, damage, destruction, perils that may cause property to be lost, damaged or destroyed.
- X parties that may be affected when property is lost, damaged or destroyed
- X The financial consequences that may result. In addition to describing these elements of Property Loss Exposure. This chapter will address the question of how to measure the amount of money required to overcome the financial consequences of a property loss. This, by far, is the most difficult component to estimate.

Types of Property

Property Loss Exposures exist because property exists. Families own property, use it, depend on it as a source of income or services and rely on its value. For our purposes, property is any item with value. It may decline in value, or even become worthless if it is lost, damaged or destroyed.

Different kinds of property have different qualities that affect the owner's exposure to loss.

Property can be classified in a number of different ways. One common approach is to distinguish between **real property** (land and attachments to the land, such as buildings) and **personal property** (all property that is not real property). Insurance people use categories that relate to the insurance treatment of property. Most types of property are:

- X buildings
- X contents of buildings
- X money and securities
- X motor vehicles and trailers
- X property in transit
- X ships and their cargo
- X boilers and machinery

These categories overlap to some extent. Consider money and waterborne cargo. Money can be included in the contents of buildings. Cargo on a ship is a form of property in transit. These categories are listed separately here because they represent types of property for which specific forms of insurance have been developed.

Buildings

Buildings include more than bricks, mortar and other building materials. Most also include: plumbing, wiring, heating and air conditioning equipment that can lead to leaks, electrical fire and explosions. Most buildings contain some basic equipment: fire extinguisher, snow shovels, lawn mowers, outdoor furniture used to service the building and surrounding land. A high-rise building usually has elevators and may have specially designed portable platforms, hoists and tracks for use by window washers. This equipment is considered to be part of the building. Property permanently attached to the structure such as carpets, shelving, built-in appliances, or paneling is considered part of a building.

The exterior shell of a building, the outside walls and the roof, is exposed to damage from natural forces (such as hail) and from human forces (such as vandalism). Other events, such as a plumbing leak, may damage a building's interior primarily. Fire is a severe threat to both the exterior and interior of a building.

Dwelling Contents

A dwelling's contents may include furniture, televisions, stereo equipment, appliances, kitchen ware, groceries, clothing, sports equipment, tools, gardening equipment and many other items usual to the occupancy of a home. All of these items are referred to as the *dwelling contents* or simply *contents*. These items are grouped together for several reasons. *First*, they are normally located in

the dwelling and they are exposed to essentially the same perils as the dwelling. *Second*, many of these items usually can be determined easily in the event of a loss.

High Value Property - Some items of personal property, many of which otherwise would be classified as dwelling contents, are worth considerable sums of money. This type of property is categorized separately, especially for insurance purposes, because of the ease with which it may be stolen and removed from the dwelling. Such items include coins, money, securities, silverware, precious metals, jewelry, gems, watches, furs and firearms.

Property with Intrinsic Value - Property with intrinsic value is property whose value comes from its essential nature of unique characteristics. It needs to be separately identified in the analysis of Personal Property Loss Exposures. *An antique chair is an example of this type of property.* Such items would need to be separately insured because property insurance contracts typically settle personal property losses on the basis of the cost to repair, the time to repair, or its replacement cost less depreciation. Property with intrinsic value to the owner may not be replaceable at any cost, and its value needs to be established at the time that insurance coverage is purchased. In addition to antiques, other items with high intrinsic value might include works of art, stamp collections, valuable papers and records, photographs and negatives, and computer software and media on which data are stored.

Business Personal Property - This is personal property owned by an individual's business or employer. Most property insurance contracts are written to provide coverage for the family's limit or exclude coverage for business personal property. An individual who keeps business personal property at home may be financially responsible in the event of a loss to that property. Depending on the type of property insurance the individual carries and the value of the business personal property kept at home, additional insurance may be required to cover this exposure.

Motor Vehicles, WaterCraft, and Other Mobile Property - Personal Insurance covering dwellings and their contents typically excludes or provides only very limited coverage for mobile property. Physical damage to motor vehicles of all types, as well as aircraft, usually is excluded from coverage. Limited coverage may apply to watercraft and trailer. If a family owns any of these kinds of mobile property, it should be identified as such so that separate insurance may be purchased.

Perils Affecting Property

A peril is a cause of loss. (There is much confusion between the definitions of peril and hazard). Some insurance policies even use the phrase "cause of loss" in place of peril. Most perils affect property by leaving it in an altered state. A fire may change wood to ashes. A collision may change a car to dented, twisted scrap. Some perils do not alter the property itself but they do affect a person's ability to possess or use it. This

often happens when property is lost or stolen. It is still quite usable but it is not usable by its proper owner. Many insurance policies contain a list of covered perils or causes of loss. Policies may also list perils that are specifically excluded from coverage. Some policies cover all causes of loss. Policies may also list perils that are specifically excluded from coverage. Some policies cover all causes of loss except those specifically excluded.

The perils examined here are often mentioned in Property Insurance and are among the major causes of loss.

Most Property Insurance Policies cover a number of different perils but this is not always the case. Policies once covered only the peril of fire. Over time, insurance policies covering other perils have evolved. Because of the perils that have been added to fire policies, it is now possible for a single policy to mention the perils of fire, windstorm, hail, aircraft, collision and vehicle damage, riot and civil commotion, explosion, smoke, vandalism, sprinkler leakage, sinkhole collapse, volcanic action and certain other so-called *broad form* perils. Crime perils are covered in crime insurance and some package policies, while the perils of earth movement and flood may be covered in special types of insurance.

Other perils, such as maintenance perils and catastrophe perils, are generally uninsurable.

Perils and Hazards

The terms "peril" and "hazard" are often used when discussing loss exposures.

A peril is a cause of loss. Examples of perils that cause property losses are fire, burglary, collision, and flood.

A hazard is anything that increases the likelihood of a loss or the possible severity of a loss.

Example:

- X *Careless smoking practices are a fire hazard because they increase the likelihood of fire.*
- X *Paint cans or oily rags are fire hazards because they enable a fire to spread and cause severe damage.*

Hazards need not relate to a specific peril. A general attitude of carelessness creates a hazard because it increases the likelihood of loss by many different perils.

Fire - Fire is one of the most serious of perils, however, not every fire is a cause of loss. A gas fire on a kitchen range, an oil fire in a home furnace, and wood fire in a fireplace cause no loss unless they get out of control.

Sometimes the term *friendly fire* is used to refer to fires that remain in their intended place. Fires that leave their intended place are called *hostile fires*. If this book were accidentally dropped into a fireplace, many fire insurance policies would not pay for the loss of the book, however, if sparks flying from the fireplace set the house on fire, a *hostile fire* would have occurred and the damage would be covered by fire insurance. When they do get out of control, fires burn property and also cause heat and smoke damage.

Extinguishing a fire may also cause damage as fire fighters knock holes in windows and roofs and spray water on property to keep it from burning. Heat, smoke and water spraying could be considered separate perils. When these conditions occur because of a fire, the fire is the *proximate cause* of the entire sequence of damaging conditions or events. The proximate cause of a loss is the event that sets in motion an unintended chain of events contributing to the loss.

Sometimes fire takes place following another peril. *Lightning may crack the walls of the house and set it on fire. An explosion may knock down a wall and start a fire. An earthquake may crack the foundations of a building and break gas lines, leading to a fire.*

It is standard practice that policies covering the peril of fire also state that they cover the peril of lightening. The peril of explosion is almost always included in the same policy. While many Property Insurance Policies do not cover damage directly caused by an earthquake or flood, they do cover damage by a fire that might "ensue".

Damage **caused by fire** includes damage resulting from those conditions accompanying the fire (such as flame, heat and smoke) and those events that can be linked back to the fire in an unbroken chain of causation (such as explosion or collapse), resulting from the fire or damage by fire-fighting units or devices. It does not matter that the fire itself was caused by some other peril such as an earthquake.

If an insured had insurance covering the peril of fire but not the peril of earthquake, damage from fire would be covered even if the fire resulted directly from the earthquake. Through the eyes of the insurance policy, fire caused a portion of the loss. That policy would not cover the portion of the loss caused by earthquake damage.

A logical question is how to draw the portion of the loss confined solely to earthquake damage and the portion caused by fire, since the insurer will pay only for the latter. The answer will be quite difficult but the problem is not one unusual to the property insurance field. For now, the key point is the general concept of proximate cause rather than the practical loss adjustment dilemma.

Windstorm - Like fire, windstorm can cause serious damage to buildings and their contents, as well as, to other property. Windstorm includes hurricane and tornadoes but is not confined to those notorious disturbances. Less severe winds can also produce damage.

Water damage due to flood, waves or spray may accompany a windstorm. Many insurance policies cover windstorm but not water damage. When a loss occurs, it is not always easy to determine which damage is done by wind and which by water.

Hail - Hail consists of ice particles created by freezing atmospheric conditions. Hailstones the size of marbles, golf balls or baseballs can cause substantial damage to autos, buildings and other property in the open. Aluminum siding is susceptible to

dimpling caused by hail. Even light hail not capable of damaging most property can cause serious crop damage by knocking grain kernels out of standing grain or by destroying blossoms on fruit trees.

Aircraft - Aircraft damage occurs when an airplane or satellite, or part of such an object, strikes property on the ground. Although such incidents are rare, the damage can be severe. Property near a flight path is more likely to incur aircraft damage than property at other locations.

Collision and Vehicle Damage - Collision refers to damage to a motor vehicle or watercraft resulting from its impact with another vehicle, vessel, or other object. Vehicle damage refers to damage by a motor vehicle to some other kind of property, such as a building. When a car runs into a house, the house suffers vehicle damage and the car suffers collision. Insurance policies that have collision as a covered peril usually also cover the upset or overturn of the vehicle either by naming the additional peril or by stating that the word "collision" includes upset and overturn. This practice resolves the question of whether physical contact with a road or land adjacent to it is a "collision".

Riot and Civil Commotion - While there may be legal distinctions between riot and civil commotion, both terms refer to approximately the same kind of unruly mob behavior. Insurance covering riot invariably covers civil commotion. While losses from these perils do not occur very often, they can be quite large.

Explosion - An explosion is a violent expansion or bursting accompanied by noise. Explosions include combustion explosions resulting from the igniting of gases, dust or other explosive materials. Combustion explosions are often followed by fire. Explosions may also occur when a pressurized object bursts, as in the case of the bursting of a tank containing compressed air. An explosion can destroy an entire building. Grain elevators and other buildings containing dust are particularly vulnerable. Explosion of boilers and other pressurized objects can unleash "unguided" missiles with enough force to match the damage done by dropping of a small bomb.

Smoke - Normal cooking in a home, restaurant, or industrial operations sometimes produces smoke. This normal smoke should not cause a loss. Sudden or accidental release of large amounts of smoke can result in considerable damage to walls and other objects.

Some property is susceptible to smoke damage. In a clothing or grocery store, a relatively small amount of smoke may cause considerable damage. When damaging smoke comes from a fire, the fire is generally considered to be the proximate cause of the loss. However, the sudden malfunction of a home's oil-burning furnace may result in the discharge of clouds of grimy, sooty smoke. In that case, the resulting damage is not caused by fire. An independent peril from the fire has occurred. Fortunately, Property Insurance Policies naming the peril of fire almost always name smoke as a covered peril as well.

Vandalism - Vandalism is the willful and malicious damage to or destruction of property. **Examples** of vandalism include: *crafty spray-painting onto building walls, defacement of statues or other objects of art, and the multiple incidents of mischief that usually occur on Halloween.* Some insurance policies refer to "vandalism and malicious mischief". Others simply use the term "vandalism".

In some instances, it is difficult to distinguish damage caused by vandalism from damage caused by riot and civil commotion's. This usually present no insurance problem since the vandalism peril is normally not included in an insurance policy that does not include the riot and civil commotion peril.

Sprinkler Leakage - Many commercials and institutional buildings, as well as, some private residence are equipped with automatic sprinkler systems. An automatic sprinkler system is designed to discharge water (or chemical or gas) when a fire occurs, thus extinguishing or containing the fire. When a fire sets off a sprinkler, any water damage from the operation of the sprinkler is considered to be proximately caused by fire. Sometimes, however, an automatic sprinkler system discharges accidentally. The pipes may freeze and burst or a buildup of heat from some other cause other than fire may cause the system to discharge. Maintenance workers may accidentally bang a ladder against a sprinkler head and cause it to discharge. Such accidental discharges are considered part of the sprinkler leakage peril.

Compared to fire, sprinkler leakage in most cases is not a serious threat to a building. Vulnerability of contents may be another matter, however. With some occupancy, such as dealers in paper products, sprinkler leakage losses can be devastating.

Sinkhole Collapse and Mine Subsidence -

The action of underground water on limestone or similar rock formations may create empty spaces underground. A sinkhole collapse occurs when land suddenly sinks or collapses into one of these empty spaces. This problem occurs most often in Florida. A similar problem exists in states such as Pennsylvania and West Virginia because of underground mining. The mine subsidence peril is present when the ground surface sinks as underground open spaces resulting from the extraction of coal or other minerals are gradually filled in by rock and earth from above.

Volcanic Action - While Florida has its sinkholes and West Virginia has its mine subsidence, the Pacific Coast states of Alaska and Hawaii have volcanoes. The peril of volcanic action encompasses loss resulting from volcanic eruption such as Mount St. Helens.

The volcano action peril has an interesting history. At one time, many property insurance policies specifically excluded losses by volcanic eruption. Since there were no active volcanoes in the Continental United States, specific reference to volcanoes began to disappear from insurance policies as they were revised and simplified. When Mount St. Helens erupted

for the first time, many policies did not specifically provide or exclude coverage for volcanic action but did not cover the peril of explosion. There was considerable debate over whether a volcanic eruption constitutes an explosion. Insureds seeing explosion as a covered peril and noting no formal policy definition of the term requested coverage for damage for the eruption. The outcome was that many losses were treated as explosion losses and claims paid. Today, most insurance policies once again mention the peril of volcanic action, either specifically providing or excluding coverage.

Broad Form Perils

Many Basic Property Insurance Policies cover damage caused by the specific perils discussed above. Other Property Insurance Policies often referred to as Broad Form Policies, add coverage against an additional group of perils. These other perils include:

- X **Breakage of glass** - Glass may break as a result of causes other than the perils named earlier.
- X **Falling objects** - Tree or other objects falling into a building.
- X **Water damage** - Damage to carpets, floors, or ceilings caused by sudden leaks.

Crime Perils

Theft - is a general term meaning any act of stealing. It includes the taking of money or property of another. Some insurance policies cover the peril of theft; others cover only a specific type of stealing; burglary or robbery.

Burglary - is a type of theft committed by someone who breaks into a building and illegally removes property. Insurance policies usually define burglary to breaking *out* of a building. Why? Thieves sometimes hide inside a building before it is closed for the night and make a forcible exit after stealing some of the contents. Most burglary insurance applies only if there are "signs of forcible entry or exits". A thief, who wrongfully enters or exits from a building through an open window or uses a stolen key, would not generally be considered a burglar for **insurance purposes**. The party suffering the loss might regard the event as a "burglary" but insurance policies usually require forcible entry or exits as a necessary part of burglary.

Robbery - is a type of theft committed by someone who takes property from a person in the presence of that person through use of intimidation or force. A purse snatching or a holdup is a robbery, a break-in is a burglary and both are thefts. Shoplifting is an example of a theft that is neither burglary nor robbery.

Theft of any kind may be committed by employees or family members, or by strangers. Theft by employees may be called *embezzlement*, *employee dishonesty* or a *fidelity loss*.

An increasing common form of theft involves the manipulation of computer records to transfer money or other property to someone who is not the rightful owner. Theft involving the manipulation of computerized records is called *computer theft*.

Earth Movement

One type of earth movement, earthquake, is uncommon in most parts of the country, however, there are areas where earthquakes occur with some frequency and other areas where geologists predict a major quake will eventually occur. Property in these areas is susceptible to damage from earth movement.

Flood

Property owners, with "tongue-in-cheek", sometimes define floods as "rising waters accompanied by a sinking feeling". For insurance purposes, however, the term "flood" may encompass a variety of situations, including temporary overflow of inland or tidal waters, usually rapid accumulation of surface waters, and even mud-slides and collapse of land along the shore of a lake. A flood may be the result of rain or melting snow, or it may be the result of a burst dam or some other hazard of human origin.

Property located on low-lying land has a greater exposure to flood than property located in high areas. The U.S. Government has identified areas in many communities where the probability of an eventual flood is significant, although possible flood damage is not limited to property located within these so-called flood plains.

Policies covering motor vehicles and property in transit frequently cover the flood peril but it is excluded in most policies covering buildings and contents, however, coverage in limited amounts is available through the National Flood Insurance Program.

Maintenance Perils

Discussions to this point have concentrated on perils covered by most insurance policies. Numerous other perils can also cause loss to property.

- X wear and tear
- X marring and scratching
- X rust
- X gradual seepage of water
- X damage by termites, pets, or vermin

These perils may not be covered even in the broadest Property Insurance Policies. Insurance works well for definite and accidental losses. Some of these excluded perils (rust, wear and tear, marring and scratching) involve the results of ordinary use and aging rather than unexpected damage. Others (water seepage, termites or pet damages) are preventable through property care and maintenance.

Catastrophe Perils

The insurance mechanism functions best when many insureds pay small premiums in order to provide a fund for payment of large losses incurred by relatively few insureds. Some perils that affect a great many people at the same time are generally considered to be uninsurable, since resulting losses would be so widespread that the funds of the entire insurance business might be inadequate to pay all claims. For this reason, most Property Insurance Policies exclude coverage against loss by catastrophic perils such as war and nuclear reaction.

Some exceptions: ships and their cargo may be endangered if they sail into an area

affected by a localized war (one that flares up suddenly). "War risk" Insurance is available to cover ships and cargo unless the War Exposure appears extremely hazardous.

Similarly, limited amounts of insurance against nuclear reaction are available to the owners and operators of facilities that use nuclear materials.

Parties Affected when Property is Damaged or Destroyed

The party most affected when property is lost, damaged or destroyed is the owner of the property. Other parties affected may include:

- X secured lenders of money
- X users of property
- X other holders of property

The Property Owners

If the property has some value and is lost, damaged or destroyed, the owner of the property incurs a financial loss because of the cost of repairing or replacing the property.

Secured Lenders

When money is borrowed to finance the purchase of a car, the lender usually acquires some conditional rights to the car, such as the right to repossess the car if the borrower fails to make loan payments. This right gives the lender security. This lender is called a *secured lender*. When an individual or business borrows money to buy a home or a building, the property serves as a security for the loan and the secured lender is called

a *mortgagee* and the borrower is a *mortgagor*.

When property is used to secure a loan, both the property owner and the lender are exposed to loss. **Example:** *a fire destroys a mortgaged house; the mortgagee loses the security for the mortgage loan. Similarly, if a financed car is destroyed in an accident and the owner has no money to pay off the loan, the lender would have only a worthless banged up car to repossess. Insurance policies may protect this interest by naming a lender as a mortgagee or as a loss payee.*

Users of Property

Some events result in losses to users of the damaged property, even though they do not own it. **Example:**

- X *Colleen rides to work every day as a passenger in Mitchell's car. If Mitchell's car is in an accident, Colleen may have to use a more expensive means of transportation.*
- X *The twenty-year lease of a fish store, signed eight years ago, specifies a rental rate much lower than the cost of rent of similar space today. If the building is destroyed, the lease will be canceled and the fish store will have to pay higher rent in the rebuilt building or elsewhere.*

Other Holders of Property

There is another group of parties who do not own property but are responsible for its safekeeping. Dry cleaners, TV repair shops,

public truckers and many other businesses temporarily hold property belonging to others. Holders of property entrusted to them by others are called *bailees*.

Potential Financial Consequences

The loss of property, or damage to it, may have undesirable financial consequences. The adverse financial impact may occur in any one of 3 ways. A property loss may: reduce the value of one's property, because an increase in one's expenses or it may reduce one's income.

Reduction in Value of Property

When a peril occurs and adversely affects property, the property is reduced in value. The actual amount of the reduction in value can be measured in different ways, sometimes with differing results. If the property can be repaired or restored, one measure of the reduction in the value is the costs of the repair or restoration. A further reduction may occur if the repaired property is worth less than it would be worth had it never been damaged.

The same property may have a number of different "values" depending on the method by which the value is determined. For insurance purposes, the most common valuation measures are replacement cost value and Actual Cash Value. In certain situations, however, other valuation measures can be used.

Replacement Cost Value

The replacement cost of a property item is the cost to replace it with new property of like kind. Replacement cost means the money to build a new house like the one destroyed by fire or putting a new roof on a warehouse that has had its roof blown off by a windstorm. Some Property Insurance Policies agree to measure and pay losses on this basis.

Notice that this way of determining "value" ignores the fact that most existing property is **not new**. Taken in isolation, a new roof has a higher value than a fifteen-year-old roof. If the "used" roof is destroyed, how much money is needed to restore the building to use to put on another roof? The owner has no option but to have a **new** roof added. There is no resale market in used roofs or roofing material.

Is the building "worth more" with a new roof? Probably, but that position focuses on market value and assumes conversion of the building to cash. Once damage occurs, most building owners merely want to restore the building to its pre-loss use as soon as possible. In most cases, this simply cannot be done without new materials. Since insurance coverages are designed to protect the property owners against reduction in value, property owners usually recognize the need for new materials in their method for determining a property's value.

Actual Cash Value

Actual Cash Value is a measure that does not ignore the fact that most property has

been used. Actual Cash Value is usually defined by insurers as replacement cost value minus accumulated depreciation. Depreciation, as used here, is different concept from depreciation used for accounting purposes for 2 reasons:

First, while accounting depreciation follows certain accounting conventions, the depreciation component of Actual Cash Value considers physical condition, age, use and other factors affecting the remaining usefulness of the property.

Second, while accounting practices subtract depreciation from the property's original cost to the owner, the calculation of Actual Cash Value subtracts depreciation from the replacement cost. This point can make a dramatic difference between an item's book value and its cash value. Book value is the value of an asset as shown in a firm's accounting records. Book value always declines over time as the property wears out or is used up in contributing to the earnings of the firm (barring renovation or other unusual circumstances that might increase book value). The Actual Cash Value for insurance purposes may increase, however, as often happens with buildings. The replacement cost, new, of buildings rises faster than depreciation reduces the value.

***Example:** suppose a home was constructed several years ago at a cost of \$75,000 and it would cost \$100,000 to build the same home today because of higher costs of labor and building materials. The Actual Cash Value of this home might be \$90,000, the replacement cost new today (\$100,000) minus*

depreciation (perhaps 10% of \$100,000, or \$10,000). The \$90,000 Actual Cash Value of the home is higher than the Actual Cash Value when the home was new, even though the home was depreciated.

With certain kinds of property, both the replacement cost and Actual Cash Value produce the same result. If a firm buys 10 new copying machines and they are destroyed before being used, there is no depreciation to subtract from the replacement cost in determining their value. Replacement cost and Actual Cash Value is one and the same.

An Actual Cash Value settlement would not pay a homeowner the full cost of replacing a roof blown off in a tornado. Instead, there would be a reduction for depreciation. **Example:** *a tornado does blow the roof of a ten-year old house and the roof otherwise would have been expected to last twenty years. Assume further that the cost of replacing the roof is \$2,000. An Actual Cash Value settlement would pay \$1,000. This approach reimburses the homeowner for the unused value remaining in the partially worn roof but it does not pay the entire repair bill. A replacement cost settlement would pay the entire \$2,000 for the new roof.*

Increased Expenses

When property is damaged, the property itself declines in value and the owner, or other affected party, suffers a corresponding loss. In addition, the owner or other user of that property may have to incur extraordinary expenses in acquiring a

temporary substitute or in temporarily maintaining the property in usable condition.

Example: *a family whose house is damaged may have to stay in a hotel for awhile, at considerably greater expense than living at home.*

Because so many variables are involved, it is difficult to estimate the extra expenses that might be required to stay in business following damage to a business property or to keep a family together and maintain its standard of living after a home is damaged. Determining the extent of a Property Loss Exposure involves consideration of the extra expenses required in the event of the loss of property.

Lost Income

Much property is used to produce income. When such property is damaged, income may be lost because the income-producing capacity of the property is reduced or terminated entirely until the property is repaired, restored, or replaced. Lost income may result if there is damage to property that is owned and rented to others part of the time. Others rent garages or rooms in their homes. If a loss makes such rental property unusable, the property owner will suffer an income loss until the property can be repaired and rented again.

Chapter 2 - Review Questions

1. Any item with value is considered:
 - A. insurance
 - B. money
 - C. securities
 - D. property
2. Fire, burglary and collision are examples of:
 - A. hazard
 - B. loss exposure
 - C. peril
 - D. all of the above
3. Careless smoking in bed is an example of:
 - A. peril
 - B. hazard
 - C. loss unit
 - D. none of the above
4. This peril includes hurricanes and tornadoes:
 - A. Windstorm
 - B. Earthquake
 - C. Fire
 - D. All of the above
5. An example of a maintenance peril would be:
 - A. Fire
 - B. Collision
 - C. Wear and tear
 - D. Windstorm

ANSWERS

1. D
2. C
3. B
4. A
5. C

Chapter 3 – Liability Loss Exposures

"Success seems to be largely a matter of hanging on after others have let go." William Feather

Introduction

A Standard Homeowner's Policy includes a very important protection, Personal Liability. This is known as Section II, Coverage E - Personal Liability. This section states that "if a claim is made or a suit is brought against an insured for damages because of Bodily Injury or Property Damage caused by an occurrence, the company will pay up to the stated amount in the policy". Our purpose in this chapter is to discuss the law and liability. The way the law specifically treats Homeowners Policy protection will be covered in a later chapter.

Financial resources are diminished as the result of a claim for money damages because of injury or harm to another party.

Liability Loss Exposures have the following elements:

- X Resources that may be exposed to loss.
- X The possibility that a claim or money damages may be brought.
- X The financial consequences that may result.

Resources Exposed to a Liability Loss

Liability Loss Exposures put all of an individual's financial resources at risk of loss. When a court orders an individual to pay liability damages, the amount of the damages is based on the loss to the injured party. The individual's financial resources available to pay such damages are not the court's concern. As a result, all of an individual's savings and property are exposed to loss because of the possibility that the individual might have to liquidate them to pay a large liability damages award. In addition, courts have the power to attach a portion of an individual's assets, if necessary, to pay for liability damages.

The fact that all of an individual's assets, plus his/her future income may be required to pay for liability damages makes the possibility of a liability loss a particular threatening exposure.

Possibility of a Claim for Money Damage

For Liability Loss Exposures, the peril or cause of loss is the reason of a claim for money damages. Unless a claim for money damages occurs, an individual's financial resources will not be diminished. In addition, as soon as a claim for money damages is brought, financial resources

begin to be diminished by the costs of investigating the claim and preparation to defend against legal action that may ensue. Therefore, the making of a claim against an individual is the action that brings about a liability loss.

As the chapter evolves, we will be discussing the law and how it pertains to Liability Loss Exposure. Keep in mind that claims for liability damages are governed by Civil Law. Civil Law deals with the rights and duties of citizens with respect to one another. The settlement of disputes between individuals and the redress of wrongs committed against individuals are within the scope of Civil Law. Several bases for claims of liability damages exist under Civil Law. Individuals are most likely to face claims arising out of Tort Liability, Contractual Liability and Statutory Liability. We will discuss these later in the chapter.

Nature of Law

Because it is the legal system that enforces obligations, an understanding of the law helps in recognizing Liability Loss Exposures. Complex legal questions require the professional expertise of an attorney. Some fundamental legal terms and concepts are essential knowledge for anyone dealing with Liability Loss Exposures or Liability Insurance.

Law exists in a civilized society to enforce certain standards of conduct. By placing limits on the freedom of some individuals, laws protect all other individuals.

While the law generally makes the world a safer and more secure place, it also imposes

certain responsibilities. Where there are rights, there are also duties. Each individual must accept the constraints of the law in order to have the benefits of the law. The law accomplishes its objectives by holding people responsible for their conduct.

An important distinction exists in the American legal system between Criminal and Civil Law. While Criminal Law cases generally receive more headlines, insurance-related cases are more likely to involve Civil Law.

Criminal Law - Certain kinds of conduct so endanger the public welfare that society makes laws to prohibit them. **Examples:** *laws prohibit murder, rape, robbery, arson, fraud, theft, and driving while intoxicated. Such offenses are crimes.*

A law-abiding citizen has no reason to fear the possibility of incurring Criminal Law penalties. This chapter concentrates on Liability Loss Exposures arising from Civil Law.

Civil Law - Actions that are not necessarily crimes can still cause considerable harm to other people. Civil Law serves to settle disputes and to redress wrongs against individuals. In the absence of laws, a dispute between neighbors can turn into a never-ending feud. Civil Law procedure enables individuals to enforce the rights that have been infringed upon by others.

Example: *property rights occupy an important place in American law. The old saying that a "man's home is his castle" suggests that property rights should have priority over most other objectives of the law. When someone else infringes on property rights, such as trespass, vandalism, or*

theft (even though these are also crimes), the property owner may go to court to have the property rights restored.

In the same way, the law protects personal rights. If someone inflicts bodily injury, invades the privacy of another, or harms the reputation of another person, the injured person may seek justice in court. By protecting such personal rights, the law contributes to everyone's safety.

Civil Law enforces contract rights. People are more willing to make agreements or contracts with one another when they know that those contracts are enforceable. If two parties make a contract but one party does not honor it, the other party can ask the court to compel adherence to the contract or pay damages. This possibility of seeking justice from a higher authority promotes commerce by making contracts more reliable. Not surprisingly, in ancient cities the market place and the law court were often side by side.

In a Civil Law proceeding, the aggrieved party must bring the case to court by hiring a lawyer, or by going to Small Claims Court where lawyers are not necessary.

Sources of Law

Although it is easy to see the benefits of the law, it is usually more difficult to determine exactly what the law on a particular point is. There must be some source of law that the society accepts as binding. In the United States, there are essentially 4 sources of law: Constitutional, Statutory, Common and Administrative Law all govern American Society. They differ, however, in their origin.

Constitutional Law - The Supreme Law of the land is the Constitution. The Constitution specifies the structure of the Federal Government and outlines the respective powers of the legislative, executive and judicial branches of the government. The Constitution provides for a federal system of government in which powers not specifically granted to the Federal Government are reserved for the individual states. The Constitution guarantees to all citizens certain fundamental rights, such as freedom of speech, religion, freedom from unreasonable searches and seizures, the right to trial by jury and the right to due process of law.

All other laws must conform to the Constitution. The courts interpret the Constitution to decide constitutional issues that may arise. If the Supreme Court decides that a particular law conflicts with the Constitution, that law becomes invalid. The Supreme Court is the highest level of law. Its decision provides the final resolution of a disputed issue and lower courts must follow the Supreme Court decision in judging future cases on the same issue. Thus Constitutional Law consists of the Constitution itself and all of the decisions of the Supreme Court that interpret the Constitution.

Each of the separate states also has a constitution establishing the powers of the state government. Each state also has a Supreme Court to resolve legal conflicts in the state government and to hear appeals on matters of State Law. However, states must follow the Constitution of the United States, and decisions of a state Supreme Court bearing on a constitutional issue may be appealed to the Supreme Court of the United States.

Statutory Law - Legislatures at national, state and local levels enact laws or statutes to deal with perceived general problems. At the national level, Congress considers many proposed new laws each year. Any member of the Senate or the House of Representatives may introduce a bill. It may be referred to a committee for study or perhaps for hearings before it is debated on the floor of the Senate or House. If the bill receives a majority vote in both the Senate and the House and the President signs it, it becomes a law. State Legislatures and Town Councils also make new laws in similar fashion. Collectively, these formal enactments of legislative bodies are referred to as Statutory Law.

Common Law - In contrast, the Common Law has evolved in the courts by the force of custom. When a King's judges began hearing disputes in medieval England, they had little basis for their decisions except common sense and the prevailing notions of justice. Each decision became a precedent for similar cases in the future. Gradually, certain principles evolved that the King's judges applied consistently to all cases. These principles became known as Case Law or Common Law.

These common law principles guided Judges not only in England but also in the English colonies in America. Thus, the English Common Law heavily influenced the American Legal System. When neither Constitutional nor statutory law applies, judges still rely on precedents of previous cases in reaching their decisions. Legislation now exists that modifies or replaces Common Law principles, but Common Law is still important in matters of legal liability.

Administrative Law - A final source of law is the numerous federal, state and local governmental agencies that have regulatory powers derived from Statutory Law. **Examples** include the *National Labor Relations Board, the Federal Trade Commission, the Environmental Protection Agency, State Public Utility Commission and Local Zoning Boards*. These regulatory bodies issue detailed rules and regulations covering a particular public concern or relating to a particular industry. Such rules, regulations, and decisions that implement the objectives of Statutory Law are called Administrative Law.

Other Elements of a Liability Loss

Statutory Law, Common Law, or Administrative Law could provide a basis for a finding of legal liability. However, there must be some standard in the law against which the conduct of the purportedly liable person can be measured. Thus, the law plays a critical role in liability losses.

While one party may or may not recognize its responsibility for some harm to another party, it is the legal process that enforces the liability. The legal process confirms the responsibility for the harm and determines that appropriate restitution. The factors involved in a Liability Loss include:

- X a legal basis for claim of one party against another
- X a definite injury or harm to the party making the claim
- X some conduct by the other party for which the other party is responsible

X An agreement of the parties or a judgment of the court concerning the form or the amount of the restitution owned to the injured party.

The remainder of this chapter considers each of these elements of Liability Loss in greater detail.

Legal Rights of Recovery

For an injured party to have a Right of Recovery from another party, some principle of law must create a link between the two parties. Often this link appears in the Law of Contracts. Any law or legal principle establishes a relationship between the two parties may support a claim, but this discussion must be confined to the most common theories of recovery. A party that initiates the suit in court trial is known as the *plaintiff*.

Torts

Long ago the word *tort* meant any kind of wrongful act. Although the word still covers a wide variety of wrongful acts, legal practice has narrowed the meaning. Torts do not include acts such as "white lies" that may be morally wrong but do not lead to legal action. Crimes, wrongs against society rather than merely against a particular individual, differ from torts because Criminal Law deals with crimes and Civil Law does not. Within the practice of Civil Law, there is a distinct body of principles. With these exceptions, almost any other wrong may be a tort. Therefore, Tort Law is that branch of Civil Law that deals with wrongs other than breaches of contract.

A wrong usually leads to legal action only when some damage or injury results and the issue are who must pay for these consequences. The concern of Tort Law is determining responsibility for injury. Although largely modified restated in statutes, Tort Law still rests partly on Common Law because courts determine responsibilities in such cases according to the prevailing theories of justice and the precedents of previous cases. Like other areas of Common Law, a Tort Law evolves over time as courts sought solutions to new problems that arose in a changing society. As expectations of safety and security rise and injuries become more costly, Tort Law becomes increasingly important as a means of determined responsibility for injury.

No matter how much sympathy for the victim of an injury, there must be some standard for assigning the responsibility to someone else if the victim is to be compensated. Tort Law provides essentially 3 possible standards for finding legal liability. If a tort is **intentional**, the liability for the consequences follows. If a tort is **unintentional**, negligence may be grounds for a finding of legal liability. Some activities are so inherently dangerous that **absolute liability** for a resulting injury may exist even though no harm is intended and no negligence is involved.

Intentional Torts - Deliberate acts that cause harm to another person, regardless of whether the harm is intended, are called intentional torts. An **Example** is *defamation of character, which includes both libel and slander*. **Libel** occurs when someone prints and distributes an untrue defamatory

statement about another person. **Slander** is a spoken defamatory untruth about another person. Liability judgment for libel tends to be greater than the amounts awarded for slander.

Negligence

While such Intentional Torts may lead to liability judgment, the greatest number of liability cases arises from negligence. Negligence occurs when one fails to exercise the appropriate degree of care. It involves acting differently than a reasonably prudent person would under similar circumstances. Tort Law enables injured parties to obtain compensation if they can demonstrate that someone else's negligence led to their injury.

Elements of Negligence - A liability judgment based on negligence depends on 4 elements. The 4 elements of negligence are:

1. A duty to act that is owed another person
2. A breach of that duty
3. The occurrence of an injury
4. An unbroken chain of events leading to that injury.

Duty to Act - the *first* element of Negligence is that a person must have a duty to act that constitutes an obligation to another person. *A homeowner has a duty to keep icy sidewalks safe for visitors.*

Breach of Duty - In order for a person to be held negligent, a breach of duty owed must occur. A breach of duty is the failure to exercise the degree of care expected of a reasonable person in that situation. When

entertaining guests in the homes, hosts have a duty to protect them from harm. Not only must the host warn the guests of any danger, but the host must also take steps to see that guests are not harmed. **Example:** *owing a large, aggressive dog and seeing that it is properly confined when guests arrive. Just telling the guests that the dog is vicious is not enough to meet the standard of care required. If the dog attacks a guest sitting in the living room, the host will be held responsible for the injuries.*

In other situations, the same person might not be held responsible for the dog's attack. **Example:** *if the dog attacks an intruder who breaks a window and enters the home while the owners sleep. Since reasonable people are not expected to protect intruders from harm, they have not breached their duty and are not responsible for the resulting injuries.*

Injury - the *third* element of negligence is that definite injury or harm must actually occur to the claimant. There may be a legal duty to act and a breach of duty; but unless someone suffers injury, no recovery can be made based on negligence.

Unbroken Chain of Events - A finding of negligence also requires that the breach of duty initiate an unbroken chain of events leading to the injury. The breach of duty must be the **proximate cause** of the injury. **Example:** *Jane injures a child alighting from a school bus; her careless driving is the proximate cause of the injury. When one passes a properly stopped school bus at a high rate of speed and hits a child, there is a direct casual relationship between the driver's action and the injury to the child.*

Responsibility for Negligence

Individuals, business firms and other organizations may be held responsible for negligence. Generally, one expects the person whose conduct is negligent to be responsible for the consequences. This person may be called the Tortfeasor, the wrong doer, or the negligent party. In addition to the person who actually commits the act, other persons or organizations may be held responsible for the wrongdoer's action. This responsibility is called ***Vicarious Liability***. It is also possible for two or more parties to be jointly liable. If so, they are called Joint Tortfeasors.

Vicarious Liability - Vicarious Liability exists when one is held liable for the actions of another person. Such situations extend liability and include not only the actual wrongdoer but also a person or organization responsible for the wrongdoer. Were this not the case, business organizations could escape liability for negligence, since the person must act on behalf of a business organization for that entity to perform any act.

Vicarious Liability often arises in business situations from the relationship between employer and employee. A person at work performing work-related activities is generally acting on behalf of the employer. Therefore, the employer is vicariously liable for the actions of the employee. Parents can be held vicariously liable for the actions of their children who are engaged in an activity on behalf of their parents. *If the Green's 14 year-old son cuts the grass and loses control of a power mower which injured the foot of the White's 5 year-old daughter, the Green's could be held liable for their son's actions.*

Absolute Liability - Although most liability cases arise from negligence, liability under Tort Law is not entirely limited to cases of injury caused by deliberate or negligent conduct. In certain other situations as well, Tort Law may give an injured person a Right of Recovery. In these dangerous situations, there is ***absolute liability*** for any injury regardless of the intent or the carefulness of the person held liable. The situation itself rather than the person's conduct become the standard for determining liability. A family's pet dog may be considered a dangerous animal if it has a history of attacking strangers or is a breed known to be vicious. If so, Absolute Liability exists and a person attacked by the vicious dog would not have to demonstrate negligence on the part of the dog's owner in order to claim restitution for injuries.

Absolute Liability also exists for owners of guns and other firearms. They may be under lock and key but the owner might still be held liable for any injuries they cause.

Strict Liability - A similar but slightly different concept, often applies in cases of injury involving defective products. The Strict Liability Doctrine eases the injured person's burden of proof in that he can recover from the manufacturer by showing that the harmful product was unreasonably dangerous, even if the manufacturer was not negligent. So, Strict Liability can have almost the same effect as Absolute Liability in holding someone responsible merely because of the outcome.

Contracts

Tort Law enables an injured person to receive restitution from a wrongdoer be-

cause the wrongdoer has breached a duty generally recognized in the law, such as the store's duty to maintain safe conditions for customers, or because the law generally holds a person to seek restitution because the other party has breached a duty voluntarily accepted in a contract. A contract is a legal enforceable agreement between two or more parties in which each makes some promise to the other. If one party fails to honor the promise, the other may go to court to enforce the contract. In such a case, it is the specific contract, rather than the law in general that the court interprets. Two areas involving obligations that are contractual in nature are the assumption of Liability under a Contract and Breach of Warranty.

Liability Assumed Under Contract - Parties to a contract might find it is convenient for one to assume the financial consequences of certain liabilities of the other. The party assuming the liability may be closer to the scene, exercise more control over operations, or have the ability to respond to claims more efficiently. **Example** of this would be *an owner of a building and a contractor made a contract in which the contractor accepts responsibility for some of the action of a subcontractor. If one of these specified actions of a subcontractor injures another party then the contractor will pay the damages to the injured party.* Such agreements are called **hold harmless agreements**.

Breach of Warranty - The Law of Contracts also governs claims arising from Breach of Warranty. Contracts for sales of goods include ***implied guaranties*** or promises by the seller. **Example:** the seller warrants that the

item is fit for a particular purpose. *If Jane buys the hair conditioner recommended and sold by her beautician, she relies on the implied warranty that the conditioner will be good to her hair. If the conditioner damages her hair instead, the beautician may be held liable for a breach of warranty. The buyer does not have to prove negligence on the part of the seller. The fact that the product did not work shows that the contract was not fulfilled.*

Damages

For a Liability Loss to occur there must be some definite harm sustained by another person. ***Compensatory damages*** are intended to compensate the victim for harm suffered. A damage award is usually an amount of money judge equal to the victim's loss. That is the amount the party held liable will have to pay.

Occasionally, a court may award ***punitive damages*** as well because the conduct of the wrongdoer is particularly outrageous. By making the wrongdoer pay more than the amount required compensating the victim, the court makes an example of the outrageous conduct to discourage its repetition. The amount of liability loss includes, but can be greater than, the total losses sustained by the victims.

Bodily Injury

Bodily Injury is any physical injury to a person. Bodily injury losses that the liable party can expect to pay include hospital bills, physician's fees, and lost income and rehabilitation expenses of the injured party. In legal terminology, payments covering such costs are called **special damages**.

In addition to these direct costs, the liable party may also be required to pay **general damages** for pain and suffering and loss of consortium. Pain and suffering damages are awarded for the physical and mental pain and suffering that a person incurs because of the bodily injury. **Example:** *when a person is badly burned on the face and arms, for general damages compensate the injured party for the physical pain and the potential disfigurement as well as for mental suffering.* Damages for Loss of Consortium compensate someone for the loss of companionship because of an injury to the spouse.

Property Damages

Property damage losses occur when a person caused direct or indirect damages (such as loss of use of property) to another person's property. Property damage awards are normally limited to the value of the damaged property, loss of income due to the damage, and additional expenses that occur because of the damage.

Other Kinds of Personal Injury

In addition to bodily injury, a person can be harmed in other ways, such as damage to one's reputation, whereas legal practices use "personal injury" as a synonym for "bodily injury", insurance contracts use a more limited definition of "personal injury" which includes libel, slander, invasion of privacy, discrimination, and malicious prosecution (improper institution of criminal proceedings against another with malice). Any of these acts may cause harm to another person for which the perpetrator may be held liable.

Defense Costs

Defense costs include not only the fees paid to lawyers but also all other expenses associated with the defense of a liability claim. These expenses can include wages the defendant loses to attend and prepare for the trial, investigation expenses, witness fees and the cost of appeal bonds.

Liability Judgments

Whatever the legal basis of liability, the damage or injury, and the conduct or situation creating the liability, a Liability Loss becomes a definite legal obligation as a result of the legal process. At any point in the process, the parties may agree on the extent of the liability and settle the matter accordingly. If they do not agree, the injured party may seek a definitive judgment in court, which would then become the other party's legal obligation.

The Legal Process

The legal process provides a mechanism for an objective determination of liability. The process protects the rights of persons injured through the actions of others and assures them of compensation for their injury. Because the legal process can be time-consuming and expensive, many liability cases are settled out of court. Even people convinced of the merits of their case may be better off if they compromise early rather than fight a court battle through the end.

The Trial - During the trial, the plaintiff (party initiating the suit) tries to prove that the defendant's (party named in the suit) behavior toward the plaintiff caused injury.

Witnesses to the events, expert witnesses, and the plaintiff's testimony may provide evidence. The defendant has an opportunity to cross-examine each witness and to present a defense.

One of the best defenses to a negligence claim is that the defendant did not commit a negligent act, but instead acted in a reasonable manner that is commonly accepted by society.

Second common defense invokes the legal Doctrine of **Contributory Negligence**. This defense asserts that the negligence of the plaintiff contributed to the injury. **Example:** *in the case of an automobile accident, the defendant may have been speeding, and the plaintiff intoxicated and thus partly to blame for the accident. The argument is that the defendant should not be held liable for the loss because a sober person in the same situation would not have been injured.* The laws of many states now allow juries to apply the Doctrine of **Comparative Negligence** and assess damages in proportion to each party's degree of responsibility.

A *third* possible defense applies the doctrine of **risk assumption**. In this defense, the defendant argues that the plaintiff knew of the risk in advance of the injury and therefore assumes the risk. *This defense might apply in a suit initiated by a hockey fan hit by a puck in the stands at a game. Team management might argue that it is common knowledge that pucks go into the stands and that the protective shield around the ice ring is a reasonable amount of protection for the fans. As long as the management of the team has taken this reasonable precaution to*

protect the fans; the fans assume the remaining risk.

Role of the Insurance Company

Under the terms of the Liability Insurance Contract, the insurance company agrees to pay the legal expenses incurred in defending a case even if the suit is without merit and also to pay judgments covered by policy. Thus the insurance company carries most of the burden of the lawsuit. The insurance company usually retains a local attorney who knows not only the law but also the way local juries and judge's think and act. Outside attorneys who have specialized expertise in certain areas of the law, or familiarity with the insurance company's strategy and practices, may also be retained. Since it has many dollars hinging on the outcome, the insurance company often controls the entire defense process. In most Liability Insurance Policies, the insurer retains the right to decide whether to fight the claim or settle out of court. If a trial leads to a judgment against the defendant, the insurer must decide whether to appeal the case to a higher court. In professional liability cases especially, defendants are more concerned about how the outcome affects their professional reputations while the insurance company is more concerned about the litigation process.

Valuation of Liability Losses

The Valuation of Liability Losses is not nearly as exact as the Valuation of Property Losses. If the parties do not reach a settlement out of court, the amount of the defendant's liability may be decided by the judge or jury. In a bodily injury claim,

medical bills, lost income, extra expenses, loss of consortium, pain, suffering and punitive damages (where applicable) claim for damages, the jury can reject it, or accept some parts and reject others. Once the jury leaves the courtroom to consider its verdict and the amount of any award, the process is out of the hands of the lawyers and the judges until the jury returns. When the jury returns and announces its verdict and the jury's award is not in keeping with the facts presented, the respective parties may appeal the case to a higher court.

In cases where a death has occurred, the plaintiff's attorney, through the use of an expert witness, may try to calculate the economic value of the deceased person's life. This calculation includes the present value of the deceased person's earnings, fringe benefits and value of household services; the jury can accept or reject the testimony of the expert witness.

Property Damage Liability Claims can be evaluated more objectively than Bodily Injury Claims. No damages for pain and suffering, loss of services, or loss of consortium are involved. However, these can still be dispute over the fair market value of the property at the time of loss and the amount of damage that actually occurred. The value of fine arts or collectible items may be particularly difficult to judge. The facts regarding the value of the property damage are submitted to the jury for its judgment. It may accept or reject the arguments of the plaintiff's position and make the award as it sees fit. Generally, however, there are fewer disputes over Property Damage Liability Claims than Bodily Injury Claims.

Chapter 3 - Questions

1. In a Homeowners Policy, Section II - Coverage E is known as:
 - A. Property Protection
 - B. All Risk Protection
 - C. Personal Liability
 - D. All of the above
2. If two parties do not agree on the fact or the extent of one's liability to the other, who decides?
 - A. the defendant
 - B. the injured party
 - C. the insurance company
 - D. the court
3. What law deals with wrongs other than Breaches of Contract?
 - A. Tort
 - B. Defamation
 - C. Contract
 - D. None of the above
4. Which of the following is/are elements of negligence?
 - A. Duty to act that is owed to another person
 - B. Breach of that duty
 - C. Occurrences of an injury
 - D. All of the above
5. Damages that are intended to compensate the victim for harm suffered are called:
 - A. Punitive damages
 - B. General damages
 - C. Compensatory Damages
 - D. All of the above

ANSWERS

1. C
2. D
3. A
4. D
5. C

Chapter 4 – Homeowners Insurance

"Cherish your vision and your dreams as they are the children of your soul, the blueprints of your ultimate achievements." Napoleon Hill

Introduction

As noted, Homeowners' Policies provide a package of Property and Liability Coverages tailored to the needs of most homeowners, apartment renters and condominium owners. This chapter focuses on the Homeowners Policies developed by the Insurance Service Office (ISO), an advisory organization serving insurers throughout the United States. Some insurers may use similar policy forms developed by the American Association of Insurance Services (AAIS), an advisory organization similar to ISO. Still, other insurers may develop their own policy forms.

Homeowner Policies

The most widely used HO policy is the HO-00-03 Special Form and it is the basis for much the discussion in this chapter. Two other widely used homeowner's forms HO-00-04 Contents Broad Form (for apartment renters) and HO-00-06 Unit Owners Form (for condominium owners) are discussed in a later chapter.

All homeowner's policies include the following components:

- X Declarations
- X Insuring Agreement
- X Definitions

- X Section I - Property Coverages Perils Insured Against Exclusions Conditions
- X Section II - Liability Coverages Exclusions Additional Coverages Conditions
- X Conditions applicable to both Section I and Section II

Declarations

The first items on the declarations page usually are the policy number and the policy period. In most states, the policy periods begin at 12:01 am, standard time at the insured location. The date coverage begins is known as the *inception date*. The name of the insurance company may also be included in this section of the declarations.

The next items on the declarations page are the name and mailing address of the insured. If the address of the residence to be insured is not the same as the insured's mailing address, the address of the insured residence is also included.

The coverages under Section I and Section II are listed and a Limit of Liability is shown for coverage. The amount of the premium also is included in this part of the declaration page, either as a single amount of all coverages or broken down to reflect the premium for coverage.

The HO form under which coverage is provided is also indicated on the declarations page. The HO Form number may be pre-printed, or it may be filled in as part of the listing of forms and endorsements that are part of the policy. Endorsements are listed by number and any change resulting from an endorsement is shown in the same section of the declarations page.

Next, the deductible to be applied to property is listed. The standard deductible is \$250. The amount of the deductible may be increased or decreased with a corresponding decrease or increase in premium. Homeowners' deductibles are discussed in a later chapter.

If the insured owns another residence for which Section II coverage is to be provided, the location of that residence must be shown. **Example:** *if an insured owns a vacation home, the insured's HO policy covering the primary residence can also provide liability protection for the vacation home. The insured can then purchase separate insurance covering only the property loss exposures arising out of ownership of the vacation home.*

Finally, if the insured premises are mortgaged, the mortgagee's name and address must be listed on the declarations page. This gives the mortgagee specific rights under the policy.

The Insuring Agreement

The insuring agreement, which applies to all coverages, states the following:

"We will provide the insurance described in this policy in return for the premium and compliance with all applicable provisions of this policy".

A contract requires consideration from both parties. The insurer's consideration is its obligation to provide the specified insurance coverage for the policy period. The insured's consideration has two parts: the obligation to pay the policy premium and the obligation to comply with the policy conditions.

Definitions

When a contract is drawn up by one party and accepted by the other party, it is known as a Contract of Adhesion. Any ambiguities in a Contract of Adhesion are constructed against the party that drew the contract. Since the Homeowners Policy is a Contract of Adhesion, it is necessary to clearly define the terms used in the contract.

The terms "you" and "your" are defined in the HO-3 as referring to the "named insured", as shown in the declarations, and the spouse if a resident in the same household. The terms "we" and "our" refer to the insurer providing the coverage.

The term "resident premise" is also defined. It means the one family dwelling, other structures and grounds, or that part of any other building in which the insured resides and which is known as the "residence premises" in the declarations. "Residence premises" also means a two-family dwelling where the insured resides in at least one of

the family units and which is shown as the "residence premises" in the declaration.

Most of the other terms defined at the beginning of the HO policy refer to Section II - Liability and are discussed in a later chapter.

Property Coverages

The HO-3 policy includes the following 5 types of Property Coverage:

- X Coverage A - Dwelling
- X Coverage B - Other Structures
- X Coverage C - Personal Property
- X Coverage D - Loss of use
- X Additional Coverages

The description of each type of coverage includes definitions and exclusions intended to clarify the intent of the coverage.

Coverages "A" and "B" - Coverage for the insured's real property: the dwelling and other structures (such as a detached garage) is provided under coverages A and B.

Covered Property - Coverage A applies to the dwelling and attached structures on the residence premises. In addition, coverage is provided for building materials and supplies located on or next to the residence premises for use in construction alteration, or repair of either the dwelling or other structures on the residence premises. Coverage A does not apply to land, including the land on which the dwelling is located.

Coverage B applies to other structures on the residence premises that are detached from the dwelling. The policy clarifies the

distinction between attached and detached structures by stating that a structure connected to the dwelling only by a fence or utility line is considered to be detached. Once again, land is specifically excluded. Other structures used in whole or in part of business are excluded. Other structures rented to someone other than a tenant of the dwelling are also excluded unless such a structure is used solely as a private garage.

The Homeowners Policy uses the phrase ***Limit of Liability*** to identify the amount of insurance applicable to each of the coverages. The phrase **amount of insurance, amount of coverage, and coverage amount** are used in insurance practice and in this book are synonyms for Limit of Liability.

When a HO-3 is purchased, the insured chooses the Coverage A - Limit of Liability based on the value of the covered dwelling. The Coverage B - Limit of Liability is automatically set at 10% of the amount of insurance for Coverage A unless the insured purchases a higher amount of insurance. An insured whose residence premises contains a large detached garage, workshop, barn, guest house or several smaller detached structures, may need to increase the Coverage B - Limit of Liability beyond the amount automatically provided.

While the covered perils are the same for Coverages A and B, the determination for which coverage applies to a garage or a shed is important. A policy with \$100,000 Coverage A - Limit of Liability would automatically provide \$10,000 of additional

insurance for a detached garage or shed. If the same structure were attached to the insured's dwelling, it would be included in the \$100,000 Coverage A - Limit of Liability.

Covered Perils - The HO-3 insures against risks of direct loss to property described in Coverages A and B but only if that loss is a physical loss to property. Coverage is further limited by the exclusions described below:

Exclusions

Some of the exclusions that limit the property coverages in Section I apply only to Coverages A and B. Other exclusions apply to all of the Section I coverages.

Exclusions Applying Only to Coverages "A" and "B"

The exclusions are the key to analyzing the perils insured against under Coverage A and B because direct physical loss to property is covered unless specifically excluded. The following exclusions apply only to Coverage A and B.

Collapse - Losses involving collapse is specifically excluded unless the cause of the collapse is described under the Additional Coverages Provision.

Freezing - When the dwelling is vacant, unoccupied or under construction, the insured must maintain heat in the building or shut off the water supply and drain the system and appliances of water. Otherwise,

freezing of a plumbing, heating, air conditioning or automatic fire protective system or of a household appliance is not covered. Damage caused by discharge, leakage or overflow from within such a system or appliance is excluded unless the preceding precautions have been taken.

Foundations Retaining Walls, and Non-Building Structures - Loss by freezing, thawing, pressure or weight of water or ice to fences, swimming pools, foundations, retaining walls, piers, wharf's or docks, also is excluded. This exclusion applies whether or not the water or ice was driven by wind; therefore, there is no coverage even if a loss to any of these structures was the result of a windstorm.

Dwelling Under Construction - Theft in or to a dwelling under construction is excluded. The theft exposure is much greater during construction than it is after construction is completed and the property is occupied.

Vandalism and Malicious Mischief - There is no coverage for vandalism and malicious mischief if the dwelling has been vacant for more than 30 consecutive days immediately before the loss. A dwelling being constructed is not considered vacant. There is a distinction between "vacant" and "unoccupied". A vacant dwelling is empty and unfurnished. An unoccupied dwelling is furnished but the residents are not on the premises. Therefore, if an insured from Vermont spends January and February in Florida, the Vermont dwelling is unoccupied but not vacant while the insured is in Florida.

Risks of Direct Physical Loss Exclusion

Coverage A and B insure property against risks of direct physical loss that are not specifically excluded. Policies that provide such broad coverage generally contain an exclusion that lists specific causes of loss that are not insured. Thus, Coverages A and B do not insure losses caused by any of the following:

1. Wear and tear, marring, deterioration
2. Inherent vice, latent defect, mechanical breakdown
3. Smog, rust or other corrosion, mold, wet or dry rot
4. Smoke from agricultural smudging or industrial operations
5. Discharge, dispersal, seepage, migration, release or escape of pollutants (unless caused by a peril covered under Coverage C)
6. settling, shrinking, bulging or expansion, including resultant cracking of pavements, patios, foundations, walls, floors, roofs or ceilings.
7. birds, vermin, rodents or insects
8. Animals owned, or kept by, an insured. There is coverage if any of the listed perils cause water damage (not otherwise excluded) from a plumbing, heating, air conditioning or automatic fire protective sprinkler system or household appliance. This includes the cost of tearing out and replacing any part of a building in order to repair the system or appliance. There is no

coverage for loss to the system or appliance from which the water escaped.

Concurrent Causation Exclusion

Sometimes there is more than one peril involved in a loss. As such, each peril may be called a *concurrent cause* of the loss and insurance problems can arise if one of the perils is covered and another is excluded.

The HO-3 and many other insurance policies that provide coverage for risks of direct physical loss contain provisions intended to resolve problems arising from losses including Concurrent Causation. Thus, the HO-3 does not insure for loss to property described in Coverages A and B if the loss is caused by any of the following:

1. **Weather Conditions** - This exclusion applies only to conditions that contribute to a loss that would otherwise be excluded. **Example:** *damage caused by windstorm would not be affected by this exclusion.*
2. **Acts or Decisions of Others**
This exclusion denies coverage when loss results from acts or decisions, including the failure to act or decide, of any person, group, organization or government body.
3. **Faulty, Inadequate, or Defective Plans or Actions** - This exclusion eliminates coverage for any loss resulting from improper planning, zoning, development, surveying, settling, design, specifications, workmanship, repair, construction, renovations, remodeling, grading, soil compacting, materials or

maintenance of any property on or off the residence premises. However, these exclusions do not apply to any ensuing loss to property if such loss is not excluded or accepted by some other policy provision.

Exclusions to All Section I Coverages

The HO-3 contains 8 general exclusions that apply to all of the coverage in Section I. Those exclusions are:

Ordinance of Law - Loss caused by enforcement of any ordinance or law regulating the construction, repair, demolition of a building or other structure is not covered unless specifically provided under the policy. **Example:** *an old dwelling not meeting the current building code is damaged. Because of the provisions of a building ordinance, repairs would have to include extensive modifications to the dwelling's wiring, plumbing and foundation. The additional cost of these modifications is not covered because of the Ordinance or Law Exclusion.*

Earth Movement - There is no coverage for property damage from earthquake (including land shock waves associated with a volcanic eruption), landslide, mine subsidence, mud-flow, and earth sinking, rising, or shifting. However, if there is a direct loss by fire, explosion, breakage of covered glass or safety glazing material insurers, coverage is provided for the ensuing loss. The earth movement exclusion does not apply to loss by theft, such as looting following an earthquake.

Water Damage - The water damage exclusion is often referred to as the flood exclusion but, in fact, it also excludes other types of water damage to which dwellings and their contents are exposed. Water damage from the following is excluded:

1. Flood, surface water, waves, tidal water, overflow of a body of water, spray from any of these whether or not driven by wind.
2. Water which backs up through sewers or drains or which overflows from a pump.
3. Water below the surface of the ground, including water which exerts pressure on, or seeps or leaks through a building, sidewalk, driveway, foundation, swimming pool or other structure. However, direct loss by fire, explosion or theft resulting from water damages is covered. **Example:** *if the dwelling is flooded and the insured is evacuated, the flood damage would not be covered, but furnishings stolen from the dwelling by looters would be covered.*

Power Failure - Loss caused by the failure of power or other service utility is excluded if the failure occurs off the residence premises. Therefore, if a hurricane knocked out the power from the local electric company and a freezer full of meat spoiled, there would be no coverage for the loss of the meat. If the power failure is caused by an insured peril on the residence premises, any resulting loss is covered. If lightning strikes the dwelling causing a power interruption, the consequent freezer food spoilage would be covered.

Neglect - If the insured neglects to use all reasonable means to save and preserve property at and after the time of loss, there is no coverage for any damage that results from the insured's neglect. This exclusion encourages the insured to take reasonable steps to protect endangered property. The requirement that property must also be protected following the loss encourages the insured to exercise the same degree of care for the insured property as he/she would if the property were not covered by insurance.

War - This exclusion applies to war, as well as, to any of the following types of actions and any consequences of these actions:

- X undeclared war, civil war, insurrection, rebellion, or revolution
- X warlike acts by military force or military personnel
- X Destruction, seizure or use for a military purpose.

Discharge of a nuclear weapon is considered a warlike act even if such discharge is accidental. The War Exclusion takes away some of the worldwide coverage for personal property ordinarily provided under Coverage C. Therefore, the loss would not be covered if the insured's luggage and its contents were damaged when rebellion breaks out in the foreign country the insured is visiting.

Nuclear Hazard - Losses caused directly or indirectly by nuclear hazard is excluded but direct loss by fire resulting from the nuclear hazard is covered. This exclusion is unusual in that the actual Nuclear Hazard Exclusion

is part of the Section I - Conditions, discussed later in this chapter.

Intentional Loss - There is no coverage for any loss arising out of any act committed by or at the direction of an insured with the intent to cause a loss. Not only must the act be intentional but the loss must also be intended. This exclusion eliminates coverage for all insured when an intentional loss is committed by or at the direction of any insured. **Example:** *there is no coverage available to the innocent spouse of an arsonist who burned down the family home.*

Coverage C provides insurance for personal property of the insured. Special limits apply to some types of property and some property is excluded from coverage.

Covered Property

Coverage C provides worldwide coverage for personal property owned or used by an insured. At the insured's request, coverage is extended to personal property owned by others while the property is on the part of the residence premises **occupied by an insured**. The requirement that the property be on the part of the residence premises occupied by an insured is designed to eliminate coverage from the personal property of a tenant.

At the request of the insured, personal property owned by a guest or a residence employee is covered while the property is in any residence occupied by an insured. The term "any residence" is broader than the "residence premises" but note that coverage

under this section is limited to guests of the insured and residence employees.

If personal property is scheduled (described and listed separately) on another policy or endorsement such as the scheduled Personal Property Endorsement, such scheduled property is not covered under Coverage C. For this reason, the subject matter of Coverage C is at times called Unscheduled Personal Property. The overall Limit of Liability for Coverage C is 50% of the Coverage A figure. A limitation of 10% of the Coverage C amount exists for personal property usually located at a secondary residence. There is a minimum of \$1,000 coverage for such property.

Assume that John and Marsha Cabot, residents of Miami, have a HO-3 with Coverage A limit of \$200,000. The Limit of Liability under Coverage C would be \$100,000 (50% x \$200,000). The Cabots also own a summer cabin home in North Carolina. The HO-3 with their Miami house would provide \$10,000 (10% x \$100,000) coverage for personal property usually located at the secondary residence in North Carolina. Furniture, appliances and household items left year round in North Carolina would be subject to the \$100,000 limitation. If the Cabots regularly carried their television, videocassette recorder and clothing back and forth from Miami to North Carolina, these items would not fall under the \$10,000 limitation.

Property Subject to Special Limits of Liability

Eleven types of property are subject to special Limits of Liability under Coverage C of the HO-3. These limits do not increase the overall Coverage C Limit of Liability but represent sub-limits within the overall limit. The special limit for each category is the total limit for each loss for all property in that category. Following are the special Limits of Liability:

1. \$200 on money, bank notes, bullion, gold other than goldware, silver (other than silverware), platinum, coins and medals.
2. \$1,000 on securities, accounts, deeds, evidences of debt, letters of credit, notes (other than bank notes), manuscripts, personal records, passports, tickets and stamps. This dollar restriction applies regardless of the medium on which the material exists. The costs to research, replace, or restore the information from the lost or damaged material is included in this Special Limit of Liability.
3. \$1,000 on watercraft, including their trailers, furnishings, equipment and out-board engines or motors.
4. \$1,000 on trailers not used with watercraft.
5. \$1,000 for loss by theft of jewelry, watches, furs, precious and semiprecious stones.
6. \$2,000 for loss of theft of firearms.

7. \$2,500 for loss by theft of silverware, silverplated wares, goldware, goldplated ware, and pewterware. This includes flatware, hollowware, tea sets, trays and trophies made of or including silver, gold or pewter.
8. \$2,500 on property, on the residence premises, used at any time or in any manner for any business purpose.
9. \$2,500 on property, away from the residence premises, used at any time or in any manner for any business purpose.
10. \$1,000 for loss to adaptable electronic apparatus while it is in or upon a motor vehicle or other motorized land conveyance. Such adaptable electronic apparatus is equipped to operate by power from the electrical system of the vehicle while retaining its capability of being operated by other sources of power.
11. \$1,000 for loss to adaptable electronic apparatus while it is (a) not in or upon a motor vehicle or other motorized land conveyance, (b) away from the residence premises, (c) used at any time, or in any manner, for any business purpose.

Property Excluded from Coverage

There are 9 categories of property not covered under Coverage C of the HO-3.

1. There is no coverage for articles separately described and specifically

insured in this or other insurance. Coverage C provides Unscheduled or Blanket Coverage. **Example:** *If a particular item, a diamond ring, is scheduled on a Personal Articles Floater Endorsement, then it is excluded from Blanket Coverage under Coverage C. This applies if the scheduled coverage is provided by an endorsement to the HO policy or if it is provided under a separate policy. This eliminates duplicate coverage and possible disputes about which coverage should be primary in the event of a loss.*

2. Animals, birds, or fish are excluded from coverage. Household pets are difficult to value and even more difficult to insure. They are subject to loss from a variety of causes including theft, illness and simply becoming lost. Property policies have traditionally excluded household pets from coverage.
3. There is no coverage for motor vehicles, all other motorized land conveyances and their equipment and accessories. Also excluded is electronic apparatus that can be operated solely by power from the electrical system of a motor vehicle land conveyance. However, the exclusion applies to equipment, accessories and electronic apparatus only while such property is in or upon the vehicle or conveyance. Coverage C does provide coverage for vehicles or conveyances not subject to motor vehicle registration and which are used to service an insured's residence or designed for assisting the handicapped.

4. Aircraft and parts are also excluded. An aircraft is defined as any conveyance used or designed for flight, except model or hobby aircraft not used or designed to carry people or cargo.
5. Property of roomers, boarders and other tenants (except property of roomers and boarders related to an insured) is excluded. Any non-related tenant should have his/her own insurance. This exclusion is consistent with the description of property of others that the policy would cover at the insured's option.
6. There is no coverage for property in an apartment that is regularly rented or held for rental to others by an insured. This refers to property, such as furniture, owned by the insured and used to furnish a rental apartment. This exclusion does not apply to the landlord's furnishings, which are subject to an additional coverage discussed later.
7. Property rented or held for rental to others off the residence premises is also excluded. This section makes it clear that property related to an insured's rental operations is excluded whether on or off the residence premises.
9. There is no coverage for business data, such as that stored in bonds of account, drawings, paper records, electronic data processing tapes, wires, records, disks or other software media. Coverage is provided for the cost of blank recording or storage media and of prerecorded

computer programs available on the retail market. Business records, including computer floppy disks, could be covered under Valuable Papers and Record Policy or Electronic Data Processing Policy if they are to be insured at all. The HO-3 is not intended to provide coverage for a business exposure of this nature.

9. Credit cards and fund transfer cards are excluded except as provided in the Additional Coverages Section described later.

Covered Perils

Insurance is provided under Coverage C for direct physical loss to **personal property** from the following sixteen perils:

1. **Fire or lightning** - The Fire Insurance provided by a HO policy is one of the most important coverages for the typical homeowner. The Homeowners Policy, following the practice in Property Insurance forms that preceded it, does not define the term **fire**. Insurers rely instead on the definition of fire that has grown out of court cases relating to insurance coverage. The courts have generally held that fire means *combustion or oxidation rapid enough to cause a flame or glow*. In addition, the courts have held that insurance coverage applies only to "hostile fires", fires that are not within their intended confines. A fire that re-mains within its intended confines, such as a fireplace, charcoal grill or stovetop is termed a "friendly

fire". No coverage is provided for damage caused by friendly fires.

Example: *no coverage is provided for scorching of the finish on a chair that was set too close to a fireplace, unless the chair itself caught fire. Likewise, there would be no coverage for fire damage to a pair of eyeglasses that melted after being accidentally dropped into a charcoal grill.*

Lightning, although not specifically defined in the HO Policy, is generally considered to be a discharge of atmospheric electricity.

2. **Windstorm or Hail** - the Windstorm Peril includes damage from violent winds, such as hurricanes and tornadoes. The coverage for loss due to windstorm or hail excludes loss to property located within a building caused by rain, snow, sleet, sand or dust, unless the direct force of the wind or hail created an opening in the roof or wall through which these elements could enter. Windblown rain entering through an open window or around the crevices of a poorly fitted one is not covered. Wind or hail damage to a boat and its equipment is covered only if the boat is located inside a fully enclosed building.
3. **Explosion** - Explosion is not defined in the policy. A loss to the contents of a dwelling caused by an explosion off the property, such as an industrial explosion or blasting work would be covered. Other covered explosions include water damage, bursting pipes and sonic booms.

4. **Riot or Civil Commotion** - The term *riot* is defined by state laws. One state defines riot as *public activity involving 3 or more persons with a common purpose who carry out that purpose with a show of force*. A civil commotion is generally considered to be a large or prolonged riot. Damage to Personal Property resulting from a riot or civil commotion is covered.
5. **Aircraft** - Damage from aircraft, including self-propelled missiles and spacecraft is covered.
6. **Vehicles** - HO Policies provide coverage for damage to the insured's property by a vehicle, even a vehicle owned by an insured. **Example:** *if a motorist lost control of a vehicle and crashed into the insured's patio furniture, the loss of the furniture would be covered under all forms of the HO policy. In addition, if the insureds son ran over a lawn mower while putting the family car into the garage, the loss to the lawn mower would be covered.*
7. **Smoke** - Sudden and accidental damage from smoke is covered. **Example:** *damage to carpets, drapes and furniture caused by smoke suddenly discharged from a faulty fireplace or heater.* Coverage is not provided for damage to personal property caused by smoke from agricultural smudging or industrial operations.
8. **Vandalism or Malicious Mischief** - These perils are not defined in the policy

but coverage is provided for willful or malicious damage to property caused by one or several persons without the violence associated with a riot.

9. **Theft** - The Theft Peril includes attempted theft and loss of property from a known place when it is likely that the property has been stolen. **Example:** *an insured checks in at an airline gate one hour before the flight departs, places some carry-on luggage in the passenger waiting area and leaves to buy a cup of coffee from a nearby vending machine. Upon returning to the waiting area, the insured finds that the carry-on luggage has disappeared. If the airline personnel at the gate have no knowledge of what happened to the luggage, the most likely presumption is that it was stolen. This type of loss would be covered and the Actual Cash Value of the luggage and its contents, in excess of the policy deductible, would be paid to the insured.*
10. **Falling Objects** - Damage caused by a falling object to personal property contained within a building is covered only if the roof or an outside wall of the building is first damaged by that falling object. **Example:** *it would be possible for a tree to fall against the exterior wall of a masonry home with sufficient force to knock a mirror off an interior wall and onto the floor without actually damaging the exterior wall. In such a case, the damage to the mirror would not be covered. If the exterior wall were damaged, loss to the mirror would be covered subject to the policy deductible.*
11. **Weight of Ice, Snow or Sleet** - Coverage is provided for personal property within a home damaged by the weight of ice, snow or sleet. Therefore, if the weight of snow collapsed the roof of the home, the resulting damage to the contents of the home would be covered.
12. **Accidental Discharge or Overflow of Water or Steam** - This policy covers loss resulting from accidental discharge or overflow of water or steam from within a plumbing, heating, air conditioner, and automatic fire protective sprinkler system or from a household appliance. **Example:** *if an automatic dishwasher malfunctions and floods the kitchen, water damage to the kitchen furniture would be covered. Coverage is not provided for the damage to the system or appliance from which the water or steam escaped. Any loss or damage from freezing is covered under the terms of the freezing peril.*
13. **Sudden and accidental tearing apart, cracking, burning, or bulging of a steam, hot water, air conditioning, automatic fire protective sprinkler system, or appliance for heating water** - Coverage for this peril includes damage to the objects or systems and the ensuing damage to personal property, such as might occur when a water heater suddenly explodes.
14. **Freezing of a plumbing, heating, air conditioning, automatic fire protective sprinkler system, or of a household appliance** - Freezing of such systems

can result in burst pipes, releasing water or other liquids that damage personal property. Coverage applies unless the dwelling is unoccupied and the insured has not taken reasonable care to maintain heat in the building, shut off the water supply, and drain the system and appliances of water.

15. **Sudden and accidental damage from artificially generated electrical current** -

Most damage of this type is caused by power surges due to sudden increases of the current in an electrical system. Damage to a tube, transistor or similar electronic equipment is excluded. If a power surge caused an electric clothes dryer to burn out, the loss would be covered.

16. **Volcanic Eruption** - Loss caused by a volcanic eruption is covered except for loss caused by earthquake, land shock waves or tremors. Property damage caused by volcanic explosion, volcanic ash, lava flow or airborne shock waves would be covered.

Coverage "D" Loss of Use

In the event of a loss under Coverage A, such as fire damage to the dwelling, the insured may lose the use of the dwelling because it is uninhabitable, while repairs are being made. The act of civil authority, such as the evacuation ordered because of a nearby fire, may also cause the insured to temporarily lose the use of the dwelling. Coverage D provides compensation to the insured in the event of such loss of use.

Compensation for loss of use is determined in one of two ways depending on the circumstances of the loss.

First method of determining payment is the ***insured's additional living expenses***, which is the insured's necessary increase in living expense required to remain in the household's normal standard of living. **Example:** *if a family were forced to move out of its home for 2 weeks, additional living expenses would typically include the costs of motels, restaurant meals and laundry service, less the cost of normally prepared meals at home and any reduction in utility bills during the period of repairs.*

The **second** method of use is ***Fair Rental Value***, which is the amount of rent that could reasonably be charged for the premises, less any expenses that do not continue while the premises are not fit for habitation.

Loss of Use Resulting from Coverage "A" Losses

Payment for this loss is made for the shortest time required repairing or replacing the damage to the dwelling. If the insured chooses to permanently relocate rather than move back into the dwelling, payment is made for the shortest time required to relocate. This basis on which the insured is compensated depends on the use of the premises at the time.

Insured's Principal Place of Residence - Loss payment is made on the basis of Additional Living Expense or Fair Rental

Value at the option of the insured. Loss payments are made on the basis of additional living expenses. The insured does not have the option of payment on the basis of Fair Rental Value.

Part of the Insured's Residence Premises

Rented to Others - When loss of use occurs to part of the residence premises rented to or held for rental to others, loss payment is made on the basis of Fair Rental Value.

Loss of Use Resulting from Action of a

Civil Authority - To be covered, loss of use must result when a civil authority prohibits the insured from using the residence premises because of a peril insured against under the policy. Loss payment is made for no more than 2 weeks on the basis of Additional Living Expense or Fair Rental Value, at the option of the insured.

Additional Coverages

The following additional coverages are included in the HO-3 to provide protection, subject to certain limitations, in the event of specific perils and types of losses:

- X debris removal
- X reasonable repairs
- X trees, shrubs and other plants
- X fire department service charge
- X property removed
- X credit card, fund transfer card, forgery and counterfeit money
- X loss assessment
- X collapse
- X glass or safety glazing material
- X landlord furnishings

Debris Removal - Coverage is provided for the reasonable expense incurred for removal of debris of covered property if the loss was caused by a covered peril. **Example:** *cost of removing debris from a house after a fire.*

The cost of debris removal is included in the Limit of Liability that applies to the damaged property. In the event that the loss for actual damage to the property plus debris removal exceeds the policy limit, an additional 5% of the coverage Limit of Liability is available for debris removal expense.

The insurer will pay up to \$500 to remove fallen trees that damage a covered structure on the residence premises. Payment will be made for (1) the insured's tree(s) felled by windstorm or hail, (2) the insured's trees felled by weight of ice, snow or sleet, (3) a neighbor's tree(s) felled by a peril that is covered under Coverage C. The \$500 amount is the most that will be paid in any one loss regardless of the number of fallen trees.

Reasonable Repairs - Coverage is provided for the reasonable cost incurred by the insured following a loss from a peril insured against, a necessary measure to protect covered property from further damage. **Example:** *if part of the roof of the insured's house is blown off during a tornado, coverage for reasonable re-pairs would pay for the purchase of plywood, tarps and other material to protect household goods from rain and weather damage until permanent repairs could be made.*

Trees, Shrubs, and Other Plants - Coverage is provided for trees, shrubs, plants or lawns on the residence premises for loss caused by fire, lightning, explosion, riot or civil commotion, aircraft, vehicles not owned or operated by a resident of the residence premises, vandalism, malicious mischief and theft.

The limit for this coverage is 5% of the Coverage A Limit of Liability but not more than \$500 of this limit will be paid from any one tree, shrub or plant.

Fire Department Service Charge - Up to \$500 of coverage is provided for fire department service charges incurred when the fire department is called to save or protect covered property from an insured peril. Coverage is not provided if the property is located within the limits of the city, municipality or protection district furnishing the fire department response.

Property Removed - Covered property is insured against direct loss from any cause while being removed from a premise endangered by an insured peril. This coverage extends for no more than 30 days while the property is removed.

Credit Card, Fund Transfer Cards, Forgery and Counterfeit Money - Up to \$500 of coverage is provided for the following:

- X The legal obligation of an insured to pay because of the theft or unauthorized use of credit cards issued to or registered in an insured's name.

- X Loss resulting from theft or unauthorized use of a fund transfer card used for deposit, withdrawal or transfer of funds issued to or registered in an insured's name.

- X Loss to an insured caused by forgery or alteration of any check or negotiable instrument.

Coverage is not provided for use of a credit card or fund transfer card by a resident of the insured's household or by a person entrusted with either type of card. Coverage is similarly not provided if the insured has not complied with all the terms and conditions under which the cards are issued.

When the Limit of Liability is being determined, all losses resulting from a series of acts committed by any one person is considered to be one loss. This coverage is additional insurance. No deductible applies to this coverage.

Loss Assessment - Up to \$1,000 of coverage is provided for loss assessment by a corporation or association of property owners charged against the insured as owner or tenant of the residence premises. This coverage is only provided when the assessment is made as a result of direct loss to the property owned collectively by all members and the loss is caused by a peril insured under Coverage A. **Example:** *suppose 4 families with adjoining lakeside properties decide to construct a pier for docking their boats. To do this they form an Association to build and maintain the pier. Sometime later, the pier is struck by*

lightning and burns to the water line. Repairs to the pier cost \$6,000 and each property owner is assessed 25% of the cost (\$1,500) to repair the pier. For any property owner who had insured his/her lake side property under the HO-3, the insured's HO-3 policy would provide \$1,000 toward this loss.

Collapse - Coverage is provided for direct physical loss to covered property involving collapse of a building or part of a building caused only by one of the following:

1. Perils insured against in Coverage C
2. Hidden decay
4. hidden insect or vermin damage
4. Weight of contents, equipment, animals or people
5. Weight of rain which collects on a roof
6. Collapse during construction, remodeling or renovation due to the use of defective materials or methods

Loss to non-building structures, underground pipes and structures, retaining walls and piers, wharf's and docks is not covered under item 2 through 6 above, unless the loss is a direct result of the collapse of a building. Collapse does not include settling, cracking, shrinking, bulging or expansion.

This coverage does not increase the Limit of Liability that applies to the damaged-covered property.

Glass or Safety Glazing Material - Coverage is provided for (1) breakage of glass or safety glazing material that is part of a covered building, storm door, or storm window and (2) damage to covered property that is caused by such glass or safety glazing material. However, there is no coverage for loss on the residence premises if the dwelling has been vacant for more than 30 consecutive days immediately before the loss occurs.

Coverage for glass and safety glazing materials does not increase the applicable Limit of Liability.

Landlord's Furnishings - Up to \$2, 500 will be paid for loss of appliances, carpeting and other household furnishings in apartments on the residence premises that the insured regularly rents or holds for rental to others. Coverage applies to losses caused by the perils insured against in Coverage C except that there is no coverage for theft. The \$2,500 limit is the most that will be paid regardless of the number of items of landlord's furnishings involved in a loss.

Conditions

The conditions applicable to Section I of the HO-3 policy primarily deal with the rights and duties of the insured and the insurer following a property loss. With few exceptions, the conditions apply to all of the Section I - Property Coverages. The Section I Property Coverages also are subject to the Section I and II conditions, discussed in the next chapter. These conditions deal with matters such as the policy period,

cancellation non-renewal, assignment, subrogation and other matters that apply to both the Property and Liability Coverage in the policy. The Section I conditions are examined in the balance of this chapter.

Insurance Interest and Limit of Liability

This condition states that the basic insurance principle for any insured's loss recovery is limited to the extent of that insured's insurable interest.

Duties after Loss

If there is a loss to covered property, the insured must make certain that the following duties are performed.

Prompt Notice - Prompt notice must be given to the insurer or its agent. The police must be notified of a theft loss. The issuer of a credit card or fund transfer card must be notified of loss, theft or unauthorized use of one of these cards. This helps prevent fraudulent losses and limits the amount of loss.

Protect the Property - The insured must protect the property from further damage, make reasonable and necessary repairs to protect the property and keep an accurate record of repair expenses. Payment for these expenses comes from additional coverage for reasonable repairs.

Prepare an Inventory - The insured must prepare an inventory of damaged personal property showing the quality, description, Actual Cash Value and amount of loss. The

insured should be able to justify the figures in the inventory with bills, receipts and related documents.

Show the Damaged Property - As often as the insurer reasonably requires the insured must show the damaged property and provide records and documents. The insured must submit to questions, under oath, while not in the presence of any other insured, again, as often as the insurer reasonably requires.

File a Proof of Loss - Within 60 days of the insurer's request, the insured must submit a signed, sworn proof of loss. This must include, to the best of the insured's knowledge and belief, the time and cause of loss, the interest of the insured and all others in the property including all liens on the property, other insurance covering the loss, and other relevant information. This helps the company to determine insurable interest, to investigate the loss and to coordinate payment with any other insurance.

Loss Settlement

The provision in this condition explains how losses to covered property will be settled. Losses to personal property, awnings, carpeting, household appliances, outdoor antennas and outdoor equipment attached or not attached to building, and non-building structures are all settled on an **actual cash basis**.

Non-building structures are those not designed for human occupancies, such as fences, concrete patios and swimming pools.

An endorsement may be added to the policy that changes the settlement basis for personal property to replacement cost. This Endorsement will be discussed in a later chapter.

Losses to the dwelling and other structures are paid on the basis of **replacement cost** with no deduction for depreciation. Insurance on a *replacement cost basis* is one of the most important features of the Homeowners Policy. The Homeowners Policy contains a provision that reduces the loss payment if the insured does not carry coverage equal to at least 80% of the replacement cost of the damaged structure. Note that the 80% figure applies not only to the dwelling but also to other covered structures. **Example:** *assume that an insured's residence premises include a detached garage. The Coverage B limit on that garage must be equal to at least 80% of the replacement cost of the garage for Replacement Cost Coverage to apply to a loss to the garage.*

Determining whether a loss under a Homeowners Policy will be settled on a replacement cost basis is a simple process. The following insurance-to-value formula is used to determine whether the insured has coverage equal to at least 80% of the replacement cost of the damaged structure.

Insurance-to-value fraction;

$$\frac{\text{Amount of insurance carried}}{80\% \text{ of replacement cost}}$$

Example: *assume that an insured carries a Homeowners Policy with a Coverage A limit*

of \$100,000 on a dwelling that has a replacement cost of \$110,000. Using these dollar amounts in the insurance-to-value fraction yields the following:

$$\frac{\$100,000}{80\% \times 110,000} = \frac{100}{88} \text{ or } 1.14$$

In the event of a covered loss to the dwelling, the insured would receive settlement on a replacement cost basis because the value of the fraction is greater than 1.

Another **Example:** *assume that the same insured's residence premises also include a detached garage with a replacement cost of \$20,000. On the HO-3, the Coverage B limit is 10% of the Coverage A limit, unless the insured purchases additional limits. Therefore, the insured's policy with \$100,000 of coverage on the dwelling provides \$10,000 of coverage on the detached garage.*

The insurance-to-value fraction yields the following result with regard to coverage on the garage:

$$\frac{\$10,000}{80\% \times \$20,000} = \frac{10}{16} \text{ or } .625$$

Because the value of the fraction is less than 1, the amount of insurance carried on the garage does not meet the policy's insurance-to-value requirements. Therefore, if a covered loss occurred to the garage, payment would not be made on a replacement cost basis. When the amount of coverage carried does not meet the insurance-to-value requirements, the policy will pay the larger of the following 2 amounts:

1. The insurance-to-value fraction, multiplied by the replacement cost of the loss.
2. The Actual Cash Value of the loss, typically meaning replacement cost less depreciation.

Example: *assume that the roof of the insured's \$20,000 detached garage was damaged by a hurricane. The calculations above show that the loss will not be settled on a replacement cost basis. However, both the replacement cost and the Actual Cash Value of the damage to the roof are needed to determine the amount the insured will receive. Assume that the replacement cost of the damage to the roof is \$1,000. Because the roof is 10 years old, the Actual Cash Value of the loss is \$500. The amount the insured will receive depends on which amount is greater: (1) the insurance-to-value fraction, multiplied by the \$1,000 replacement cost or (2) the \$500 Actual Cash Value. For purpose of illustration, the effect of the policy deductible has been ignored. Calculating the amount payable under the 1st options yields the following:*

$$\frac{\text{Amount of insurance carried} \times \text{Replacement cost } 80\% \times}{\text{Replacement cost of loss.}}$$

$$\frac{\$10,000}{80\% \times 20,000} \times \$1,000 = 625$$

Because \$625 is greater than \$500, the insured will receive \$625 in settlement of the loss. If, however, the actual cash value of the damage were \$900 because the garage roof had recently been replaced, the insured would receive a \$900 settlement. The insured always receives the larger of the two amounts.

Loss to a Pair or Set

This condition applies when there is a loss to 1 item in a pair or to part of a set of items. The loss of 1 item does not result in a total loss of the value of a pair or set. Therefore, the insurer may elect to (a) repair or replace any part to restore the pair or set to its value before the loss or (b) pay the difference between the Actual Cash Value of the property before and after the loss.

Glass Replacement

This condition is an exception to the exclusion for loss caused by enforcement of ordinances or laws. For safety purposes, many communities required that broken glass in storm doors or windows be replaced by safety glazing material such as tempered glass or plastics. Use of such materials can prevent injuries that occur when ordinary glass shatters. To encourage safety, the insurer agrees that if a glass door (or other glass subject to such a law) must be replaced following a covered loss, the insurer will pay the additional cost to meet the requirements.

Appraisal

The appraisal provision outlines the procedure for settling disputes between the insurer and the insured if they cannot agree about the amount of the loss. The insurer and the insured each select competent appraisers within 20 days of receiving a written request from the other. These appraisers then select an umpire. The 2 appraisers review the items in question and

set an amount of loss for each item. If the appraisers do not agree on the value of an item, the umpire is asked for an opinion. Agreement of 2 of the 3 persons will set a value for the amount of the loss. The final document setting the value of the contested item is called an Appraisal Award.

Other Insurance

If a loss covered by a Homeowners Policy is also covered by another insurance policy, the Homeowners Policy will contribute to the loss settlement on a **pro-rata** basis.

For the purposes of illustration, assume that a loss qualifies for payment under Coverage C of 2 Homeowners Policies. The calculation of each insurer's pro-rate share of the loss is a 2-step process. *First*, the Coverage C limits of the 2 policies would be added to find the sum of the Coverage C limits. *Second*, the Coverage C limit of each policy would be divided by the sum of the Coverage C limits. The result of this calculation, for each policy, is the percentage of loss the policy will pay.

Example: *assume that a loss is covered under policies A and B with coverage limits of \$10,000 and \$40,000 respectively. If the amount of the loss settlement were \$5,000, the pro-rate share of each insurer would be calculated as follows:*

$$\begin{aligned} \text{Sum of coverage limits} &= \\ \$10,000 + \$40,000 &= \$50,000 \end{aligned}$$

Insurer A's pro-rata share:

$$\begin{aligned} \frac{10,000}{50,000} \times \$5,000 &= \$1,000 \end{aligned}$$

Insurer B's pro-rata share:

$$\begin{aligned} \frac{40,000}{50,000} \times \$5,000 &= \$4,000 \end{aligned}$$

Suits against the Insurers

This condition sets a time of 1 year, or longer in some states, during which the insured may take legal action to settle a dispute with the insurer. It also requires the insured to comply with all other policy provisions before a legal action may be brought against the insurer. For instance, if an insured disputes the amount of a loss settlement offered by the insurer, the insured must follow the policy's appraisal provision before filing suit against the insurer.

Additional Loss Settlement Conditions

Insurer's Option - This condition gives the insurer the right, after providing written notice to the insured, to repair or replace any part of the damaged property with like property. Insurers are often able to purchase items from replacement services at costs lower than the insured would have to pay in the retail market. The result is that the insured is indemnified and the insurer has met its contractual obligation while producing loss settlement costs.

Loss Payment - This condition indicates who will be paid and when payment will be made. It is, with regard to the Section I Coverages, the insurer's promise. It states that payment will be made to the named insured unless the policy provides otherwise, or unless someone else is legally entitled to

receive payment. For instance, the "legal representative" of the insured following the insured's death. The loss settlement provisions are reinforced by the requirement that a proof of loss be filed by the insured. After the insured files the proof of loss, the insurer will pay within 60 days after reaching an agreement with the insured, receiving a final judgment (in a legal action), or following the filing of an appraisal award.

Abandonment of Property - This condition prohibits the insured from claiming that property damaged in a covered loss is automatically owned by and the responsibility of the insurer. The insurer has the option of paying for damaged items in full and then taking the item as salvage.

Mortgage Clause - Most insured dwellings are purchased with a mortgagee. In such cases, the name and address of the mortgagee (the lender) are shown on the policy declarations page. The Mortgage Clause provides that any loss payable under Coverage A or B will be paid to the insured and the mortgagee as their interest appear in the policy. In practice, insurers often draw a settlement check payable to both the insured and the mortgagee and the proceeds of the check are used to pay for repairs necessitated by the loss.

No Benefit to Bailee - When an insured delivers property to a bailee, the bailee's receipt may state that if the insured has valid insurance on the property and there is a loss, the bailee need not pay the insured.

Recovered Property - If either the insurer or the insured recovers stolen property, for which a loss payment has already been made, that party is required to notify the other of the recovery. The insured then has the option of accepting the recovered property and returning the loss payment to the insurer or giving the property to the insurer and keeping the loss payment.

Chapter 4 - Review Questions

1. The most widely used Homeowner Policy is:
 - A. HO-4
 - B. HO-6
 - C. HO-3
 - D. HO-2
2. The property coverages included in the HO-3 Policy would include all of the following except:
 - A. Dwelling Coverage
 - B. Definitions Coverage
 - C. Personal Property Coverage
 - D. Other Structures Coverage
3. "We will provide the insurance described in this policy in return for the premium and compliance with all applicable provisions of this policy." is an example of:
 - A. insuring agreement
 - B. a definition
 - C. an exclusion
 - D. none of the above
4. Coverage B Limit of Liability is automatically set at what percentage of the amount of insurance for Coverage A (unless the insured purchases a higher amount of insurance):
 - A. 40%
 - B. 30%
 - C. 20%
 - D. 10%
5. Coverage C protects:
 - A. dwelling
 - B. other structures
 - C. personal property
 - D. all of the above

ANSWERS

1. C
2. B
3. A
4. D
5. C

Chapter 5 – Homeowners Insurance for Owners of Condominium Units

Section II – Liability Coverages

"The only thing that stands between man and what he wants from life is often merely the will to try it and the faith to believe that it is possible."
Richard M. DeVos

Introduction

Insurance for tenants represents an important market. The number of apartment dwellers is already large increasing for a number of reasons: the high price of single family homes has forced many younger people to postpone home ownership and to continue renting apartments; there are older people who move to apartments from large single-family homes and workers who rent apartments in urban areas to avoid commuting.

Exposures

The 3 major types of Loss Exposures faced by tenants are Loss to Additions, Loss to Personal Property and Legal Liability.

Additions and Alterations - Property exposures for tenants include Additions and Alterations the tenants may have made in the dwelling itself. These Additions and Alterations may include new paneling or electrical fixtures that become part of the building and, as such, are real property. Such Additions and Alterations are sometimes referred too as "tenant's improvements and betterment".

Personal Property - Personal Property owned by the tenant represents the most significant Property Exposure. Personal

Property includes such items as furniture, bedding, clothing, televisions, videocassette recorders, stereos and record tape collections. Such items often are referred to as *contents*.

Legal Liability - Tenants have a Premises Liability Exposure for people who enter there home. **Example:** *a guest may be injured after tripping over a loose carpet in an apartment and may seek damages on the basis of Negligence Liability.* Apartment dwellers also have a Liability Exposure for injuries to other tenants and damage to the property of other tenants or the owner of the apartment building. **Example:** *If an apartment dweller allows a bathtub to overflow, the water may damage the contents of the apartment below and the apartment building itself, resulting in liability actions against the forgetful tenant.* Finally, tenants face Legal Liability Exposure that arises out of their off-premises activities, such as golf or hunting.

HO-4 Contents Broad Form

The HO-4 Policy is a combination of Property and Liability Coverages designed for apartment renters and other tenants. Discussed below are HO-4 Eligibility, a Comparison of the HO-4 Section I to the HO-3 Section I and HO-4 Endorsements.

Eligibility - A tenant of either a single-family residence or an apartment is eligible for the HO-4. There is no limit on the number of units in the apartment building, although the number of units affects the rate.

The owner-occupant of a dwelling, cooperative unit or apartment building that is not otherwise eligible for one of the Other Homeowner Policies also may purchase a HO-4. **Example:** *a person might own a five-unit apartment building, reside in one of the units and rent the other four. Such occupancy would not be eligible for a HO-3 for his/her unit. Commercial Coverage would be purchased to provide coverage for the Property and Liability Exposures represented by the apartment building itself.*

Comparison of Section I of the HO-4 and HO-3 - Since the HO-4 provides insurance for tenants; the policy does not include coverage for the dwelling and other structures provided by Coverages A and B of the HO-3. Such coverage is not needed in the HO-4 because the tenant does not have an insurable interest in the building.

The Limit of Liability for Coverage C - Personal Property in the HO-4 is the primary limit for Property Coverage. In the HO-3, the Limit of Liability for Coverage A determines the limits for the other coverages. There is no other difference in Coverage C between the two policies.

Under the HO-4, the Limit of Liability for Coverage D, Loss of Use is 20% of the Coverage C limit and coverage applies if a peril insured under Coverage C makes the residence uninhabitable. Under the HO-3, the Limit of Liability for Coverage D is 20%

of the limit for Coverage A and applies to loss of use resulting from a peril covered by Coverage A. In all other respects, Coverage D is the same under both policies. There are three differences in the additional coverages provided by the two policies. First, the limit in the HO-4 for trees, shrubs and other plants is 10% of the Coverage C limit. The limit for such property in the HO-3 is 5% of the Coverage A limit.

Second, both policies will pay up to \$1,000 for the insured's share of a loss assessment. The HO-4 pays for loss assessment that results from a peril insured against under Coverage C and the HO-3 pays if the loss assessment results from an insured peril under Coverage A. (Neither policy pays if the loss assessment results from earthquake or volcanic eruption). Since Coverage A of the HO-3 insures against risks of direct losses that are not otherwise excluded, the coverage for loss assessment under the HO-3 is broader than that provided by the HO-4.

Third, the HO-4 covers building additions and alterations. Coverage is provided for building improvements or installations, made or acquired at the insured's expense, to that part of the residence premises used exclusively by the named insured; this coverage represents additional insurance and has a Limit of Liability equal to 10% of the Coverage C limit. There is no corresponding coverage in the HO-3 but the coverage for landlord's furnishings in the HO-3 is not provided by the HO-4.

Because the HO-4 does not cover the dwelling and other structures, the perils insured against exclusions and conditions are different in the two policies. The

insured perils in the HO-4 apply only to Coverage C but they are the same perils insured under Coverage C of the HO-3. The corresponding section in the HO-3 also lists the perils that are excluded with regard to Coverages A and B. The HO-4 does not contain the concurrent causation exclusions that are in the HO-3.

The loss settlement condition in the HO-4 states only that losses are settled on the basis of actual cash value at the time of loss, but the settlement cannot be more than the amount to repair or replace the property. The loss settlement condition in the HO-3 is much more complex because of the replacement cost coverage on the dwelling and other structures. The HO-4 also does not contain the mortgage clause included in the Section I - Conditions of the HO-3.

HO-4 Endorsements

Most of the endorsements discussed in the next chapter can be used with the HO-4. However, the two Endorsements discussed below apply specifically to the Loss Exposures of tenants.

Building Additions / Alterations (HO-4-51) - as an additional coverage, the HO-4 insures Building Additions and Alterations that a tenant has installed. The Limit of Liability is 10% of the Coverage C limit but a person who has made substantial alterations to a rented unit is likely to require a higher limit. The HO-4-51 Endorsement increases the Limit of Liability for the insured's Building Additions and Alterations for an additional premium. To avoid ambiguity, the Endorsement shows, both, the increase in the Limit of Liability and the total Limit of Liability.

Waterbed Liability - Many landlords require proof of Liability Insurance before completion of lease arrangements for a tenant with a waterbed. A number of insurers have filed Waterbed Liability Endorsements for use with the HO-4 to meet this need. For an additional premium, the endorsement provides coverage for liability arising out of an insured's ownership or use of a waterbed on the residence premises.

Insurance for Unit Owners

Many homeowners do not reside in one-or-two family dwellings. A special form of Homeowners Insurance is available for owners of condominium units and cooperative apartments.

Condominiums and Cooperative Apartments - Condominium ownership has two distinguishing characteristics. First, each unit owner has individual ownership and the right to exclusive occupancy of his or her unit. The *unit* is commonly defined as *the space between the walls, ceiling, and floor*. This is called the bare walls definition of exclusive ownership. Sometimes the unit owner is also responsible for parts of the unit beyond the bare walls such as exterior glass or a lean-to porch. The unit owner's responsibilities are usually outlined in the Condominium Agreement and Bylaws. As defined in the condominium agreement, the unit is an area of space. The unit owner may occupy, sell, lease or will that space.

Second, each unit owner also has an undivided interest with the other members of the condominium association in the common areas of the property. Common areas include the land, stairways, halls, parking

and storage areas and the heating and cooling systems. Usually the condominium complex is managed by an Association of unit owners.

The owner of a cooperative apartment does not own the individual unit, as is the case with a condominium. Instead, the owner has an ownership interest in the Cooperative Association or Corporation that owns all of the units. As a consequence of that ownership, the cooperative apartment owner has a right to a perpetual lease to occupy a specific unit.

Particularly in urban areas, both condominiums and cooperative apartments have become increasingly popular. Both young couples and older people prefer ownership of such units because of their convenient urban locations and because the owners do not have to perform their own maintenance.

Exposures

The 3 major Loss Exposures for unit owners are Loss to Real Property, Loss to Personal Property and Legal Liability.

Real Property - Real Property Exposures for the unit owner include alterations, appliances, fixtures and improvements that are part of the residence premises. The residence premises consist of that part of the area occupied exclusively by the unit owner. This would include any patio, yard or parking area adjacent to the unit portion of the building occupied exclusively by the unit owner. The real property exposure also includes the common areas of the property. This exposure is usually insured in a separate policy by the condominium or cooperative association.

Personal Property - The Personal Property Exposures of the unit owner are similar to those of a tenant. The unit owner's personal property may include furniture, clothing, television, stereo equipment, books, records, compact discs and tapes. Any appliances not considered part of the building structure would constitute personal property. Carpets and rugs that are placed over finished floors could be considered personal property, while wall-to-wall carpeting installed over a rough sub-floor or concrete slab is considered part of the building.

Legal Liability - The Legal Liability Exposure for the unit owner include all of those previously discussed for tenants. The unit owner's interest in the common areas carries with it a corresponding Legal Liability Exposure for events that occur in/on those areas. This **Common Areas** Liability Exposure usually is covered in a separate policy obtained by the Condominium Association or the Cooperative Apartment Ownership Association or Corporation. A loss assessment can be collected from all unit owners to pay the damages.

HO-6 Unit Owners Form

The HO-6 is designed to meet the unique insurance requirements of owners of condominium units and cooperative apartments. The Property Coverage provided is for the insured's dwelling, as well as, for Personal Property and Loss of Use.

Eligibility for the HO-6

An owner-occupant of a residential condominium unit or a cooperative apartment is

eligible for a HO-6 regardless of the number of units in the complex. Since the residence premises are defined as the unit where the insured resides, the unendorsed HO-6 cannot be used to insure a unit owned by the insured but rented or leased to others.

Comparison of Section I of the HO-6 and HO-3

The following paragraphs describe the difference in the property coverage provided by the HO-6 and the HO-3. The primary difference is the coverage provided for the insured's dwelling.

Coverage A - Dwelling - Coverage A of the HO-6 applies to the insured's real property. This coverage is provided on a named-perils basis and is separated into four categories. The *first* category includes the alteration, appliances, fixtures and improvements that are part of the building contained within the residence premises. This usually includes built-in appliances and cabinets, electrical fixtures, interior partitions.

The *second* category relates to items of real property that pertain exclusively to the residence premises, including such items as exterior glass or trees and shrubs located in a patio that is part of the residence premises. In addition, although it is in excess of the association's coverage, the coverage provided would apply to any part of the owner's portion of the building itself in the event that the association's limits proved to be inadequate.

The *third* category includes property that is the responsibility of the unit owner under an agreement of a Corporation or Association

of Property Owners. Insurance for this category of property provides coverage for any portion of the common areas of the building for which the Association Agreement has made the unit owner responsible for the insurance.

The *fourth* category of property relates to structures owned solely by the insured at the location of the residence premises but is not a part of the residence premises. An example would be a private garage that was not adjacent to the residence premises but located elsewhere in the condominium complex.

An additional difference between Coverage A of the HO-6 and the corresponding coverage in the HO-3 is that the HO-6 provides no coverage for building materials and supplies.

Coverage A of the HO-6 does not cover structures used in whole or in part for business, or structures rented to others unless used solely as a private garage. A similar exclusion is found under Coverage B of the HO-3. This illustrates the fact that Coverage A of the HO-6 combines Coverages A and B of the HO-3.

The HO-6 does not include a Coverage B.

The basic Limit of Liability under Coverage A of the HO-6 is \$1,000. This can be increased if necessary. If the association policy is written on a *bare walls* basis, the Coverage A of the HO-6 would have to provide coverage for the entire interior or the unit, including all fixtures, built-in appliances and, in a multi-story unit, the floors, stairs and ceilings between the lowest floor and the highest ceiling in the unit. This

is why it is important to review the Condominium or Cooperative Association's Coverage to determine if the basic limit for Coverage A of the HO-6 is adequate.

Coverage C - Personal Property - Coverage C provides the same coverage as the corresponding section of the HO-3. The difference is that the usual amount of Coverage C of the HO-3 is based upon the Limit of Liability for Coverage A. In the HO-6, the insured selects the Limit of Liability for the Coverage C.

Coverage D - Loss of Use - The Limit of Liability for Coverage D in the HO-6 is 40% of the Coverage C limit. Coverage is provided for a loss caused by an insured peril to the covered property or to the building containing the property, which makes the residence premises not fit to live in.

Additional Coverages - Additional coverages in HO-6 differ from the HO-3 in two ways:

1. In the HO-6, the coverage for trees, shrubs and other plants is 10% of the Limit of Liability for Coverage C.
2. In the HO-3, the corresponding Limit of Liability is 5% of the Coverage A limit. In addition, the HO-6 does not include the coverage for landlord's furnishings provided by the HO-3.

Perils Insured Against

The covered perils in the HO-6 are virtually identical to the perils insured against under Coverage C of the HO-3. Thus, the HO-6 covers loss to the insured's dwelling only if

the loss is caused by the specified perils. Under HO-3, the insured's dwelling is covered for risks of direct loss that are not otherwise excluded.

Exclusions

Because the HO-6 is written on a named-peril basis, the Section I-Exclusions does not contain the current causation exclusions of the HO-3. In all other respects, the Section I-Exclusions of the two policies is virtually identical.

Conditions

The only difference between the HO-3 and HO-6 with respect to the Section I-Conditions is found in the Loss Settlement paragraphs. In the HO-6, Real Property under Coverage A is covered at the actual cost to repair or replace, if the damage is repaired or replaced within a reasonable time. In the HO-3, Replacement Cost Coverage is provided for buildings insured under Coverages A and B, subject to an 80% insurance-to-value requirement.

HO-6 Endorsements

Just as certain endorsements relate specifically to the exposures of tenants insured by the HO-4, there are endorsements to the HO-6 that further tailor the policy to meet the needs of unit owners. Five of these endorsements are discussed below.

Unit Owners Coverage A- Special Coverages (HO-17-32) - This endorsement can be used to change Coverage A of the HO-6 to provide coverage for risks of direct loss. When this endorsement is used, the perils

insured under Coverage A of the HO-6 become identical to the insured by the HO-3.

The HO-17-32 endorsement also adds the concurrent causation exclusions that are otherwise omitted under the HO-6. This reflects the fact that concurrent causation is a problem only when policies provide coverage for risks of direct loss.

Unit-Owners Rental to Others (HO-17-33)

- This endorsement provides Property and Liability Coverage for the unit owner while the resident premises is regularly rented or held for rental to others. Theft coverage is provided for Personal Property in a rented condominium but high-value items such as money, securities, jewelry, watches and furs are excluded. The HO-17-33 Endorsement also provides Liability and Medical Payments Coverage on behalf of the unit owner for occurrences at or from the resident premises when rented or held for rental to others.

Loss Assessment Coverage (HO-04-35)

- For an additional premium the HO-04-35 endorsement increased the Limit of Liability for the additional coverages for Loss Assessment provided in Section I and Section II. For an additional premium, the insured's share of coverage loss assessment at additional locations can be covered. These additional locations must be listed on the face of the endorsement. Coverage for an assessment that results from a deductible in the insurance purchases by a Corporation or Association of Property Owners is limited to \$1,000.

A review of the Unit Owner's Deed, the Condominium Declarations (also known as

the Master Deed) and the Condominium Association Bylaws will define the common areas. It is for damage to these areas that the unit owner will be assessed in the event of a covered loss. By determining the current coverage carried by the Association, the value of these areas, the possibility of damage to more than one of these areas in one loss, and the number of unit owners who will be assessed, the individual unit owner can determine if his/her exposure is greater than the \$1,000 provided by the unendorsed HO-6. If the exposure is greater than \$1,000, the HO-4-35 endorsement should be considered.

Loss Assessment Coverage for Earthquake (HO-04-36)

- This endorsement provides coverage for a Loss Assessment made against the unit owner by a Corporation or Association of Property Owners due to the peril of earthquake. Loss assessments charged against the unit owner of a Corporation or Association of Property Owners by any governmental body is not covered. Flood and tidal waves are also excluded.

This coverage is subject to a percentage deductible based upon the Limit of Liability for the unit; the percentage is stated in the endorsement. The deductible amount will not be less than \$250 in any one assessment.

Unit-Owners Coverage C, Special Coverage (HO-17-31)

- This endorsement changes the HO-6 to provide for risks of direct loss to property insured under Coverage C, the insured's Personal Property. The typical exclusions that apply to this type of coverage are listed in the endorsement (the exclusions are similar to those for

Coverage A of the HO-3). Coverage is provided under the HO-17-31 endorsement with the understanding that the insured occupies the unit in which the covered property is located.

Section II - Liability Coverages

Homeowners Policies meet both the Property and Liability Exposures of a wide range of insured. The Section I coverage discussed up to this point provides protection against direct losses to property and the loss of use of that property. The next part of this chapter is devoted to Section II of the Homeowners Policy, which Provides Liability Coverage for Personal Loss Exposures. Section II is uniform among all of the Homeowners Policies.

Types of Losses Covered

Section II of the Homeowners Policies covers bodily injury and property damage for which the insured is legally liable. Coverage is also provided for medical expenses incurred because of bodily injury to others.

Coverage E - Personal Liability - Coverage E provides Liability Coverage if a claim is made or suit is brought against an insured because of bodily injury or property damage caused by a covered occurrence. Coverage E provides a basic Limit of Liability of \$100,000 for damages, which may be increased for an additional premium. Damages include prejudgment interest awarded against the insured. Costs of investigating claims and defending against lawsuits are not included in the liability limits but are paid in addition to any payments made for damages.

The coverage statement for Coverage E incorporates many of the terms set forth in the policy's definitions section. The term *bodily injury* means *bodily harm, sickness, or disease, including required care, loss of services and death that may result*. The term *property damage* is defined as *physical injury to, destruction of, or loss of use of tangible property*.

This coverage is on an "occurrence basis". *Occurrence* means *an accident, including continuous or repeated exposure to substantially the same general harmful conditions, which results in bodily injury or property damage during the policy period*.

Coverage E provides Liability Protection for the named insured and members of the named insured's household who are relatives. Other persons under the age of 21 who are in the care of a household member are also covered. With respect to animals or watercraft to which the policy applies, coverage is extended to any persons or organizations legally responsible for animals or watercraft that are owned by a household member. With respect to any vehicle which the policy applies, coverage is provided for any person employed by the named insured or a family member and other persons using the vehicle on a covered location with the insured's consent.

An important part of Coverage E is Premises Liability Coverage. The policy defines an insured location to include not only the residence premises but also other premises used by an insured as a residence, permanently or temporarily. The definition of an insured location also includes *vacant land owned by the insured, cemetery plots, and any part of*

a premises occasionally rented to an insured for other than business purposes.

Examples: *a neighbor's child who ran into a closed sliding glass door at the insured's home and was injured. Other occurrences that might result in a Premises Liability Claim could include a neighbor's child drowning in the insured's swimming pool or a passerby being bitten by the insured's "friendly" dog.*

In addition to the Premises Liability Coverage, Coverage E provides Liability Protection for off-premises, non-business activities of the insured. Off-premises occurrences include sport and hobby accidents. **Example:** *while playing baseball with friends, the insured may injure another player by throwing the bat in the excitement of getting a hit.*

Coverage E also provides defense for liability suites even if the suit is groundless, false or fraudulent. The duty to defend on the part of the insurance company is broader than the duty to indemnify. Therefore, if there is doubt about coverage, the insurer often will defend the case but reserve its rights to withdraw from the defense if it determines that the occurrence is not covered.

The insurer may investigate and settle any claim or suit that it decides is appropriate without the permission of the insured. The insurer's duty to defend ends when the amount paid for damages resulting from the occurrence equals the Limit of Liability.

Coverage F - Medical Payments To Others
- Coverage F will pay the necessary medical expenses that are incurred or medical

expenses ascertained within three years from the date of the accident causing bodily injury. Coverage applied to accidents that occur on the insured premises or as the result of an action by the insured at any location. The basic limit under Coverage F is \$1,000 per person but the insured may select a higher limit. By prompt payment of physicians and hospital bills for an accident, for which the insured might be responsible, troublesome litigations often can be avoided.

Coverage F is not intended to provide accident insurance for the named insured's family. Therefore, any insured under the policy is excluded from coverage.

Exclusions to Coverages E and F

The Liability Coverage in Section II provide broad protection for the insured, however, the exclusions in Section II limit or eliminate coverage for specified types of occurrences. Some of the exclusions apply to both Coverage E and F; others apply only to Coverage E or Coverage F. The following exclusions are applicable to Coverages E and F:

- X expected or intended injury or damage
- X insured's business
- X premises rented or held for rental
- X professional services
- X non-insured locations
- X motor vehicles
- X water craft
- X war
- X aircraft
- X communicable disease
- X abuse or sexual molestation
- X controlled substances
- X home day-care (excluded by endorsement in most states)

These exclusions are described in the following paragraph. The exclusions relating to the non-insured location, motor vehicles, water crafts and aircraft do not apply to bodily injury to a residence employee if the injury arises out of or in the course of employment by an insured.

X **Expected or Intended Injury or Damage** - Bodily injury or property damage that is expected or intended by the insured is excluded. **Example:** *an insured breaking a window in a neighbor's house following an argument.*

X **Insured's Business** - Bodily injury or property damage arising out of or in connection with a business engaged in by an insured is excluded. The Homeowners Policy is intended to provide only Personal Liability Coverage. Business activities must be covered under an appropriate lines policy.

X **Premises Rented or Held for Rental** - There is no coverage for liability arising out of the rental or holding for rental of any part of any premises by an insured. However, this exclusion does not apply to rental of an insured location:

1. on an occasional basis if used only as a residence
2. In part for use only as a residence unless more than 2 roomers or boarders are lodged in a single family unit.
3. In part as an office, school, studio or private garage.

X **Professional Services** - Liability arising out of the rendering of, or failure to render, professional services is excluded. Professional services would include, i.e., the services of an insurance agent, physician, nurse, engineer or architect.

X **Non-Insured Locations** - An insured location is defined in the definition section as noted above. The policy excludes coverage for liability arising out of any premises owned, rented, or rented to others by an insured that is not an insured location as defined in the policy. Premises, other than the residence, that the insured uses as a residence must be shown in the declarations or acquired during the policy period in order to be considered an insured location. It is important for the insured to list all owned and rented locations in the policy declarations.

X **Motor Vehicles** - With a few exceptions, Homeowners Policies exclude coverage for liability arising out of an insured's use of a motor vehicle or motorized land conveyance, including trailers. The policy does not define "motor vehicle" but in most states the term is defined by law for motor vehicle registration, it is considered to be a motor vehicle. Notice that the exclusions are broader than motor vehicles and apply to any motorized land conveyance.

With regard to the vehicle described above, Homeowners Policies provides no coverage for liability arising out of their ownership, maintenance use, loading or unloading or entrustment to another person. Also excluded is Vicarious

Liability, whether or not statutorily imposed, for the actions of a child or minor, with regard to such a vehicle. This Exclusion applies to any vehicle an insured owns, operates, borrows or rents. Liability resulting out of the use or ownership of motor vehicles and motorized land conveyance is covered under the following circumstances:

1. A trailer while it is not being towed by or carried on a motorized land conveyance.
2. A motorized land conveyance designed for recreational use off public roads, not subject to motor vehicle registration, which is not owned by an insured.
Example: *an unregistered snowmobile rented by an insured.* Liability arising out of the use of a similar vehicle owned by an insured is only covered while on an insured location.
3. A motorized golf cart when used to play golf on a golf course.
4. A vehicle or conveyance, not subject to motor vehicle registration, that is used to service an insured's residence, designed for assisting the handicapped or in storage on an insured location.
Example: of a covered vehicle for each category would be: *a garden tractor, a motorized wheel chair and an unlicensed antique car that the insured was rebuilding as a hobby. If the antique car went into operation after it was rebuilt, Homeowners Liability Coverage would be excluded.*

This limited coverage applies to the named insured, resident relatives and

employees of the insured on and off the insured's premises. Coverage for others using one of the above vehicles with the insured's permission applies only on the insured's premises.

- X **Watercraft** - The policy excludes certain defined watercraft. The exclusion applies to the ownership, maintenance, use, loading, or unloading of this watercraft. Similarly the entrustment by an insured of such a watercraft to any person is excluded. The exclusions extend to vicarious liability, whether or not imposed by statute, for the actions of a child or minor using such watercraft. The watercraft exclusions do not apply while the watercraft is stored.

Excluded watercrafts are boats that are designed to be propelled principally by engine power, electric motor or sailing vessels that are owned by or rented to an insured. Therefore, the following types of watercraft are among those excluded:

1. Inboard or inboard outboard powerboats owned by an insured.
2. Boats with inboard or inboard outboard motor power of more than 50 horsepower that are rented to an insured.
3. Boats powered by one or more outboard engines or motors of more than 25 total horsepower, provided the engines or motors are owned by an insured.
4. Sailing vessels with or without auxiliary power that are 26 feet or more in length and are owned by or rented to an insured.

- X **Aircraft** - The ownership, maintenance, use, loading, and unloading of an aircraft is excluded. As with moving vehicles and watercraft, the aircraft exclusion extends to the entrustment of an aircraft by an insured to any person or vicarious liability, whether or not imposed by statute, for the action of a child or minor using an aircraft.
- X **War** - Homeowners Policies exclude bodily injury, property damage caused directly or indirectly or as a consequence of war. The definitions of war include civil war, insurrection, rebellion, revolution, warlike act by a military force or military personnel, destruction or seizure, use for a military purpose, discharge of a nuclear weapon. These are deemed to be war-like acts, even if it is accidental and is excluded.
- X **Communicable Disease** - Bodily injury or property damage that arises out of the transmission of a communicable disease by an insured is excluded. This Exclusion responds to a series of court decisions that found coverage in the Homeowners Policy for the insured's liability for damages as the result of infecting another person with the herpes virus. Such coverage was never contemplated by homeowner's actuaries when setting the rates for the policy and this exclusion makes that intent clear.
- X **Abuse or Sexual Molestation** - Liability or bodily injury or property damage arising out of sexual molestation is excluded. Also excluded is liability resulting from corporal punishment and physical or mental abuse.
- X **Controlled Substances** - Homeowners Policies also exclude liability for bodily injury or property damage arising out of the use, sale, manufacture, delivery, transfer or possession of a controlled substance. This includes, but is not limited to, cocaine, marijuana, LSD and all other narcotic drugs. This exclusion **does not apply** to the legitimate use of prescription drugs by a person following the orders of a licensed physician.
- X **Home day-care** - Coverage for a Home Day-care Business is limited under Section I and excluded under Section II. To emphasize that there is no coverage for liability arising out of a Home Day Care Business, most states require insurers to add the HO-04-86 Endorsement to Homeowners Policies. This endorsement does not constitute a reduction of coverage, but it represents a clarification of certain exclusions pertaining to Home Day Care Business. The Endorsement states that if an insured regularly provides home day-care services to a person or persons other than the insured and receives monetary or other compensation for such services, that enterprise is a business. However, the rendering of Home Day Care Services by an insured to a relative of an insured is not considered a business.

The Endorsement points out that since Home Day Care conducted for compensation is a business; there is no Liability Coverage whatsoever because of the business exclusion discussed above. Further, the HO-04-96 endorsement highlights the Section I exclusion pertaining to other

structures under Coverage B, where the other structures are used in whole or in part for business. The Endorsement also states that the Section I limits of \$2,500 on business property on the residence premises and \$250 off the residence premises also apply to the Home day-care Business.

Exclusions to Coverage E

The exclusions to Coverage E - Personal Liability restrict or eliminate coverage provided for Bodily Injury or Property Damage. These exclusions apply to the following:

- X Loss Assessment
- X Property Owned by the Insured
- X Property in the Care, Custody or Control of the Insured.
- X Bodily Injury Covered by Compensating Law
- X Nuclear Liability
- X Bodily Injury to an Insured

The exclusions applicable to Coverage E are described in the following paragraphs.

Loss Assessment - If a condominium association were found liable, coverage would have to be found on the association's own policy and not the Homeowners Policies of the individual members. An Association of Owners of single-family dwellings could be exposed to a similar liability situation with respect to their individual Homeowners Policies. Reimbursement of certain loss assessments is provided as an additional coverage.

Property Owned by the Insured - Property owned by the insured is excluded from Property Damage Liability Coverage under

Coverage E. Coverage for damage to the insured's property is provided under Section I.

Care, Custody or Control - The care, custody or control exclusion is found in virtually all Liability Policies. Damage to property rented to, occupied or used by, or in the care of the insured is excluded. This exclusion does not apply to property damage caused by fire, smoke or explosion. Therefore, Liability Coverage is provided for a tenant insured by a HO-4 who is found to be responsible for a fire that destroys the apartment building.

Bodily Injury Covered By Compensation Law - The policy excludes bodily injury to any person eligible to receive any benefits either voluntarily provided or required to be provided by the insured under a Compensation Law. The exclusion applies to benefits payable under Workers Compensation, Non-occupational Disability, or Occupational Disease Laws.

Nuclear Liability - Bodily injury or property, for which an insured is covered under the Homeowners Policy, is also an insured under a Nuclear Energy Liability Policy is excluded. This exclusion also applies in the case where the insured would have been an insured under a Nuclear Energy Liability Policy is issued by American Nuclear Insurers, Mutual Atomic Energy Liability Underwriters and the Nuclear Insurance Association of Canada.

Bodily Injury to an Insured - There is no Liability Coverage for claims arising from bodily injury to an insured resident of the household. This exclusion applies to the

named insured, related residents of the same household and other persons in their care who are under the age of twenty-one.

Exclusions to Coverage F

Coverage for medical payments to others is restricted or eliminated by the following exclusions that apply only to Coverage F:

- X residence employee off-premises
- X bodily injury covered by Compensation Law
- X nuclear reaction, radiation or contamination
- X other regular residents

Residence Employee Off-Premises - Medical payment coverage is not provided in the case of bodily injury that is suffered by a residence employee while off the insured location unless the injury arises out of, or in the course of, employment by an insured. This emphasizes the fact that certain exclusions to Coverages E and F (discussed earlier) do not apply to residence employees who suffer bodily injury arising out of and in the course of employment for the insured.

The phrase "*for the insured*" is important. A part-time gardener who works once a week for the insured might be injured in the course of ordinary employment while working at someone else's house. Coverage would not be provided under the insured's policy because the injury, while arising out of the course of employment, did not arise out of employment for the insured. If the injury occurred while the gardener was purchasing seed for the insured at a hardware store, then coverage would apply.

Bodily Injury Covered By Compensation Law

- This exclusion is broader than the corresponding exclusion applicable to Coverage E, which refers to benefits voluntarily provided, or required to be provided, by the insured. The Coverage F Exclusion refers to benefits voluntarily provided, or required to be provided, under any Workers Compensation, Non-Occupational Disability or Occupational Disease Law. Thus, Coverage F Exclusion applies to anyone coming under the Coverage of such a law, regardless of who provides, or is required to provide, the coverage.

The Nuclear Exclusion - Medical payments coverage does not apply to bodily injury arising from any nuclear reaction, radiation or radioactive contamination. This exclusion applies whether the reaction, radiation or contamination was controlled or uncontrolled and however it was caused. Any consequences of such an occurrence are also excluded.

Other Regular Residents - Medical Payments Coverage is not provided for bodily injury to any person, other than a resident employee, regularly residing on any part of the insured location. This parallels the Coverage E Exclusion that applies to members of the insured's household.

Additional Coverages

Section II of the Homeowners Policy also provides four additional coverages related to an insured's liability exposures. Any amounts paid under these additional coverages are in addition to the Limits of Liability shown on the declarations page for Coverage E and F. Subject to certain limitations, coverage is provided for the following:

- X Claim Expenses
- X First Aid Expenses
- X Damage to Property of Others
- X Loss Assessment

Claim Expenses - Defense costs are considered Claim Expenses and include those expenses incurred by the insurer and costs taxed against an insured in any case the insurer defends. These defense costs can be considerable and include the expenses of claim adjusters, defense, attorneys, investigators and expert witnesses. These Claim Expenses represent additional coverage beyond the Limit of Liability and do not count against it. Therefore, there is no upper limit to the amount of Claim Expenses that might be paid under the policy. Other claim expenses that are paid include the following:

1. Premiums on bonds required in a suit defended by the insurer but not for bond amounts that are more than the Limit of Liability for Coverage E.
2. Up to \$50 per day for expenses incurred by an insured, at the insurer's request, while assisting in the investigation or defense of a claim or suit. The reasonable expenses include actual loss of earnings but not loss of other income.
3. Post judgment interests prior to the time the insurer tenders or deposits in court that part of the judgment that does not exceed the applicable Limit of Liability.

First Aid Expenses - Coverage is provided to pay expenses for first aid to others incurred by an insured for bodily injury

under the policy. This coverage does not extend to the named insured or any other insured. This additional coverage is separate from any medical payments made under Coverage F and has no limits stated in the policy.

Damage to Property of Others - Replacement Cost Coverage is provided at \$500 per occurrence for property damage to the property of others caused by an insured. This coverage is excess insurance over any amount recoverable under Section I of the policy.

Property Damage to Property Owned by an insured is excludable from this coverage. This additional coverage also does not pay for property damage:

1. Caused intentionally by an insured who is thirteen years of age or older.
2. To property owned by, or rented to, a tenant of an insured or a household resident.
3. Arising out of a business engaged in by an insured.
4. Arising out of any act or omission in connection with premises owned, rented or controlled by an insured other than an insured location.
5. Arising out of the ownership, maintenance, use of aircraft, watercraft, motor vehicles or other motorized land conveyances. A motorized land conveyance designed for off-road recreational use, not subject to motor vehicle registration and not owned by an insured, is exempt from this exclusion and, therefore, would be covered.

Loss Assessment

The HO Policy will pay up to \$1,000 for the insured's share of any Loss Assessment charged by a Corporation or Association of Property Owners under certain conditions. The assessment must be made as a result of bodily injury or property damage to which Section II of the policy would apply, or for liability for an act of a director, officer, or trustee acting in that capacity. The coverage for Loss Assessment resulting from acts of a director, officer, trustee of the Corporation or Association of Property Owners is provided only if that director, officer, or trustee is elected by the members of the Association or Corporation and serves without pay.

This coverage is limited to Loss Assessment charged against the insured as owner or tenant of the residence premises. Loss Assessment charges against the insured or a Corporation or Association of Property Owners by a governmental body is excluded. Regardless of the number of assessments, the \$1,000 limit is the most that will be paid for loss arising out of one accident or one covered act of a director, officer or trustee (an act involving more than one director, officer, or trustee in a single act). The Loss Assessment Exclusion under Coverage E, discussed previously, does not apply to this coverage.

Conditions

Conditions under Section II are subject to certain policy conditions. These conditions are listed below and described in the following paragraphs:

- X Limit of Liability
- X Severability of Insurance
- X Duties after Loss

- X Duties of an Injured Person under Coverage F
- X Payment of Claim under Coverage F
- X Suit Against the Insurer
- X Bankruptcy of an Insured
- X Other Insurance under Coverage E

Limit of Liability - The Limit of Liability for Coverage E for all damages resulting from any one occurrence is the amount shown in the declarations regardless of the number of insureds, claims made or persons injured. **Example:** *assume that an insured's erotict golf shot. Damages payable is also restricted to the policy limit for a single occurrence, regardless of the number of insureds under the policy who are held liable. Therefore, if a husband and wife insured under an HO policy are each found liable for \$75,000 in damages resulting from a covered occurrence, and the Section II - Limit of Liability is \$100,000, the policy will pay only \$100,000 of the combined \$150,000 in damages.* In both of the above examples, defense costs would be paid in addition to the Limit of Liability.

The limit under Coverage F for all Medical Expenses for bodily injury to one person, as the result of one accident, is shown in the declarations. The basic limit is \$1,000, therefore, in the case of the two injured golfers; each would be eligible for separate \$1,000 limits under Coverage F, while the occurrence would be subject to a single limit of \$100,000 under Coverage E.

Severability of Insurance - Insurance in a HO Policy applies separately to each insured. The concept of Severability of Insurance can be illustrated by a New Hampshire case in which the seventeen-year old son of an insured allegedly assaulted

another minor. The parents of the insured child sued both the son and his parents, alleging that the parents, through their neglect, allowed the assault to occur. The insurer denied coverage for both the son and his parents, relying on the exclusion regarding "bodily injury...which is expected or intended by the insured". The court agreed that there would be no coverage for the son because coverage of intentional acts is excluded. However, the court found that there would be coverage for the parents because the suit alleging their negligence would not be affected by the exclusion that applied to their son. Because the policy required that the insurer responds to the suit against the parents, even though it does not respond on behalf of their son.

In some situations, both the named insured and another party for which the policy provides coverage may be sued for different actions or omissions that result in one occurrence. **Example:** *an insured loaned a canoe to a local scout troop. The policy would provide liability coverage on the canoe. If a scout was injured while using the canoe, the scout could make a claim against the named insured, alleging poor maintenance of the canoe and against the scout troop, alleging improper supervision of the use of the canoe. The insurer would respond on behalf of both the insured and the scout troop. However, the limits of liability would not be increased even though two separate insureds were involved.*

Duties After Loss - In case of an accident or occurrence, the insured has certain duties. Not all of these duties will necessarily apply to a given occurrence. The insured's Duties after a Loss are as follows:

1. To give written notice to the insurer or its agent as soon as practical, setting forth the identity of the policy and name of the insured. The notice should also include reasonable available information on the time, place and circumstances of the accident or occurrence and the names and addresses of any claimants and witnesses.
2. To promptly forward to the insurance company every notice, demand, summons, or notice of suit frequently has a time limit during which an answer may be entered. Failure to answer will result in a default judgment. Therefore, the claimant might prevail with a groundless suit.
3. To assist the insurance company, at its request, to make settlement and to enforce any right of contribution of indemnity against any person or organization who might be liable to an insured. The insured must also assist with the conduct of suite by attending hearings and trials, by securing and giving evidence and obtaining the attendance of witnesses. This section asks the insured to cooperate vigorously in the defense of any suit, just as the insured would if there were no insurance available.
4. When claims are made for damage to the property of others, the insured, at the insurer's request, must submit a sworn statement of loss within 60 days after the loss. If the damaged property is still in the insured's control, it must be shown to the insurer on request.

5. The insured must not voluntarily make payment, assume obligation, or incur expense other than for first aid to others at the time of bodily injury. Any other voluntary payment or assumption of liability on the part of the insured is at his/her expense.

Duties of an Injured Person Under Coverage F - Under Coverage F - Medical Payments to Others, the injured person, or someone acting for that person, must send the insurer a written proof of claim as soon as is practical. The insurer may require the proof of claim to be written under oath. The injured person must also authorize the insurer to obtain copies of medical reports and records. The final duty for the injured person is to submit to a physical exam by a doctor selected by the insurer when and as often as is reasonable.

Payments of Claim Under Coverage F - When a claim is paid under Coverage F, medical payments to others, such payment does not constitute an admission of liability by an insured or the insurer. Medical payments claims are often paid in situations where the insured feels a moral obligation to a guest or other person on his/her premises although no legal liability exists. This provision points out that payment under Coverage F does not mean that the claimant can automatically collect under Coverage E.

Suit Against Insurer - The *first* provision of this condition states that no legal action can be brought against the insurer unless there has been compliance with the policy provisions.

The *second* provision states that no one has the right to add the insurer as a party to any action against an insured. This means that a claimant, or a co-defendant involved in a lawsuit against the insurer, cannot name the insurer as a party to that lawsuit.

A jury might be swayed by its decision regarding the award of damages by knowing that an insurance company, rather than the individual defendant, was responsible for payment.

A *third* provision states that no action with respect to Coverage E can be brought against the insurer until the obligation of the insured has been determined by a final judgment or an agreement signed by the insurer. An action may be brought at that time to compel the insurer to pay.

Bankruptcy of an Insured - Bankruptcy or insolvency of an insured does not relieve the insurer of its obligations under the policy. Recall that Section II - Coverages is designed to pay damages for which the insured is legally liable. An insured that is bankrupt is not likely to be able to pay damages for which he/she may be liable. As a matter of social policy, liability insurers have assumed the obligation of paying-covered liability damages on behalf of the insured, even though, in the absence of insurance, the insured could not pay the damages because of personal bankruptcy.

Other Insurance - Coverage E - Coverage E - Personal Liability is excess over any other valid and collectible primary insurance. This provision does not apply with respect to insurance specifically written

as excess over the limits of liability provided by the HO policy. **Example:** *assume that an insured carries the basic \$100,000 Coverage E limit. An excess policy purchased by the insured for \$1,000,000. Excess of loss of \$100,000, would be recognized as specifically written excess insurance.*

Common Policy Conditions

Certain conditions in the Homeowners Policies, referred to as the "common conditions", apply to both Section I and Section II. Like the Section I conditions, these common conditions outline the rights and responsibilities of the insured and the insurer. The common policy conditions are as follows:

- X Policy Period
- X Cancellation or Fraud
- X Liberalization Clause
- X Waive or Change of Policy Provisions
- X Cancellation
- X Non-renewal
- X Subrogation
- X Death of Named Insured

Policy Period

Homeowners Policies cover only losses that occur during the policy period. The Section II coverage is on an occurrence basis, meaning that the claim does not have to be filed during the policy period as long as the occurrence giving rise to the loss occurs during the policy period.

Concealment or Fraud - Coverage is not provided for an insured that has intentionally concealed any material fact or circumstances relevant to the insurance policy, either

before or after a loss. Concealment or misrepresentation must be intentional and material in order for the insurer to void the policy. A fact of circumstances is considered to be material if it would affect the insurer's underwriting of the policy had the insurer been aware of it.

The policy will also be voided if any insured has made false statements or engaged in fraudulent conduct relating to the policy.

Liberalization Clause

If the insurance company adopts a revision that would broaden the coverage under the policy without additional premium, the broadened coverage will automatically apply to the policy on the date the revision is implemented in the insured's state. The implementation date must fall within 60 days prior to the inception of the policy or during the policy period. The Liberalization Clause does not apply to changes that are implemented because a subsequent edition of the policy has been introduced.

Waive or Change of Policy Provisions - A waiver or change of any policy provision must be in writing by the insurer in order to be valid. A request by the insurer for an appraisal or examination does not waive any of the insurer's rights. **Example:** *if an insurer requests to examine damage property following loss, the insurer's request does not waive its right to deny coverage if its investigation determines that the cause of the loss is not a covered peril.*

Cancellation

The insured may cancel a Homeowners Policy at any time by returning it to the insurer or by informing the insurer in writing of the date the cancellation is to take effect. The insurer may cancel the policy only under certain conditions. If a HO policy is canceled, the premium for the period from the date of cancellation to the expiration date is refunded on a pro-rata basis, regardless of who cancels.

The insurer may cancel the policy at any time for non-payment of premium, provided the insured is generally given 10 days written notice. Also, during the first 60 days of the policy term, the insurer may cancel for any reason by providing ten day's written notice.

If the policy has been in effect for 60 days or more, including subsequent renewals, then the insurer may cancel only under two circumstances: if there has been a material misrepresentation of fact, which, if known to the insurer, would have caused it not to issue the policy. The insurer also may cancel if there has been a substantial change in the risk since the policy was issued. After the policy has been in effect for 60 days or more, 30 days written notice of cancellation is required.

Non-Renewal

The insurer may elect not to renew the policy for any reason. Non-renewal requires 30 days written notice. Proof of mailing is considered sufficient proof of notice for either cancellation or non-renewal

Assignment

Assignment of the policy to another person or persons is not valid without written consent of the insurer. This follows from the fact that an insurance policy is a personal contract between the insurer and the insured.

Subrogation

An insured may waive in writing before a loss, all rights of recovery against any person. Such waivers are often found in property leases. If the insured's right has not been waived in writing prior to a loss, the insurer may require an assignment of rights of recovery for a loss to the extent that payment is made by the insurer.

The policy requires the insurer to sign and deliver all related papers and to cooperate with the insurer if an assignment of subrogation rights is sought. Subrogation does not apply under Section II - Medical Payments to Others or to Damage to Property of Others.

Death of Named Insured

In the event of the death of the named insured or resident spouse, the legal representative of the deceased is insured, only with respect to the premises and property of the deceased covered under the policy at the time of death. The policy does not extend to the deceased's entire estate, which might include property not insured under that particular Homeowner's Policy.

This condition includes a revised definition of "insured". In the event of the death of the

named insured or spouse, the new definition of insured includes any member of the named insured's household at the time of the insured's death, but only while that household member is a resident of the residence premises. With respect to property of the named insured, in the event of the named insured's death, the definition of insured includes the person having proper temporary custody of the property until a qualified legal representative is appointed.

Chapter 5 - Review Questions

1. What types of loss exposures do tenants face?
 - A. Loss to Additions and Alterations
 - B. Loss to Personal Property
 - C. Legal Liability
 - D. All of the above

2. Personal property includes such items as furniture, bedding, clothing, TVs and stereos. Such items often are referred to as:
 - A. belongings
 - B. items
 - C. contents
 - D. Real property

3. The HO-4 does not provide coverage for:
 - A. Additions and Alterations
 - B. Dwelling and Other Structure
 - C. Personal Property
 - D. Legal Liability

4. What form is designed to meet the unique insurance requirements of owners of condominium units and cooperative apartments?
 - A. HO-6
 - B. HO-4
 - C. HO-3
 - D. HO-8

5. What coverage provides liability for the named insured and members of the named insured's household who are relatives?
 - A. Coverage F
 - B. Coverage E
 - C. Coverage B
 - D. None of the Above

Answers

1. D
2. C
3. B
4. A
5. B

Chapter 6 – Homeowners Pricing and Endorsements

"If there is a way to do it better, then find it!" Edison	Thomas A.
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Introduction

With the exception of comments on a few endorsements that apply to only HO-4 or HO-6 policies, the discussion of Homeowners Policies in the preceding two chapters have focused on the standard, endorsed HO forms. In practice, however, Homeowners Policies generally contain a variety of endorsements. These endorsements may be added to respond to an insured's special needs, to meet an insurer's underwriting requirements, or to satisfy insurance regulations. The effect of such endorsements is to modify the coverage provided under the standard unendorsed form. In many cases, adding an endorsement also changes the pricing of the policy. Different types of endorsements have different effects on Homeowners Pricing. Therefore, a complete understanding of homeowner's endorsements requires knowledge of Homeowners Pricing, as well as, Homeowners Coverage. This chapter explains Homeowners Pricing and examines Homeowners Endorsements and their effect on both the coverage and pricing of the Homeowner Policy.

Homeowners Insurance Pricing

This discussion of the development of the homeowner's premium focuses primarily on the HO-3 policy. The same pricing procedures apply to HO-1, HO-2 and HO-8, which contain, with some variations, the complete package of Homeowners Policy Coverages. Examples of Homeowners

Pricing presented in this chapter are based on information provided in the Homeowners Manual pre-pared by the Insurance Services Office (ISO).

Indivisible Base Premium - *The Homeowners Policy has an indivisible base premium, reflecting the fact that the policy consists of a package of coverages. The base premium is the amount charged for the standard package of coverages under a particular homeowner form without modifications. Once the key rating factors have been determined and the HO form and amount of coverage on the dwelling have been selected, the Homeowners pricing procedure calculates a single base premium for the entire policy.*

Primary Rating Factors

The Primary Rating Factors that determine the premium for a Homeowners Policy are the territory in which the dwelling is located, the quality of public fire protection and the dwelling construction.

While territory reflects both Property and Liability Loss potential, the fire protection and construction rating factors reflect only property loss potential. This is indicative of the fact that homeowners insurance is priced primarily on the basis of expected property loss frequency and severity. Except for territorial differences, the homeowner's premiums include what is in essence a "flat charge" for the Liability Coverage.

Territory - Each state is divided into rating territories. Differences in territories represent different levels of exposure to loss with respect to the Property, Theft and Liability Coverages provided in the Homeowners Policy.

Frequently, urban and rural areas are separated into different territories. Urban areas are often characterized by higher crime levels and greater willingness of residents to file lawsuits. On the other hand, rural areas are likely to have less fire protection than is provided in cities. Different geographic areas may also represent different exposure levels to other perils, such as windstorm. Rating territories are established on the basis of an analysis of historical data on insured losses.

Protection - This primary rating factor reflects the level of fire protection available for the insured dwelling. It takes into account only the public fire protection.

Public Protection Classes

The Public Fire Protection Classes available to homeowners is provided by the local fire department. Municipal Fire Departments are graded on a scale from Class 1 (best protection) to Class 10 (least protection). Properties located in areas graded Class 10 is referred to as unprotected.

Other Factors

Other factors considered in evaluating public fire protection for homeowners rating purposes are the distance of the dwelling to

the nearest fire station and the distance to the nearest hydrant. These conditional factors are considered in the event that two or more fire protection classifications are indicated for a Municipality or Township.

If the distance from the dwelling to the fire station is 5 road miles or less and the hydrant is located within 1,000 feet, the lower Class would be used, 5 in this case. If the distance from the dwelling to the fire station is five road miles or less but the hydrant is more than 1,000 feet away, then the higher classification would be used, 8 in this case. If the distance to the fire station is more than 5 road miles, then the property is considered unprotected, and Class 10 is used.

Construction

The Homeowners Manual divides dwelling into 4 construction categories: frame, masonry veneer, masonry and superior construction.

Frame - Frame construction consists of exterior walls, wood or other combustible materials on combustible supports or framing studs. Stucco on wood and plaster on combustible supports are considered frame. Aluminum or plastic siding over frame is rated as frame but given a different coding for statistical purposes. Although frame construction is most susceptible to fire, it has excellent earthquake resistance characteristics and is widely used in earthquake-prone regions.

Masonry Veneer - A masonry veneer structure has exterior walls of combustible construction veneered with brick or stone. Masonry veneer is typically rated the same as masonry, although a different statistical code is used. Masonry veneer is more resistive than frame construction to fire but it is extremely susceptible to earthquake damage.

Masonry - Masonry construction, also referred to as ordinary construction, consists of exterior wall construction of masonry materials such as brick, stone, adobe, or similar materials, and the floors and roof are made of jointed combustible materials. Masonry construction is less susceptible to loss from fire than frame or masonry veneer.

Superior Construction - In most cases because of cost considerations, superior construction is found in residential construction only in apartment houses and condominiums. The following 3 types of construction are rated as superior:

- X **Non-Combustible** construction which is distinguished by exterior walls, floors and roof constructed of and supported by metal or other non-combustible materials.
- X **Masonry Non-Combustible** construction, which is distinguished by masonry exterior walls and floor, and a roof of metal or other non-combustible materials.
- X **Fire-Resistive** construction, which is distinguished by exterior walls, floors and roof constructed of masonry or other

fire-resistive materials. Mostly the structures are built of reinforced concrete. Most high-rise buildings fall into this category.

Determining a Homeowners Policy Base

The homeowner's base premium is calculated using the key premium and the key factors found in the Homeowners Manual. The key premium is chosen from the manual on the basis of the Territory, Public Fire Protection, Construction, and Policy Form that apply to the covered dwelling. The key factor is chosen from the manual on the basis of the Coverage A limit on the dwelling. The base premium is calculated by multiplying the key premium by the key factor.

The *first* step in determining the base premium is to select the appropriate key premium. *Second*, find the key factor for a Coverage A amount of \$100,000. The *third* step is to multiply the key premium amount by the key factor. The product is the base premium.

There are 2 situations in which the base premium calculation is slightly more involved. The *first* is when the Coverage A amount falls between the factors given in the key factor table, such as Coverage A amount of \$105,000. The *second* is when the Coverage A amount is higher than the highest key factor shown in the Table. The methods of handling these situations are detailed in the Homeowners Manual.

Adjustments to the Base Premium

The base premium for a Homeowners Policy may need to be adjusted in some situations. Such an adjustment would be necessary when additional rating factors must be considered and when the insured increases or decreases the standard deductible.

Additional Rating Factors - Two additional rating factors that apply only under certain circumstances may require an adjustment of the base premium. An adjustment is required if the covered dwelling is of superior construction or if it is a townhouse or row house.

Superior Construction - Dwellings of Superior Construction, Non-Combustible, Masonry Non-Combustible, or Fire-Resistive earn a credit that is applied to the base premium. All other things being equal, if the dwelling described above was of Superior Construction and earned a 15% credit, the adjusted annual premium would be $\$347 \times 0.85 + \294.95 or \$295 rounded to the nearest whole dollar.

Townhouse or Row House - These types of dwellings share one or more interior walls with neighboring dwellings. As a result, their exposure to loss from a fire that starts in a neighboring residence is greater than that faced by single homes, which are physically separated from each other. If a Homeowner Policy, other than a HO-4 or HO-6, is written to provide coverage on a townhouse or row house, the base premium may be increased to reflect the greater exposure to loss from fire that originates in an adjoining dwelling. The increase is

accomplished by multiplying the base premium by a factor that is based on the total number of individual family units within the fire division containing the dwelling and the applicable fire protection class, as shown in Exhibit 1. In a group of townhouses in which the common walls are of adequate masonry construction from the basement to eighteen inches above the roofline, each townhouse would constitute a single fire division. In such a case, no adjustment to the base premium would be required, since a factor of 1.00 applies. On the other hand, in a group of townhouses with no fire resistive walls between the units, the whole group of townhouses would constitute a single fire division and an adjustment to the base premium would be necessary.

An adjustment to the base premium for a townhouse is accomplished in the following manner. Assume that the townhouse is one of six single-family units within one fire division and that the fire protection class is 2. Referring to Exhibit 1, read down the left column to find the row that applies to six family units, which is now designated 5-8. Next, choose the protection class that applies in this case classes 1-8 since the actual protection class is 2. The factor shown for 5-8 family units in protection classes 1-8 is 1.25. If the base premium is \$200, the adjusted base premium for a policy covering this townhouse would be $\$200 \times 1.52 = \250 .

EXHIBIT 1

Total No. of Individual Family Units within the fire division	No. of family code	Protection Class 1-8/9 & over
1 & 2	(1&3)	1.00/1.00
3 & 4	(2)	1.10/1.50
5-8	(4)	1.25/1.30
9 & over	(4)	Refer to Company

Increase or Decrease in Deductible

The standard deductible for Homeowners Property Coverage is \$250. At the insured's option, this deductible may be increased to \$500, \$1,000 or \$2,500. The new base premium for these deductibles is calculated by multiplying the base premium by a factor determined by the Coverage A limit and the deductible amount. The increased deductible factors used by the IIA Insurance Company are shown in Exhibit 2. Notice that the factors are all less than 1.0, meaning that an increase in the deductible results in a decrease in the base premium.

The \$250 deductible may also be decreased to \$100. The base premium is multiplied by a factor of 1.15 to develop the premium for this lower deductible. The increase in premium is subject to a minimum and a maximum additional charge.

EXHIBIT 2

HO-1, HO-2 HO-3, and HO-8 Coverage A Limit \$500	Deductible Amount		
	\$1,000	\$2,500	
Up to \$59,999	.91	.83	.75
\$60,000 to 99,999	.93	.85	.75
100,000 to 200,000	.95	.88	.75
200,001 to 250,000	.95	.88	.85
Over \$250,000 refer to Company			

Homeowners Endorsements

A variety of endorsements can be used to modify Homeowners Policies. Some of the more widely used endorsements are discussed in this section.

The Need for Endorsements

A Homeowners Policy may be endorsed to meet the needs of insureds, the underwriting requirements of insurers, or state insurance regulations.

Insured's Needs - Endorsements may be used to customize the standard coverage under a particular HO form according to the needs of the insured.

Property and Liability Loss Exposure vary considerably from one household to another and, therefore, so do their insurance requirements. Endorsements provide flexibility in meeting these individual needs.

Insurer's Underwriting Requirements - Homeowners Policies provide a very broad range of coverages to the insured. An insurer may not be willing to extend this breadth of coverage, for insurance, on a dwelling located in an area where homes regularly suffer windstorm damage. An endorsement excluding windstorm damage may be required by an insurer as a condition to providing coverage on a dwelling located in such an area.

State Regulation Requirement - The laws of the various states often required that certain Homeowners Policy Provisions be amended. A series of HO endorsements have been developed by ISO to reflect the various modifications required by individual states. These "Special Provisions" Endorsements typically modify standard HO Policy provisions in ways that are advantageous to insureds.

Affected policy provisions often include one or more of the following Areas: Cancellation and Non-renewal, definitions such as "Actual Cash Value" and "Intentional Loss", Suit against the Insurer, Duties of the Insured, Loss Payment and Valuation of Property.

Effects of Endorsement

When Homeowners Endorsements are used, they affect the coverage provided by the basic policy and the premium charged for coverage.

Effect on Coverage - Endorsements can be used to change many aspects of coverage under Homeowners Policies, including the following:

- X Personal Property Covered
- X Property Covered
- X Perils Covered
- X Activities Covered
- X Limits of Liability
- X Insurance to Value Requirement
- X Loss Settlement Valuation Method
- X Applicable Exclusions

The Endorsements may affect coverage only under Section I, only under Section II or under both.

Effects on Premiums - When the coverage provided by an HO Policy is changed by an endorsement, the premium charged for the policy is often affected. A change in premium may occur in one of 3 ways: (1) adjusting the base premium, (2) making an additional premium charge for an increase in coverage and adding this charge to the base premium, or (3) giving credit for a decrease or restriction in coverage and subtracting the credit from the base premium.

Endorsements Affect Section I - Coverages

Some of the endorsements in this group modify all of the Section I coverages. Others modify only 1 or 2 of the coverages.

All Section I Coverages

Two of the Homeowners Endorsements affect all of the Section I Coverages: **Inflation Guard Endorsements** and the **Earthquake Endorsement**.

Inflation Guard Endorsement (HO-04-04)

- The Inflation Guard Endorsement increases the Limits of Liability for Coverage A, B, C and D. The Endorsement permits the insured to select the percentage of annual increase, which applies pro-rata throughout the policy year. For instance, if the insured selects an 8% annual increase, at the end of six months the limits would be increased 4%.

Adding the Inflation Guard Endorsement requires an adjustment to the base premium. The pricing factor varies with the annual percentage in coverage selected (see Exhibit 3). As with other adjustments to the base premium, the base premium is multiplied by the appropriate pricing factor to determine the adjusted base premium.

Inflation Guard Endorsement Factors

EXHIBIT 3

Amount of Annual Increase Factor	
4%	1.02
6%	1.03
8%	1.04
Each additional 4% over 8%	add .02

Earthquake Endorsement (HO-04-54) -

The Earthquake Endorsement adds back an excluded peril to the Section I coverages of the policy. This Endorsement is priced by means of an addition to the base premium.

Earthquake Coverage is always written with as deductible. In most areas, the deductible is 5% of the Limit of Liability for each applicable coverage section, subject to a \$250 minimum.

The HO-04-54 Endorsement excludes loss resulting directly or indirectly from flood of any nature or tidal wave, whether caused by or resulting from an earthquake. Exterior masonry veneer may be either excluded or covered. If masonry veneer is covered, the entire structure is rated as masonry.

The Earthquake Endorsement rating process consists of 4 steps. **First**, the appropriate rate table is selected. These rate tables vary based on the HO form and the presence of endorsements modifying Limits of Liability. **Second**, the earthquake zone is determined from the rate table. **Third**, the rate per \$1,000 of coverage is selected based on the construction class. From construction has the lowest rate and masonry the highest; superior for fire-resistive construction is given an intermediate rate. **Fourth**, the selected rate is applied to the Coverage A amount for all forms except HO-4 and HO-6. With HO-4 and HO-6, the Coverage C limit is used as the rating basis. The selected rate is also applied to any increased limits and other coverage options the insured may have selected.

Coverages A and B

Four of the endorsements that affect only Coverages A and B are discussed below:

- X Premises Alarm or Fire Protection System (HO-04-06)
- X Ordinance or Law Coverage (HO-04-77)
- X Other Structures - Increased Limits (HO-04-48)
- X Special Loss Settlement (HO-04-56)

Premises Alarm or Fire Protection System (HO-04-16)

- In order to encourage loss control on the part of the insured, premium credits are given for premises alarm or fire protection systems, such as central station reporting burglar or fire alarms. The credit is applied by multiplying the base premium by the appropriate factor. With a 5% credit, the factor would be 0.95, $\$100 \times 0.95 = 95$ adjusted base premium.

The endorsement acknowledges the installation of an approved alarms or automatic sprinkler system on the residence premises for a premium credit. It also provides that the insured agrees to maintain this system in working order and to notify the insurer promptly of any change made to the system or its removal.

Ordinance or Law Coverage (HO-04-77)

- Older buildings often do not conform to modern building or zoning codes. If the building is damaged, any repairs or new construction would have to conform to the present zoning or building codes. The basic coverage in the Homeowner Policy provides for repair or replacement of "like kind and

quality". If the present code requires more costly repairs, the insured has a potential gap in coverage. This gap can become quite substantial if the code requires demolition of the damaged dwelling. Many city ordinances require demolition of non-conforming buildings if they are damaged to 50% of their value. **Example:** *Assume Mary's old non-conforming dwelling valued at \$100,000 suffers a \$50,000 fire loss. The Homeowners Policy would pay for the \$50,000 loss but, if the city ordinance requires that the building be demolished; Mary has suffered another \$50,000 loss. This loss is not covered in the basic policy due to the effect of the building ordinance, not the fire.*

The Ordinance or Law Coverage Endorsement provides that, for an additional premium, loss for damage by an insured peril to covered property or the building containing the covered property will be settled on the basis of any ordinance or law that regulates the construction, repair or demolition of this property. This Endorsement changes the policy by changing the loss settlement valuation method employed.

The pricing process for this endorsement requires 3 steps: first, the Coverage A amount used in calculating the base premium must be equal to at least \$96,000.00, calculated as $(\$100,000 + \$20,000) \times 0.80$. (To be fully covered in the event of a total loss, however, an insured should carry Coverage A amount equal to 100% of the re-placement cost of the dwelling plus demolition and increase construction costs).

Second, the base premium is calculated in the normal manner, multiplying the key premium from the manual by the key factor that applies to the increased Coverage A limit as determined above.

Third, the base premium calculated in the second step is multiplied by a factor of 1.10 to arrive at an adjusted base premium for the endorsement. This pricing procedure applies to the HO-1, HO-2 and HO-8.

Other Structures - Increased Limits (HO-04-48) - The Limit of Liability for Coverage B - Other Structures can be increased from 10% of Coverage A by the additions for this endorsement. The additional premium developed for this endorsement is \$2 per \$1,000 of insurance. Each structure on the residence premises for which increased limits are sought is listed on the HO-04-48 endorsement and the Limit of Liability is shown. The Limits of Liability shown on the endorsement are in addition to the 10% of Coverage A provided in the basic policy.

Special Loss Settlement (HO-04-56) - The standard Homeowners Policy provides Loss Settlement on a replacement cost basis if the Coverage A Limit of Liability represents the requirement and can be modified to 50, 60 or 70% of replacement value as shown in the policy declarations.

The endorsement is typically used on a policy written to cover a home for which the replacement cost is substantially greater than its market value. Insurers are reluctant to issue Replacement Cost Coverage on such dwellings because of the potential for moral

hazard. By adding the HO-04-56 endorsement and purchasing Coverage A limit in line with the dwelling's market value, an insured may obtain Replacement Cost Coverage for small and medium-sized losses. **Example:** *if a dwelling had a replacement cost of \$100,000 but a market value of only \$60,000, the insured could purchase a Homeowners Policy with \$60,000 Coverage A limit, endorsed with HO-04-56 to reduce the replacement cost requirement to 60%. In this way, the insured could have Replacement Cost Coverage on dwelling losses up to \$60,000 without the penalty for failing to insure 80% of replacement value, and the insurer would avoid providing coverage in excess of the dwelling's market value.*

The Endorsement also provides for the settlement of losses to personal property, awnings, carpeting, household appliances, outdoor antennas, outdoor equipment (whether or not attached to buildings), and non-building structures at Actual Cash Value at the time of loss but not more than the amount required to repair or replace.

The pricing procedure for HO-04-56 requires an adjustment of the base premium. The base premium is increased by varying amounts depending on the percentage of replacement value selected. The next result is that the insured pays a higher base premium per \$1,000 of coverage than would be the case if the standard 80% of replacement coverage had been purchased.

Coverage C

The following are 4 of the endorsements that affect Coverage C - Personal Property:

- X Coverage C increased Special Limits of Liability (HO-05-65)
- X Scheduled Personal Property (HO-04-61)
- X Special Personal Property Coverage Form HO-03

Coverage C - Increased Special Limits of Liability (HO-4-65) - The blanket coverage on Personal Property under Coverage C has special Limits of Liability for particular types of property. For an increased premium, these special limits may be increased. A similar endorsement (HO-04-66) is used for HO-3 policies that include the HO-00-15 endorsement described below.

Scheduled Personal Property (HO-04-61) - The Scheduled Personal Property Endorsement is used to provide coverage for risks of direct loss for certain special classes of scheduled property. This endorsement is actually an Inland Marine Personal Articles Floater.

Schedule Coverage may be provided for jewelry, furs, cameras, musical instruments, silverware, golfer's equipment, fine arts, post-age stamps and rare and current coins. The rating for these coverages is based on Standard Inland Marine Rating Procedures. A different rate per \$100 of value applies to each category of property.

For Scheduled Musical Instruments, coverage applies only to amateur musicians. The endorsement states that the insured agrees not to perform with the covered instrument(s) for pay unless the policy specifically provides for such performance. Coverage for professional musicians requires payment of a significantly higher premium.

The Endorsement provides only limited Named-Perils Coverage for breakage of fine arts. Upon the payment of an additional premium, specific fine arts articles may be covered on a Risks of Direct Loss basis.

The advantage of Scheduled Coverage under the HO-04-61 endorsement for these classes of special property is two fold. **First**, the schedule coverage provides Limits of Liability of any amount required. The Homeowners Policy has limitations with respect to these types of property. **Second**, the endorsement provides coverage for risks of direct loss. **Example:** *if Marie dropped her expensive camera into the surf while photographing an ocean sunrise, the loss would not be covered under Coverage C of her Homeowners Policy. If the camera were scheduled on the HO-04-61 endorsement, the loss would be covered.*

When writing these classes of property on the HO-04-61, certain types of underwriting information must always be provided. Each item should be carefully described and identified, including serial numbers where applicable. Appraisals should be periodically updated. Expensive jewelry items should be photographed.

Special Personal Property Coverage (HO-04-90) This Homeowners Policy Covers Personal Property on an Actual Cash Value basis. Therefore, if an insured's 4 year-old television set is stolen, the loss payment will be reduced by a deduction for depreciation and will fall short of the amount required to replace the television with a new one.

The HO-04-90 Endorsement changes the basis of Loss Settlement for Personal Property from Actual Cash Value to Replacement Cost. The endorsement also extends replacement cost coverage to certain articles or classes of property if they are separately described and specifically insured in the policy. These types of property include jewelry, furs, cameras and related equipment, musical equipment, silverware, gold ware, pewter, and golfer's equipment. The endorsement states that the payment at the time of loss will be no more than the least of the following amounts:

1. Replacement cost at the time of loss with out deduction for depreciation.
2. The full cost of repair at the time of loss.
3. The Limit of Liability that applies to Coverage C, if applicable.
4. Any special Limits of Liability stated in the policy.
5. The Limit of Liability that applies to any item separately described and specifically insured in the policy.

When the replacement cost for the entire loss under the endorsement is more than \$500, the insurer will pay no more than the actual cash value until the actual repair or

replacement is complete. After repair or replacement is complete the insurer may, within 180 days of the date of loss, make claim for the difference between actual cash value and replacement cost. This clause enables the insurer to ascertain that the insured actually replaces the property before payment is made on a replacement cost basis. Since the insured receives new for old and is to that extent better off later after the loss, this provision is designed to reduce moral hazard.

The Homeowners Manual indicates a 15% increase in the base premium when the HO-04-90 Endorsement is added to a HO-2 or HO-3. If the Coverage C limits are increased to 70% of Coverage A, as some insurers required when this endorsement is added, the additional premium for the increased limit is added to the base premium, which is then increased by 15%. Even if the increase in Coverage C limits is not required, an inventory of replacement value of contents by the insured will most often show a need to increase the Coverage C limits for complete protection in the event of a total loss.

When the HO-04-90 Endorsement is added to either a HO-04 or HO-06, the base premium is increased by 35%. This larger increase factor reflects the fact that the majority of the property coverage in the HO-4 and HO-6 forms is on personal property.

Endorsements Affect Section II - Coverages

Various endorsements are available to extend the Personal Liability Coverages of

Section II. Many of these endorsements provide an opportunity to "buy back" coverage excluded in the basic homeowners contracts. The following are among the endorsements that affect Section II of a Homeowners Policy:

- X Watercraft (HO-24-25)
- X Snowmobile (HO-24-65)
- X Business Pursuits (HO-24-71)
- X Personal Injury (HO-23-82)
- X Additional Residence Rented to Others (HO-04-70)

Watercraft (HO-24-75) - This Endorsement provides Liability and Medical Payments Coverage for certain watercraft. For an additional premium, Coverage E - Personal Liability and Coverage F - Medical Payments to Others are extended to bodily injury and property damage arising out of the ownership, maintenance, use, loading, or unloading of a watercraft described in the endorsement. Losses arising out of entrustment of the described watercraft are also covered. Further coverage is provided for vicarious liability, whether or not imposed by statute, for the actions of a child or minor using the described watercraft.

The Endorsement provides for the listing of the horsepower and description of watercraft powered by outboard engines or motors of more than 25 total horsepower and other watercraft with inboard or inboard/outdrives power. Sailing vessels, with or without auxiliary power, that is 26 feet or more in length are described in a separate paragraph. The descriptions and other information about the watercraft are used both for underwriting purposes and for rating.

Watercraft, other than sailing vessels, is not covered while being operated in or practicing for a prearranged or organized race. With respect to watercraft with inboard or inboard/ outdrive motor power and sailing vessels, coverage does not apply to bodily injury to any employee of an insured arising out of an "in the course of employment by the insured" if the employee's principal duties are in connection with the maintenance or use of the watercraft. Many large inboard motor vessels have a paid captain or deck hand that operates and maintains the vessel. An insured with such an employee would have to obtain separate coverage for the employee. With respect to the same type of watercraft, no coverage is provided if the watercraft is used to carry persons for a charge or is rented to others. Notice that the last two exclusions do not apply to watercraft with outboard motors.

The additional premium for the Watercraft Endorsement is based on the type of vessel, its length and speed. The premium ranges from a nominal amount for outboard motors over 25 hp but less than 50 hp to hundreds of dollars for inboard or inboard/outboard motor-boats 26-40' long with a speed over 30 mph.

In some areas of the country, watercrafts are used only during part of the year and are stored or not in use the rest of the year. The part of the year during which watercrafts are used is called the *navigational period*. Although coverage in the HO-24-95 Endorsement must be written for the entire policy period, a pro-rata adjustment may be

made in the premium for the endorsement to reflect the navigational period of each year.

Snowmobile Endorsement (HO-24-64) - Coverage may be provided for liability arising from the operation of owned snowmobiles by adding the HO-24-64 endorsement to a Homeowner Policy. The premium charge is a minimum premium for each snowmobile for any period within a policy year.

Business Pursuits (HO-24-71) - When this Endorsement is used, Coverage E - Personal Liability and Coverage F - Medical Payments to Others apply to those specified in the Endorsement. When the insured is a teacher, liability for corporal punishment may be added for an additional charge.

There is no coverage for liability arising out of business pursuits of the insured in connection with a business partnership that the insured owns or financially controls. Liability arising out of professional services of any nature, other than teaching, is also excluded, as is bodily injury to an employee. When the insured is a member of the faculty or teaching staff of any school or college, there is no coverage for liability arising out of the use of draft or saddle animals, aircraft, motorized land conveyances and watercraft when used for instructional purposes.

Personal Injury (HO-24-82) - This Endorsement may be used to add Personal Injury Coverage to Coverage E - Personal Liability. Personal Injury is defined in the endorsement as *injury arising out of false arrest, detention or imprisonment, malicious*

prosecution; libel, slander, defamation of character, invasion of privacy, wrongful eviction or wrongful entry. The HO-24-82 Endorsement contains a special set of exclusions pertaining to this coverage. These provisions exclude liability assumed by the insured under contract or agreement except for any indemnity obligation assumed by the insured under a written contract directly relating to the ownership, maintenance or use of the premises.

Further exclusions apply to injury caused while violating a Penal Law or Ordinance; injury directly or indirectly related to the employment of a person by the insured, injury arisen out of a business engaged in by the insured, civic or public activities performed for pay by an insured and injury to an insured.

Additional Residence Rented to Others (HO-24-70)

The definition of insured location under Coverage E - Personal Liability and Coverage F - Medical Payments to Others is broadened under the HO-24-70 Endorsement to include *an additional residence rented to others.* The residence may not house more than 4 families. The Endorsement provides for the listing of the location of this additional residence and an indication of the number of families that occupy it.

The premium charge for this coverage is an additional premium that varies by territory and by the number of families at the additional residence. This charge varies

from a nominal amount for one family to over \$200 for 4 families in some territories.

Endorsements Affecting Sections I and II

Certain endorsements affect both Section I and Section II of the Homeowners Policy. The following 3 Endorsement that affect both the Property and Liability Coverage are discussed below:

- X Permitted Incidental Occupancies - Residence Premises (HO-04-42)
- X Home Day Care Coverage (HO-04-97)
- X Additional Insured - Residence Premises (HO-04-41)

Permitted Incidental Occupancies - Residence Premises (HO-04-42) - If an insured owns a business conducted on the residence premises, Property and Liability Loss Exposure arising out of that business may be insured through the use of the HO-04-42 endorsement. The business constituting the incidental occupancy is listed in the endorsement, which also provides the indication of whether the business is conducted in the dwelling or in a separate structure. The location of the business on the residence premises affects the rating of the endorsement.

When the HO-04-42 Endorsement is added to the policy, the \$2,500 Special Limit of Liability on Business Personal Property applies only to Business Personal Property not used in the covered business. Consequently, in the event of a loss,

Personal Property that is used in the business and is insured under the Endorsement is covered, along with the insured, up to the Limit of Liability for Coverage C. The Endorsement provides that Coverages E and F shall apply to occurrences that arise out of the insured's incidental use of the premises for the business covered by the Endorsement.

Home Day Care Coverage (HO-04-97) - Home day care centers represent a special kind of incidental occupancy. In recent years, increased litigation involving home day care centers has made this exposure difficult to underwrite.

The number of persons receiving day care services is listed on the Endorsement. As is the case with the Incidental Occupancies Endorsement, information is required about the location of the day care center, whether it is in the dwelling or in another structure on the residence premises. If another structure is involved, a Limit of Liability is indicated and a rating charge per \$1,000 of coverage is made. The Endorsement extends the Coverage C Limit of Liability to property used in the day care business. Thus, the \$2,500 limit for Personal Property on the residence premises used for business purposes does not apply to the property used in the day care business.

When the HO-04-97 Endorsement is used, coverage under Section II of the Homeowners Policy applies to Bodily Injury and Property Damage arising out of the day care business. However, there is no coverage for liability arising out of the use

of draft or saddle animals, vehicles for use with those animals, aircraft, motorized land conveyances and water- craft. Bodily injury to any employee of an insured, other than residence employee, is also excluded.

The Endorsement includes an annual aggregate Limit of Liability applying to both Coverages E and F. This limit applies regardless of the number of occurrences, insureds, claims made or persons injured. A similar aggregate annual Limit of Liability applies under Coverage F for any one person. Therefore, most that will be paid under Coverage F for medical expenses payable for bodily injury to any one person is the dollar amount shown in the declarations for Cover-age F. This does not increase the aggregate Limit of Liability.

Additional Insureds - Residence Premises (HO-04-41) - The insured in a Homeowners Policy is usually an *owner-occupant*. There are some other situations in which more than one person or entity may have an insurable interest in the dwelling. **Example:** *Bob is a purchaser-occupant who has entered into a long-term installment contract for the purchase of a dwelling. However, title does not pass to Bob from Sally, the seller, until all the terms of the installment contract have been satisfied. Sally retains title until completion of the payments and in no way acts as a mortgagee. In this case, Bob could purchase a Homeowners Policy as named insured on the declarations page and Sally could be covered as an additional insured by using the HO-04-41 Endorsement. The Endorsement would show not only Sally's name but also the extent of her insurable interest.*

The Endorsement may also be used to cover the interest of the grantor of a life estate. Additionally, if a two-family dwelling is co-owned by two persons, each of who has a distinct residence with a separate entrance, only one of the co-owners may be shown as the named insured under the Homeowners Policy that insures the dwelling. The interest to the co-owner not shown as the named insured may be partially protected by use of the HO-04-41 Endorsement but there would be no coverage for bodily injury to an employee of the co-owner.

Chapter 6 - Review Questions

1. What premium is the amount charged for the standard package of coverages under an HO form without modifications?
 - A. Gross Premium
 - B. Net Premium
 - C. Base Premium
 - D. All of the above

2. What primary rating factor reflects both property and liability loss potential?
 - A. Quality of public fire protection
 - B. Territory
 - C. Dwelling construction
 - D. None of the above

3. Endorsements can be used to change many aspects of coverage under a Homeowners Policy, such as:
 - A. persons covered
 - B. perils covered
 - C. property covered
 - D. all of the above

4. Many endorsements that extend to Personal Liability Coverage of Section II provide an opportunity to:
 - A. "Buy Back" Coverage
 - B. Exclude Coverage
 - C. Lessen Coverage
 - D. None of the above

5. An endorsement that affects Sections I and II would be:
 - A. Business pursuits (HO-24-71)
 - B. Personal injury (HO-24-82)
 - C. Home day care coverage (HO-04-97)
 - D. None of the above

Answers

1. C
2. B
3. D
4. A
5. C

Chapter 7 – Other Residential Insurance

"A man without a purpose is like a ship without a rudder."

Introduction

The previous three chapters described the Homeowners Policies used by a large number of people to insure their Real and Personal Property. This chapter discusses other types of Residential Insurance.

Owners of mobile homes and farms can insure their residences under Homeowners Policies that include endorsements specifically designed for these types of residence under Dwelling Policies. These are Mono Line Policies that provide Property Coverage similar in many ways to the Property Coverage in Homeowners Policies. In some instances, the owner of a residence may not be able to purchase Homeowners Insurance because the location of the residence does not meet underwriting requirements. The owners of such residences may be able to purchase Property Insurance through Fair Plans or Beachfront Plans, which are Assigned Risk Plans for Property that is difficult to insure in the standard insurance market.

This chapter concludes with a family residence insurance case. This case presents several loss situations and explains how Homeowners Policies and other types of residence insurance would apply to the losses.

Homeowners Insurance for Mobile Homeowners

As housing prices have increased in recent years, so have mobile homes sales. Mobile homes are generally less expensive than conventional housing. The flexibility of mobile homes also makes them useful when the housing requirement may not be permanent. Often in "boom" towns when employment is temporarily increased due to the operation of an oil shale facility or surface mine, the workers purchase and set up mobile homes. Mobile homes also are used as summer or vacation homes.

Exposures

The owners of mobile homes face the same exposures to loss, as do owners of conventional homes. Therefore, a mobile homeowner may experience loss to the dwelling or another structure on the residence premises and the contents of either. There is also an exposure to Liability Loss because of Bodily Injury or Damage to the Property of Others.

The Mobile Home and Other Structures

The mobile home itself is Personal Property rather than Real Property. The essence of the mobile home is its impermanence. In some areas of the country, a mobile home is

required to have wheels and axles attached even when set up. This is to emphasize the mobile nature of the structured dwelling. These differences are usually recognized in the manner in which the mobile homes are taxed. Therefore, mobile homes are sometimes taxed as vehicles rather than structures.

When a mobile home is set up, it may be surrounded by skirting that conceals the wheels and gives the appearance of a permanent structure. Patio covers are often attached to mobile homes and sheds and similar outbuildings set up nearby. When they are set up, mobile homes are subject to the perils as any other structure. Exposures to the perils of fire, vandalism, and crime are roughly equivalent to those of a conventional dwelling. Mobile homes are also susceptible to damage from windstorm and earthquake depending on how they are set up.

Mobile homes generally do not remain on their tires. They are set on blocks or piers and, in some cases, on masonry footings. Masonry footings provide a very stable foundation. But they are costly and therefore seldom used. When the mobile home is set up, there are 2 major considerations with respect to the windstorm and earthquake perils. *First*, the piers or footings must be strong and stable enough to properly support the unit. The *second* consideration, tie down, is important because a windstorm may either move a mobile home sideways or lift it off the ground. An earthquake can subject the unit to sudden and severe upwards and sideways

thrusts. Therefore, a properly set up mobile home should not only have a strong and stable foundation, but it should also be tied down to anchors buried in the ground to prevent the unit from moving upwards or sideways.

Mobile homes frequently suffer severe damage in hurricanes or tornadoes, often resulting in total loss of the units, as well as, loss of life of the occupants. Since mobile homes may be relegated to less desirable housing areas by zoning laws, they are often located in areas subject to flooding. Theoretically, the mobile nature of the mobile home should make it possible to move a unit that is threatened by rising water but this is seldom practical. A residential mobile home may be constructed of 2 or 3 modules. Each of these modules may be as large as 10x60 feet.

These units are mobile only in a technical sense. It usually takes many hours of specialized labor to prepare a unit for moving. Units on masonry foundations can take days to prepare.

When mobile homes are moved from the sales lot to the set-up site or from one site to another, they are subject to Transportation Perils. The high cost of disassembly, transportation and reassembly result in infrequent mobile home moves after the initial set-up.

Other Personal Property and Personal Liability

The contents of a mobile home are similar to those in a conventional dwelling and are subject to the same perils. The mobile home owner also is subject to the same liability perils as the owner of a conventional home. Consequently, there are corresponding similarities in coverage needs.

Mobile Home Coverage

Owners of mobile homes have several options for insuring their dwellings. The American Association of Insurance Services (AAIS) and some specialty insurers have developed policies especially for mobile homes. Insurers that use forms developed by the Insurance Services Office (ISO) provide coverage for mobile homes by attaching a Mobile Home Endorsement, MH-04-01, to a Homeowners Policy. The following discussion is based on the ISO forms, specifically the endorsement used with an HO-3 policy. According to ISO rules, the endorsement may be used with an HO-2 Policy. Tenants of mobile homes may use the HO-4 policy without modification.

Mobile Home Endorsement (MH-04-01) - A mobile home is eligible for coverage if it is designed for portability and year-round living. The mobile home also may not be less than 10' wide x 40' long.

The Mobile Home Endorsement, the Attached Homeowner Form and the Declarations Page constitute the complete Mobile Home Policy. As with all

Homeowners Policies, other endorsements may be attached to modify the coverage. The Mobile Home Endorsement states that the insurance is subject to all applicable provisions of the Homeowners Form except as revised by the Endorsement. The differences between the HO-3 and the Mobile Home Policy are in the definitions of "residence premises". It is changed to mean the mobile home and other structures located on land owned or leased by the insured where the insured resides. The location must be shown as the residence premises in the declarations.

Coverage a - Dwelling

The Dwelling Coverage applies to mobile homes used primarily as a private residence. Coverage applies to structures and utility tanks attached to the mobile home. It also applies to floor coverings, appliances, dressers, cabinets and similar items that are permanently installed. This provision recognizes the fact that standard features of most mobile homes are built-in cabinets and appliances.

Coverage B - Other Structures

The Limit of Liability for Coverage B is 10% of the limit that applies to Coverage A. However, if that amount is less than \$2,000, a minimum limit of \$2,000 is provided.

Additional Coverages

The additional coverage for property removed provides up to \$500 for reasonable expenses incurred by the insured for removal and return of the mobile home if it is endangered by an insured peril. No deductible applies to this coverage.

Section I - Conditions

The condition regarding Loss Settlement does not include carpeting and appliances as property to be valued on the basis of Actual Cash Value. These types of property are included in Coverage A and are covered for risks of Direct Loss.

The Mobile Home Endorsement applies to loss to a pair, set of panels and will pay the reasonable cost of repairing or replacing damaged paneling to match the undamaged part as closely as possible. The insurer does not guarantee the availability of matching panels and will not be liable for replacement of all paneling if a suitable match is not found.

Under the Mortgage Clause, the word "mortgage" includes a trustee or lien holder. Mobile homes are not considered Real Property and liens may take the form of Chattel Mortgages or Trust Certificates.

Other Mobile Home Endorsements

A Mobile Home Policy can be endorsed with many of the Homeowners Endorsements. The following 4 endorsements are unique to Mobile Home Coverage:

- X Actual Cash Value (MH-04-02)
- X Transportation/permission to Move (MH-04-03)
- X Mobile Home Lien Holder's Single Interest (MH-04-04)
- X Property Removed Increased Limit (MH-04-06)

Actual Cash Value - Mobile Home Endorsement (MH-04-02) - This coverage on an Actual Cash Value basis is desired for the mobile home. The MH-04-02 Endorsement is used in addition to the MH-04-01. The MH-04-02 Endorsement changes the Loss Settlement terms to an Actual Cash Value basis. At the insured's discretion, covered property losses may be settled in one of three ways.

The insurer may pay the cost of repairing the damage, the cost of replacing the damaged property with similar property (but not necessarily from the same manufacturer) or it may pay the amount in money. If the amount is paid in money, the insurer will pay no more than the lowest of (1) the difference between Actual Cash Value of the property before and after the loss, (2) the cost of repairing the damage, or (3) the cost of replacing the damaged property with similar property.

Transportation/Permission to Move Endorsement (MH-04-03) - The Transportation/ Permission to Move Endorsement provides coverage for Perils of Transportation and at the new location, anywhere in the United States or Canada, for a period of 30 days from the effective date of the Endorsement. The perils of transportation are collision, upset and stranding or skidding (while the mobile home is being transported on a licensed ferry line).

Mobile Home Lien Holder's Single Interest Endorsement (MH-04-04) - The Mobile Home Lien Holder's Single Interest Endorsement provides coverage for the lien holder only. The first coverage is Transportation Coverage for the limited perils of Collision and Upset. This coverage is designed to cover a loss while the unit is being delivered. In addition, coverage is provided to the lien holder for loss due to the owner's conversion, embezzlement or secretion of the mobile home. Since the mobile home can be moved, some lien holders require the mobile homeowner to purchase this Endorsement to protect the lien holder's interest in the event of any of the covered losses.

Property Removed Increased Limit Endorsement (MO-04-06) - The Mobile Home Endorsement provides \$500 in order to cover removal expenses for a mobile home threatened by an insured peril. With a large, multi unit mobile home, removal costs alone may run over \$2,000. Added to this would be about the equivalent expense of resetting the mobile home up after the threat from the insured peril had passed. For this reason, the Property Removed Increased Limit Endorsement H0-04-06 provides a means for the insured to purchase a sufficiently high removal limit to cover the expenses to take down, transport and set the mobile home up again.

Vacation Mobile Home Endorsement - Many mobile homes are used in recreational areas as vacation homes. While some of these are set up in mobile home parks, many are not. For instance, a mobile home may

be placed in the mountains or at the side of a lake or river. The exposures faced by vacation mobile homes are somewhat different from the exposures for mobile homes used as ordinary year-round residences. Often vacation areas do not have full-time fire departments. Also, there may be no telephone in the mobile home or no neighbors nearby to report a fire in the owner's absence. All of these factors contribute to the likelihood of increased loss severity if a fire does occur. Because many vacation mobile home residences are located in heavily wooded areas, they are subject to unusually high fire hazards. Placing a mobile home in a forest area increases potential loss frequency and probable severity.

Homeowners Insurance for Farm Owners

Farm owners may be eligible to insure the Liability Exposures from their farming operations under Homeowners Policies with the appropriate endorsements. These endorsements cover incidental-farming operations on the residence premises or at another location, or larger farms operated away from the residence premises. The Endorsement can be used only if the farming is not the insured's primary occupation.

Incidental Farming Personal Liability Endorsement (HO-24-72) - The Incidental Farming Personal Liability Endorsement extends the Personal Liability and Medical Payments Coverage in Section II to incidental farming operations conducted by the insured. If the farming is on the insured's residence premises, it must be

incidental to the use of the premises as dwelling, and the income derived from it may not be the insured's primary source of income. Coverage also applies if the residence premise is used for the sheltering and raising of animals. Coverage is not available, however, if the residence premise is used for raising purposes.

If the incidental farming activities are at a separate location, that location must be specified in the Endorsement. The permissible farming activities include the boarding or grazing of the insured's animals or use of the land as garden space. The income derived may not be the insured's primary source of income and there is no coverage if the location is used for racing purposes.

Farmers Personal Liability Endorsement (HO-24-73) - This Endorsement is designed to cover the Liability Exposure arising out of a commercial farming operation conducted away from the insured's residence premises. The Endorsement contains a supplemental declaration page. Some of the definitions applicable to Section II of the Homeowners Policy are modified to reflect that farming operations are covered. The Section II - Liability Coverages and Section II - Exclusions in the endorsement replace those in the Homeowners Policy. A new coverage (Coverage G) may be selected by the insured to cover animal collision. Additional conditions apply if farm employees are covered.

Declarations

The *first* portion of the HO-24-73 Endorsement consists of a Supplementary Declaration Page which sets forth all farm premises rented, owned/operated by the insured or rented to others. An advance premium is charged for each of the farm premises indicated.

For farms owned/operated or rented/operated by the insured or the insured's employees, the total acreage of the initial farm premises is indicated. An additional farm premises with buildings and a rate per premises are also listed.

For farms owned by the insured but rented to others, the declaration lists all farm premises without buildings, each farm premises with buildings and the rate that applies per premises, along with the total acreage of farms rented to others. An additional flat charge for all such farms is based on the total acreage.

Coverage under the Endorsement assumes that no business other than farming is conducted on the insured location. Therefore, if any other businesses are conducted, they must be listed in the declarations.

The *second* section of the declarations applies to farm employees. The covered employees are separated into 3 categories based on the number of days per year they are employed. A different rate per employee in each category may be charged, or the premium may be based on a rate per \$100 of payroll

If coverage for Animal Collision (Coverage G) is desired, the number of animals to be covered should be indicated in the final section of the declarations. The Coverage G Limit of Liability is \$400 per animal.

Definitions

The definition of "business", as it applies to coverage under the HO-24-73 Endorsement, does not include farming and the definition of "insured location" is changed to "include the farm premises". The Endorsement also adds definitions on "farm employees", "farming", and "insured farm employees".

Coverage and Exclusions

Only Section II of the Homeowners Policy is changed by the HO-24-23 Endorsement. Medical Payments Coverage is extended to insure farm employees and to persons who are injured by farm employees off the insured location in the course of employment by the insured. Under the Endorsement, the exclusions for Coverage E and F apply to Pollution Liability and to Bodily Injury for Farm Employees.

Coverage B is provided only if a premium is paid for this coverage. Coverage G pays the amount shown in the declarations for loss by death of any cattle, horse, mule, donkey, swine, sheep or goat owned by an insured. In order to be covered, death must have been the result of **collision** between the animal and a vehicle not owned or operated by the insured or an employee. The collision must occur while the animal is within a public

highway and is not being transported. *If a farmer's cow were killed by a vehicle that entered the pasture, there would be no coverage.*

Additional Conditions

If a premium is shown in the declarations for Coverage of Farm Employees, the coverage is subject to additional conditions. The premium shown in the declarations is a deposit premium that will be applied to the earned premium due at the end of the policy period. The insured must keep records necessary for premium computation and must send copies to the insurer at the end of the policy period. The insurer also reserves the right to inspect the insured's operations and audit the insured's records and books.

Other Coverages for Residences

Coverages for Residences are not always written on Homeowners Policies. Some residences are not eligible for Homeowners Coverage. In some cases, this is because the value of the dwelling is below the homeowner's program minimum. In other cases, the residence may not be owner-occupied or it may not be eligible because of underwriting reasons. **Example:** *any residences in Southern California located in brush areas and subject to wind-driven brush fires. Few, if any, insurance companies write Homeowners Policies for homes in these areas. Most of these residences must find alternative coverage.* In other cases, the insured may not want the full range of Homeowners Coverages,

preferring a Mono Line approach. A final reason for purchasing alternative coverage is cost. An individual may only be able to afford the minimum for insurance required by the lending institution holding the mortgage on the dwelling. In this case, the homeowner's package of coverages may appear to be too expensive.

The Dwelling Program is 1 of the alternatives to the Homeowners Policies. Other alternatives include Fair Plans and Beachfront Plans.

The Dwelling Program

The Dwelling Program provides Property Coverage for Dwellings and their Contents. The Dwelling Program includes 3 forms: DP-00-01, DP-00-02 and DP-00-03, which offer Dwelling and Contents Coverage similar to that offered under Section I of the HO-1, HO-2 and HO-3, respectively. The policy structure and approach to Property Coverage is like that found in the Homeowners Policies.

The following discussion compares the Mono Line Coverage in the Dwelling Forms with the coverage in the Homeowners Policies.

Insuring Agreement and Definitions

The Dwelling Forms is similar to that of the Homeowners Policy. The insuring agreements are identical. The first major difference occurs in the Definition Section.

The Dwelling Forms only define "you" and "yours" (the named insured and the spouse, if a resident of the same household) and "we", "us" and "our" (the insurance company). The remainder of the definitions in the Homeowners Policy pertains to the Liability and Medical Payment Coverage of Section II. As the Dwelling Forms do not have Liability or Medical Payments Coverage, these definitions are unnecessary.

Coverages

The Dwelling Forms provide coverage for the insured's dwelling, other structures on the described location, the insured's personal property and loss of use of the dwelling.

Coverage A- Dwelling - The Dwelling Forms refer to the "described location", while the Homeowners Policy refers to the "residence premises". When referring to the dwelling on the described location, the Dwelling Forms specify that it is used principally for dwelling purposes. The Dwelling Forms also specifically state that if not covered elsewhere in the policy, building equipment and outdoor equipment used for the service of and located on the described location are covered. The remainder of the Coverage A language is identical in the Dwelling and Homeowners Forms.

Coverage B - Other Structures - There are some minor differences in wording between the Dwelling and Homeowners Forms, but the coverage is essentially the same.

Coverage C - Personal Property - The coverage for Personal Property in the Dwelling Forms applies to Personal Property, usually to the occupancy of a dwelling owned for or used by the insured or resident family members, while the property is on the described location. This is a more restrictive description to the covered property than is in the Homeowners Policy, which covers Personal Property Owned or Used by an Insured while it is anywhere in the world.

There are no special Limits of Liability in the Dwelling Forms with respect to any type of property, while the Homeowners Policy provides Special Limits of Liability on many types of property excluded in the Dwelling Forms. **Example:** *the Dwelling Forms exclude boats, other than rowboats and canoes, but the Homeowners Policy provides a limit of \$1,000 on water craft, including their furnishings, equipment and outboard motors.*

The Homeowner Policy has special limits on theft losses to jewelry, furs, firearms, silverware and similar types of coverage. The Unendorsed Dwelling Forms have no theft coverage, only coverage for damage done by burglars.

The Coverage C Limit of Liability in the Dwelling Forms is chosen by the insured. In the Homeowners Policy, the Coverage C Limit of Liability is a set percentage of Coverage A and can be increased at the insured's option. If an insured is a landlord, he or she can choose to purchase only Coverage A under the Dwelling Program.

There is no such option with the Homeowners Policy. A tenant may choose to purchase only Coverage C under a Dwelling Form, thereby obtaining Property Coverage similar to that provided by a HO-4 policy.

Coverage D - Fair Rental Value and Coverage E - Additional Living Expenses - Coverage D and E in the Dwelling Forms correspond to Coverage D - Loss of Use in the Homeowners Policy. The only distinction between the forms concerns Fair Rental Value. The Homeowners Policy provides Fair Rental Value Coverage only if the residence premises where the loss occurred is the principal place of residence of the insured. There is no requirement that the dwelling be the principal place of residence of the insured.

Dwelling form DP-00-01 (basic form) includes only Coverage D, Fair Rental Value. Coverage for additional expenses is added by endorsement, for an additional premium.

Other Coverages

Many of the "other coverages" provided in the Dwelling Forms correspond to the "Additional Coverages" in the Homeowners Policy but there are some differences. Loss Assessment Coverage, which is included automatically in the Homeowners Policy, can be added to the Dwelling Forms by endorsement.

The following paragraphs discuss the other coverages in the Dwelling Forms and compare them with the coverage provided in the Homeowners Policy.

Other Structures - The Dwelling Forms provide up to 10% of the Coverage A Limit of Liability for Loss to Other Structures. Use of this coverage does not reduce the Coverage A Limit of Liability for the same loss. Similar coverage is provided in the Homeowners Policy under Coverage B.

Debris Removal - The Debris Removal Coverage of the Dwelling Forms is included in the Coverage A Limit of Liability. The Homeowners Policy provides an additional 5% of the Coverage A limit for Debris Removal if required.

Improvements, Alterations, and Additions - The Dwelling Forms, like the HO-4 Policy, provide 10% of the Coverage C Limit of Liability to cover a tenant's Improvements, Alterations and Additions. There is no comparable coverage in other Homeowners Forms.

Worldwide Coverage - In the Dwelling Forms, up to 10% of the Coverage C Limit of Liability is provided for loss to the property covered under Coverage C, except rowboats and canoes, while anywhere in the world. The Homeowners Policy provided worldwide coverage for Personal Property Owned or Used by an Insured but a 10% limitation applies to property usually located at a secondary residence.

Rental Value and Additional Living Expense - Under the Broad and Special Dwelling Forms (DP-00-02 and DP-00-03), the insured may use up to 10% of the Coverage A Limit of Liability for loss of both Fair Rental Value and Additional

Living Expense. Use of this coverage does not reduce the Coverage A Limit of Liability for loss of Fair Rental Value. Payment under this coverage reduces the Coverage A Limit of Liability by the amount paid for the same loss.

Reasonable Repairs - The Dwelling Forms and the Homeowners Policy provide coverage for the cost of Reasonable Repairs made solely to protect covered property from further damages. This coverage does not increase the Limit of Liability that applies to the covered property.

Property Removed - Covered property is protected if it is removed from premises endangered by an insured peril under both the Dwelling and Homeowners Forms. In both cases this coverage applies to direct loss from any cause for a period of 30 days (a limit of 5 days applies to the basic Dwelling Form).

Trees, Shrubs, and Other Plants - In the Dwelling Forms and the Homeowners Policy, the aggregate Limit of Liability that can be applied to trees, shrubs, plants or lawns is 5% of the Coverage A limit. The limit for any one tree, plant or shrub is \$500. This coverage can be added by endorsement to Dwelling Form DP-00-01, the basic form.

Fire Department Service Charge - As in the Homeowners Policy, the Dwelling Forms will pay up to \$500 for fire department service charges. Coverage is not provided if the property is within the city limits, municipality or protection district furnishing

the fire department response. This coverage is Additional Insurance and no deductible applies.

Collapse - The Broad and Special Dwelling Forms (DP-00-02 and DP-00-03) provide the same coverage for Collapse that is provided in the Homeowners Policy. This coverage is not available in the Basic Dwelling Form.

Glass or Safety Glazing Material - Dwelling Forms DP-00-02 and DP-00-03 provide coverage for the breaking of glass or safety glazing material that is part of a building, storm door/ storm window, and damage to covered property by such glass or safety glazing material.

Coverage does not apply if the dwelling has been vacant for more than 30 days. Similar coverage is provided in the Homeowners Policy.

Perils Insured Against

The following examinations of the perils insured against in the Dwelling Program are based on the Dwelling Special Form, DP-00-03. (This form will be referred to as DP-3 in the following discussion). Forms DP-00-01 and DP-00-02 provide coverage against essentially the same perils covered by the HO-1 and HO-2 forms. To the extent that there are differences, the Dwelling Forms tend to provide narrower coverage. For instance, there is no theft coverage for Personal Property under any of the Dwelling Forms, although such coverage can be added by endorsement.

Coverage A and B

The DP-3, like the HO-3, insures against risks of Direct Loss to Property under Coverage A and B. In each policy, the Coverage for Direct Loss to Real Property is defined by the perils that are excluded. Those causes of loss that are not excluded are covered. The DP-3 Form excludes coverage for theft of any property that is not part of a covered building or structure. It excludes loss by wind, hail, ice, snow, or sleet to (1) outdoor radio and TV antennas and aerials and (2) trees, shrubs, plants or lawns. The other DP-3 exclusions are essentially the same as those in the HO-3.

Coverage C

Although the Coverage C perils under the DP-3 form are similar to the perils covered by the HO-3, there are some differences. Theft of Personal Property is not covered under the DP-3, but coverage is provided for damage to Personal Property caused by burglars, unless the dwelling has been vacant for more than 30 days. The DP-3 specifically excludes pilferage, theft, burglary and larceny under the Vandalism or Malicious Mischief peril.

The Windstorm or Hail Coverage also differs slightly from the HO-3 in that the DP-3 specifically excludes windstorm or hail damage to canoes, rowboats, plants, shrubs and trees. The HO-3 does not cover windstorm or hail damage to trees, shrubs and other plants but it does cover damage to water craft and their trailers, furnishings, equipment and outboard motors, while inside a fully enclosed building.

Dwelling Policy Conditions

The DP-3 Form contains a single section of conditions. These same conditions are found in the HO-3 Policy, however, some conditions are applicable only to Section I, while others are applicable to both Section I and II. The Dwelling Policy does not contain the references to Loss by Theft and to Credit Card or Fund Transfer Card Coverage that are in the Homeowners Policy.

Coverages for Liability and Theft Loss -

The Dwelling Forms do not provide coverage for Liability or for Theft Losses. Coverage is available, however, through a Personal Liability Supplement and Theft Endorsements.

Personal Liability Supplement -

Liability Coverage may be written in conjunction with the Dwelling Policy or independently as a separate policy through the Personal Liability Supplement. The Personal Liability Form DO-24-01 provides basic Personal Liability Coverage (Coverage L) and Medical Payments to Others Coverage (Coverage M). These coverages are similar in format and language to Coverages E and F in Section II of the Homeowners Policy.

The definition in the Personal Liability Supplement (PL) differs from the Homeowners Policy only in regard to "residence premises". The definition of "residence premises" in the DL Form includes a *1-4 family dwelling*. The corresponding language in the Homeowners Policy refers to *1-or-2 family dwellings*.

Coverage L - Personal Liability and Coverage M - Medical Payments to Others of the DL Form are identical to Coverages E and F of the Homeowners Policy. Similarly, the exclusions and additional coverages in the DL form are virtually the same as those applicable to Section II of the Homeowners Policy. The only difference is that the additional coverage for Loss Assessment in the Homeowners Policy is not provided in the DL form, as with the Dwelling Forms, the conditions and the conditions applicable to Section I and II in the Homeowners Policy.

Fair Plans

Fair access to insurance requirements plans were set up in response to the urban riots of the 1960's. At that time, property insurance was difficult to obtain in the "congested urban core" of many major cities.

The Fair Plan Program is an Assigned Risk Property Program. In order to be eligible for Fair Plan Coverage, the insured must have the property inspected. Only property that meets the inspection criteria will be insured.

When the program was drawn up, the concern was that well-kept properties with inner city locations would be prevented from obtaining coverage by virtue of their location. The program directs that the inspection of the property must concentrate on the property alone and ignore "environmental perils". The environmental perils that the program designers had in mind were primarily those found in run-

down, crime-ridden urban slums. Others noticed that brush hazards found in wealthy, tree-studded suburban areas might also be considered "Environmental Hazards".

Many Fair Plans do not provide the Homeowners Coverage package but such coverage is available in some states. In most states, however, only coverage for fire and a limited number of other perils is provided by the Fair Plan. Other coverages are provided by means of a Difference in Conditions Policy written outside of the Fair Plan. Such policies can provide coverage for Risks of Direct Loss, while excluding fire and the other perils covered under the Fair Plan Policy. Since it is the Fire Peril that is the major concern in these cases, the Difference in Conditions Policy can be written in the private market.

Beachfront Plans - Beachfront Plans are part of an Assigned Risk Property Insurance Program that is somewhat like the Fair Plan. The origins of the plans differ in that the Beachfront Plans were set up in response to heavy windstorm losses rather than urban riots.

Beachfront property in many parts of the country is exposed to heavy windstorm losses during hurricanes and lesser windstorms. Much of this property also is vulnerable to damage from high waves. The Beachfront Plans provide coverage for fire and windstorm losses. Losses from high waves are generally excluded.

Family Residence Insurance Case - Jim and Mary Pierce own a home at 1 Beacon

Place, in Palm Harbor, Florida. It is a single-family home with 3 bedrooms and 2 baths. The mortgage on this dwelling is held by National Bank and Trust.

Jim Pierce has an office in the home where he runs an investment advisory business as a sideline. Jim's in-home office is the only location of that business, which Jim operates as a sole ownership. Mary Pierce is an amateur nature photographer and has several expensive cameras and lenses. With the exception of Jim's business property and Mary's photography equipment, they own no other remarkable Personal Property.

The Pierces also have a summer cottage at Ocean City, New Jersey. This cottage has two bedrooms and two baths. A 2-car detached garage also is located on the premises. The Pierces have no mortgage on the property.

Family Residence Coverages - Jim and Mary Pierce have purchased an HO-3 Policy with \$200,000 Coverage A limit on their 1 Beacon Place home. This \$200,000 of coverage is approximately equal to the replacement cost of the dwelling.

*The Pierces had added several endorsements to their HO-3 policy to meet their needs. Since Jim has an office in the home, which is a permitted incidental occupancy, **Endorsement HO-04-02** has been added to the policy. In order to keep the policy's Property Coverage current with inflation, the Pierces purchased Inflation Guard Coverage under an **HO-04-46 Endorsement**. Mary's camera collection is listed as Scheduled Property on the*

*Scheduled Property **Endorsement HO-04-61**. The Pierces have added the Personal Property Replacement Cost Endorsement, **HO-04-96**, to their policy. Due to this Endorsement, the Pierce's insurer requires that they carry a Coverage C limit of \$140,000, which equals 70% of the Coverage A limit. The Pierces receive a premium credit for the 3 smoke alarms in the house. The premises alarm for Fire Protection System **Endorsement HO-04-16** was added to the policy to reflect the presence of alarms. National Bank & Trust has its interest in the Pierce's dwelling protected by being listed as the mortgagee on the declarations page of their policy.*

The Pierce's have purchased a DP-3 Policy to cover their summer cottage in New Jersey. The dwelling is covered for \$50,000, which is its approximate replacement cost. The garage is covered for \$6,000, the limit chosen by the Pierce's. They have also purchased \$15,000 of DP-3 Contents Coverage on the furnishings and other items usually left at the cottage. A \$100 deductible applies to all covered losses.

HOMEOWNERS LOSS SITUATIONS

Section I Coverages

The following situations apply to the Property Coverages of the HO-3 and DP-3 Policies. Each loss is a separate occurrence.

Loss: *Jim and Mary Pierce suffered a loss to the kitchen of their Florida home as a result of a smokey grease fire started by food cooking on their stove. The woodwork*

and ceiling was stained by the heavy smoke and built-in kitchen cabinets were damaged. The Pierce's reported the loss and were asked by their insurer to get 3 estimates from contractors. The estimates ranged from \$3,850 to \$4,425 to clean and repaint the kitchen and to repair and replace the damaged cabinets. The contents of the kitchen were also damaged. The Pierce's can replace the damaged small appliances, cookware and utensils for \$650.

Comment: Because the Pierces carry Insurance to Value, the repairs to the kitchen will be paid under Coverage A with no deduction for depreciation. The adjuster for their insurance company accepted the estimate of \$3,850 for the Coverage A loss. The Coverage C loss of \$625 was also found to be in order. Thus, if replacement is made, the Pierce's recovery will be as follows:

Coverage A	3,850
Coverage C	625
Less Deductible	<u>(250)</u>
Total Payment	\$4,225

Assume that the Pierces had carried Coverage A limit of only \$100,000 at the time of the above loss. What amount would the Pierce's receive for the loss to the dwelling?

The insurance-to-value fraction yields:

Insurance Carried
80% replacement cost

$\frac{\$100,000}{200,000} = .5$ or .625
80% x .625 = .5

Because the insurance-to-value fraction equals less than 1.0, the Pierces would not receive Replacement Cost Coverage on the loss to the dwelling. The Pierces would receive the greater of the following amounts: (1) the insurance-to-value fraction, multiplied by the replacement cost of the loss, less the deductible or (2) the Actual Cash Value of the loss less the deductible.

If the Pierces and the adjuster agreed that the Actual Cash Value of the loss is \$3,300, what settlement would the Pierces receive? To answer this question, the following calculation using the insurance-to-value fraction is required to determine the settlement:

$$\frac{\$100,000}{80\% \times \$200,000} \times (3,850 - 250) - \frac{5}{8} \times 3,600 = \$2,250$$

Loss Settlement on an Actual Cash Value basis would be \$3,300 - \$250 or \$3,050. Since \$3,050 is greater than \$2,250, the Pierce's loss would be settled on an Actual Cash Value basis for \$3,500.

Loss: *The sewer backs up at the Pierce's Florida home and water overflowed from the drains. The overflow in their first-floor powder room damaged the contents of their linen closet and vanity. In addition, it costs \$475 to cleanup their home.*

Comment: Damage caused by water backing up through sewers is excluded under Coverage A and is not a peril insured against under Coverage C. There would be no coverage for damage to the dwelling or its contents.

Loss: *Due to malfunction of the water heater, steam sprayed into the laundry room of the Pierce's Florida Home, causing \$350 worth of irreparable damage to their clothing. It costs \$50 to replace a defective part in the water heater.*

Comment: Under Coverage C, damage to Personal Property caused by the accidental discharge of steam from within a plumbing system is covered. The Pierce's will receive the replacement cost of the clothing because of the Personal Property Replacement Cost Coverage (HO-04-90) Endorsement, less the \$250 deductible. Under Coverage A, coverage for this type of accidental discharge excludes damage to the system or appliance from which the water or steam escaped. Therefore, there will be no payment for the cost to repair the water heater.

Loss: *A five-story apartment building near the Pierce's Florida home was severely damaged by fire. The Fire Department ordered the Pierce's and several of their neighbors to evacuate their homes because the fire threatened to spread to homes near the apartment building. The Pierces were not allowed to return to their home for 3 days after the fire because the Fire Department feared that the fire-gutted apartment building might collapse. The Pierces incurred the following Additional Living Expenses during this period:*

1. \$375 for 3 nights lodging at a motel
2. \$270 for 3 days of restaurant meals

The cost of groceries for the Pierces averaged \$35 per day when they eat at home.

Comment: Coverage D Loss of Use provides coverage for Additional Living Expenses if a civil authority prohibits the insured from use of the residence premises as the result of direct damage to neighboring premises by a peril insured against under the Homeowners Policy. The Pierces' \$375 motel bill and their additional expenses for meals qualify for payment under Coverage D. The Pierces' additional food expense is the \$270 cost of restaurant meals less the \$105 that they would have spent to eat at home, which comes to \$165. The Pierces' recovery will be as follows:

Motel Bill	\$375
Additional Cost of Meals	165
Less Deductible	<u>(250)</u>
Total Payment	\$290

When determining the Loss Settlement in such a case, it is necessary to consider other increased expenses, such as laundry, transportation and telephone. However, the insured's usual expenses for such items, as well as, any decrease in the cost of utilities or other expenses would be considered in determining the total amount of the additional expense.

Loss: *When the Pierces returned to Palm Harbor from New Jersey, they found that the rear door of their home had been broken open and that several items had been stolen. The Pierces' losses are as follows:*

<u>Item</u>	<u>Replacement-Cost or Value</u>
Jewelry	\$1,495
Cash	250
Video Cassette Recorder	350
Nikon FA Camera Body	525
Nikon 500mm Lenses	475
Replacement for rear door and trim	300

The Pierces reported the loss to their insurer and the police as required in the HO-3 Loss Settlement Conditions. An adjuster visited the Pierces' home, photographed the rear door, and obtained copies of receipts and other supporting evidence for the Pierces' Personal Property Claim.

Comment: Theft is a covered peril under Coverage C of the Homeowners Policy and under the Scheduled Personal Property Endorsement. The Pierces will receive settlement under these coverages for the loss of their Personal Property. Damage done by burglars is not excluded under Coverage A, so the Pierces' Loss Settlement will include the cost of repairs to the rear door. Each item of the Loss Settlement is described below.

Jewelry - *The Pierces' \$1,495 jewelry loss is \$495 greater than the \$1,000 HO-3 sub-limit on jewelry. In addition, their HO-3 contains a \$250 deductible applied to the total theft loss. These 2 limits on recovery*

are applied in the following way: the \$250 deductible applied to the total jewelry loss of \$1,495 leaves an insured jewelry loss of \$1,245. Next, the sub-limit of \$1,000 is applied to the loss, resulting in a payment of \$1,000 for the jewelry loss. Because the deductible has been satisfied by this portion of the loss, no deductible applies to the balance of the loss.

Cash - The HO-3 contains a \$200 sub-limit on cash, which is the amount the Pierces will receive for the loss.

VideoCassette Recorder - The HO-3 provides the insurer with the option of making Loss Settlement by replacing damages or stolen property. Insurers frequently use replacement services from which they can purchase appliances at a lower cost than the insured would have to pay in the retail market. The Pierce's insurer may replace their stolen VCR with a comparable new model or pay its replacement cost.

Camera Body - The replacement cost of the stolen camera is greater than the amount on the Pierce's Scheduled Personal Property (HO-04-61) Endorsement. Therefore, the insurer's payment will be limited to the amount of insurance shown. \$480

500MM Lens - The replacement cost of the lens is less than the amount of insurance shown on the Pierce's HO-04-61 Endorsement. Therefore, the insurer will pay this lesser amount of \$475 or replace the lens.

Damage to the Dwelling - The full \$300 cost for repairing the damage done by the

burglars breaking into the dwelling will be paid under Coverage A, since the Pierces carry Coverage A limits that meet the HO-3 Insurance-to-Value Requirements.

Additional Comments: The Personal Property Replacement Cost Endorsement HO-04-90 provides that if the entire loss is more than \$500, the insurer will pay no more than the Actual Cash Value of Covered Personal Property until the actual repair or replacement of an item is complete. If the Pierces decide not to replace any of the stolen items, then payment for any item not replaced would be made on an Actual Cash Value basis because their total Personal Property loss exceeds \$500.

If any of the stolen items are recovered and returned to the Pierces, or their insurer, after the Loss Settlement, the party to whom the items are returned must notify the other. The Pierces would then have the option of accepting the recovered items and returning the loss payment to the insurer or allowing the insurer to keep the items as salvage and retaining the loss payment already made.

Loss: During a severe storm, several feet of snow accumulated on the roof of the detached garage at the Pierce's New Jersey property. The garage roof caved in under the weight of the snow, causing some structural damage to the garage walls. At the time of the loss, the replacement cost of the garage was \$8,000. Based on estimates from 3 contractors and considering the age of the roofing material destroyed, the Pierces and their insurer's adjuster agreed on the following values of the loss: (1) a Replacement Cost Value of \$3,300 and (2) an Actual Value of \$2,800.

Comment: Damage to the garage is covered for risks of Direct Loss under Coverage B of the Pierce's DP-3 policy. Damage to the garage caused by snow accumulation is not excluded and is covered. The DP-3 Policy provides Replacement Cost Coverage on Other Structures if the amount of coverage carried equals at least 80% of the structure replacement cost. The Pierces' coverage does not meet this requirement so the insurance-to-value fraction must be applied to the replacement cost of the loss to determine the amount payable if settlement is made on this basis. The calculation, which includes the \$100 policy deductible, is as follows:

$$\frac{\$ 6,000}{80\% \times \$8,000} \times (3,300 - \$100) = \frac{15}{16} \times \$3,200 = \$3,000$$

The Pierce's will receive \$3,000 in payment for the loss because this is greater than the \$2,500 settlement amount on an Actual Cash Value basis (\$2,900 less the \$100 deductible).

Section II Coverages

The following situations apply to the Liability and Medical Payments Coverage of the HO-3 policy. Each loss is a separate occurrence.

Loss: *The Pierces went to Vermont on a weekend ski trip. As James was skiing down a steep slope, he collided with another skier who had stopped to adjust the bindings on his skis. The other skier, Bruce, was hospitalized with a broken hip as a result of the accident.*

Comment: Coverage E of the Homeowners Policy provides coverage for liability arising out of accidental bodily injury caused by the insured. Because the Coverage E limit of the Pierce's Homeowners Policy is \$100,000, the insurer will pay court awarded damages or a negotiated settlement for this loss up to the \$100,000 policy limit. In addition, the insurer will pay the costs associated with investigating the claim, negotiating a settlement or defending the case if it goes to court.

Loss: *Jim and Mary entertained their friends Chip and Dee at their Florida home one weekend. Dee tripped walking up the stairs and hurt her ankle. Mary and Dee went to the emergency room of a local hospital, where the Doctor determined that Dee had sprained her ankle but had suffered no broken bones. The cost of the emergency room visit and follow-up care by Dee's Doctor amounted to \$375.*

Comment: Coverage F of the Homeowners Policy provides for the payment of necessary medical expenses that arise out of bodily injury to a guest in the insured's home. Coverage is provided without regard to negligence or fault on the part of the insured up to the policy limit purchased. The Pierce's Coverage F limit is \$1,000 and Dee's medical expenses will be paid in full under the Pierce's Homeowners Policy.

Assume that Dee sustained this injury at the Pierce's New Jersey Cottage. Would either the Pierce's DP-3 or HO-3 policy respond? The DP-3 Policy provides Property Coverage only and would not respond to this loss. The Pierces had requested their insurer include their Ocean City cottage as an

"Other Insured Location" for Section II Coverage under the HO-3 Policy. Therefore, Coverage F, as well as Coverage E, applies to losses occurring at either the Florida home or the Ocean City cottage. Dee's medical expenses would not have been paid in full if the loss had occurred at the Pierce's vacation cottage.

Loss: *Jim trimmed several trees and bushes at the Pierce's Florida home one weekend. He borrowed a gas-powered chipper from a neighbor to turn the cuttings into mulch for the garden. Jim accidentally dropped a rock into the machine, breaking some of its blades. Repair costs for the machine were \$175.*

Comment: The HO-3 provides up to \$500 of coverage for Accidental Property Damage to the Property of Others. In this case, the adjuster would confirm that the repair costs were reasonable and pay the full bill, reimburse Jim or the neighbor for payments made. The payments under this additional coverage are made whether or not the Pierces are legally liable for the loss.

Loss: *As Sandy, one of Jim's investment clients, was leaving the Pierce's home, she slipped on the slick, rain drenched cement that had not been swept or mopped up. Sandy suffered a broken wrist. Her medical expenses were \$1,500. Sandy sought payment from Jim for these medical expenses.*

Comment: Sandy's injury arose out of Jim's use of the Pierce's residence for business purposes. Coverage for Liability Damage

and Medical Expenses arising out of this bodily injury is available to the Pierces only because they added the Permitted Incidental Occupancies Endorsement (HO-04-42) to their HO-3 Policy. Sandy's medical expenses exceed the Pierce's Coverage F medical payment limit of \$1,000. However, because of the circumstances of the injury, it is possible that the Pierces could be held liable for the cost of Sandy's medical expenses, as well as, other damages should she choose to bring suit against them. The insurer will respond under Coverage E of the HO-3 Policy and pay Sandy's \$1,500 of medical expenses.

Loss: *Sal, a client of Jim's investment advisory service, asked Jim whether he should sell 1,000 shares of a particular stock or hold on to it in the hope that the price would go higher. Jim recommended that Sal sell the stock immediately and Sal did. In the two weeks after Sal sold the stock, its price increased \$10 per share. Sal sued Jim alleging that Jim's bad advice had resulted in a \$10,000 loss to Sal.*

Comment: Any liability on Jim's part for Sal's loss arises out of Jim's rendering of professional advisory services. Liability arising out of the rendering of **professional services** is excluded under the HO-3 policy, and the permitted incidental occupancies endorsement does not provide this coverages. The insurance company would provide no coverage for this liability claim under the Pierce's HO-3 policy.

Chapter 7 - Review Questions

1. Mono Line Policies that provide property coverage similar in many ways to the property coverage in Homeowners Policies are?
 - A. Vacation Home Policies
 - B. Auto Policies
 - C. Dwelling Policies
 - D. All of the above

2. Frequently mobile homes suffer severe damage in:
 - A. Snow storms
 - B. Heavy rains
 - C. Sunshine and heat
 - D. Hurricanes

3. The minimum Limit of Liability for Coverage B under a Mobile Home Endorsement is:
 - A. 2,500
 - B. 500
 - C. 1,500
 - D. 2,000

4. An alternative to purchasing a Homeowners Policy would be the purchase of:
 - A. Dwelling Program
 - B. Various Endorsements
 - C. An Umbrella Liability Policy
 - D. None of the above

5. Property insurance that was difficult to get in the "congested urban core" areas of many major cities was addressed by what plan?
 - A. HUD Plan for Development (HUD)
 - B. Intercity Redevelopment Organization (IRO)
 - C. Fair Access to Insurance Requirements (FAIR)
 - D. None of the above

Answers

1. C
2. D
3. D
4. D
5. C

Chapter 8 – Homeowners Coverage Recommendations

"A wise man will make more opportunities than he finds." Francis Bacon

Introduction

As we finish our study of Homeowners Policies, we will offer a general view of the various forms available and then make specific recommendations.

Most consumers who own a home have Homeowners Insurance. The problem is there is a good chance that very few of these homeowners have really given their coverage any thought. The time most homeowners think about their Homeowners Policy is when the premium arrives or when a tree crashes through the living room, a fire barbecues the kitchen or a burglar absconds with the family silver.

Homeowners Insurance can help ease the financial pain. It can also add to one's frustration and distress if a loss is endured only to find that the insurer has another ordeal in store for the victim. The problem is, until it comes time to make a claim, it is difficult to know whether the insurer will provide a Fair and Fast Settlement.

The potential problems for Fair and Fast Settlement does not rest entirely on the insurers shoulders. The homeowners must be aware of their coverages and existing gaps (if any exist).

Homeowners Insurance is designed to provide full coverage for Dwelling, Contents

and Liability Exposures. It safeguards individuals against these types of exposures through a multiple combination of coverages provided by: a Fire Policy on a building and its contents, a Comprehensive Personal Liability

Policy and Theft Coverage: The basic concept of Homeowners Coverage is to require certain minimum amounts of coverage on both the Dwelling and the Contents and to include Theft Coverage and Personal Liability Insurance on a mandatory basis. There are multiple forms to cover homeowners, renters and condominium dwellers.

The insurance professional's role in evaluating Homeowners Coverage is to review Homeowner Policies to ensure adequacy and appropriateness for the client, as well as, to verify that any changes are needed. It is important to check that no gap exists between the various Casualty Coverages. Many clients are under-insured with policies that have inefficient premiums.

Clients frequently do not understand the difference between replacement cost and market value and are confused about who and what is covered and for how much.

How does one go about purchasing a Homeowners Policy? With several policy types to choose from, the insurance professional needs to become familiar with each, to

ensure that the client is purchasing the most suitable forms. As the forms were discussed extensively in previous chapters, we will give a "thumb nail" summary of each. All forms will provide 2 sections of coverage. **Section I** provides coverage on the *Insured's Own Property* and can vary accordingly. **Section II** Provides *Liability and Medical Payments Coverage*, which is identical under all forms.

Picking the Right Policy

Insurance companies offer 6 basic types of Homeowners Insurance Policies.

HO-1 - This "basic" Homeowners Policy protects the client's home against 11 named perils. That is rarely enough; so many states are phasing out this type of coverage.

HO-2 - The "broad" Homeowners Policy covers the client's home against 17 named perils. A variation of HO-2 is available to most mobile home owners. This type of policy generally costs 5-10% more than the HO-1 Coverage as it protects property from fire, wind and living in the path of the moving St. Helen's volcano, burst pipes and a short circuited electrical system.

HO-3 - The "special" Homeowners Policy protects the client's home against all perils except those specifically excluded by the contract. It typically costs 10-15% more than the HO-1 Policy. Some of the exclusions are earthquakes, sewer backups, floods and wars.

Many companies also offer a "Guaranteed Replacement Cost" Policy, which goes a step further than a standard HO-3. It offers to pay the full amount needed to replace the home and its contents, even if that exceeds the policy limit. Despite its name, however, many companies set limits for this coverage, paying only up to 120-150% of the policy's face value. The limit for Contents Coverage is generally set at 75% of the home's replacement cost, as opposed to the standard 50% on other policies. (This type of policy, usually written as a form of HO-3, offers coverage similar to what was formerly called HO-5, a policy that has been phased out by most companies).

HO-4 - The Renters Policy generally protects the possessions of tenants in a house or apartment against 17 named perils. It also provides Liability Coverage but does not protect the actual dwelling, which should be covered under the landlord's policy. Renters who do not want Liability Protection can opt for a policy that covers only Personal Property.

HO-6 - The policy for Co-op and Condominium owners provides coverage for Liability and Personal Property, much like HO-4. While insurance purchased by the Co-op or Condominium Association covers much of the actual dwelling, individuals wanting coverage for improvements must write them into a HO-6 policy. If the client adds a porch for instance, he/she will need an Endorsement.

HO-8 - Primarily for older homes, this policy covers the same perils as HO-1 but insures the house only for repair costs or its Actual Cash Value, not its Replacement Cost because the cost of rebuilding with the materials and details of the original would make Replacement Cost Coverage prohibitively expensive. A HO-8 policy pays to restore the damaged property but not necessarily with the same kind or quality of materials as the original. Perils covered would be the 11 risks commonly used for HO-1 Policies. This means burst pipes and faulty wiring is excluded.

Insuring Against Other Risks

Some perils are generally not covered by any of the standard Homeowners Policies. Chief among them: floods and earthquakes. Residents of areas prone to crime, fires and windstorms may also find insurance companies unwilling or unable to sell them policies. For owners of high-risk homes, there are several options.

Flood Insurance - the National Flood Insurance Program, administered by the Federal Emergency Management Agency (FEMA), offers Flood Insurance through the Federal Government and some 85 private insurers. To qualify, homeowners must live in one of 18,300 flood-prone communities that have taken specific steps to control flood damage. Rates vary according to the structure of the house and its vulnerability to flooding. The average annual premium is about \$308, which provides around \$85,000 in coverage.

While FEMA estimates as many as 11 million buildings may be at risk of flooding, only 2.6 million are currently insured for it. An estimated 90% of the homes in the 1992 Midwest floods were not insured for flood damage. For homeowners who might be tempted to wait until a flood alert is sounded, take note: **there is a 5 day waiting period between the time a Flood Policy is purchased and when it becomes effective.**

Earthquake Insurance - Most insurance companies offer Earthquake Coverage as an Endorsement on Homeowners Policies. Premiums can run as high as 50% of a home's regular coverage but rates vary according to the vulnerability of the house. Wood-frame homes, which tend to withstand quakes better than bricks, cost much less to insure.

Windstorm Insurance - Most policies include insurance for windstorm damage. However, companies may exclude coverage for the peril if a house is unusually vulnerable to windstorms by virtue of its location. Seven coastal states currently have Beach and Windstorm Insurance Plans to pick up where the regular policies leave off. Those states are: Alabama, Florida, Louisiana, Mississippi, North Carolina, South Carolina and Texas.

High-Risk Policies - Insurers may refuse to sell Full Replacement Cost Coverage for homes they deem to be particularly vulnerable to fire, crime or other perils. Unsafe wiring, unrepaired structural damage or a history of vandalism may make a home uninsurable at some companies.

31 states and the District of Columbia offer fair access to insurance requirement plans, for people who have difficulty obtaining insurance in the standard market. Fair Plans are operated by private insurers, which share the losses and profits in proportion to their business in the State. Fair Plan Policies are often more expensive and less comprehensive than standard Homeowners Insurance.

Residents of high-crime areas who have the required security devices also may qualify for insurance with the Federal Crime Insurance Program. The policy covers only losses due to burglary or robbery.

Coverage Types

Homeowners Policies provide coverage for a broad range of perils with the successive forms covering more. There are several types of Section I Coverage. Remember as previously noted, Coverage A covers the Dwelling and provides protection on the dwelling itself. That includes structures attached to the dwelling and material and supplies located on the premises or adjacent to the premises, which are intended for use in construction, alteration or repair of the dwelling.

It is also used to cover a home under construction. Land is not covered. Generally, land is valued at 20% of the total purchase price of a house. The client's dwelling amount of coverage should only reflect 80% of the total value of the home.

Coverage B covers Other Structures. This includes the garage and other detached (separate from the dwelling with a clear space) structures and equals 10% of the Coverage A amount. It may include non-building structures as fences, patios or even a swimming pool. It excludes buildings used for business purposes, except for the rental to anyone if used exclusively for garage purposes.

Coverage C, which provides for Contents Coverage under HO-2 and HO-3, is 50% of the amount of coverage on the dwelling. Under forms HO-4 and HO-6, the minimum coverage on contents is \$6,000. The Contents Insuring Agreement on all forms is identical.

The client must be aware that Personal Property limitations exist under a HO policy. Jewelry, watches, fur, and precious/semi-precious stones lost by theft are indemnified up to \$1,000 per item. Coverage in excess of this amount needs to be secured by an endorsement, which provides first dollar coverage for those higher-priced items anywhere in the world; **examples would include a mink coat and a diamond engagement ring.** If more coverage is desired on a particular item, one can "schedule" or specifically list that item for additional coverage. This is for high-priced items, such as jewelry, furs, silverware, etc. and should be insured for the covered amount (which should be in line with the replacement cost basis). The actual invoice for an older item or an appraisal is needed.

Coverage D is Loss of Use Coverage and provides for Additional Living Expenses and Loss of Rental Income. Under Form HO-2 and HO-3, coverage is 20% of the amount of the dwelling. Under HO-4, coverage is 20% of the Contents Coverage, and under form HO-6 it is 40% of the amount of the contents. It also provides protection against loss involving both the part of the premises occupied by the insured and any part rented to others. The Additional Living Expense Coverage pays for the necessary increase in living expenses incurred by the insured to continue as nearly as is practical the normal standard of living of the household when the premises were rendered uninhabitable by an insured peril. Payment is made only for the period required to repair or replace the damage, or if the insured permanently relocates, for the period required to settle the house elsewhere.

Basic Recommendations

This section is in 2 parts, "*Saving Money on Homeowners Premiums*" and "*The Proper Amount of Homeowners Coverage to Purchase*". We end the chapter with ideas on getting a Fair Settlement if disaster does strike.

"Saving Money on Homeowners Premiums"

Many of the underwriting factors that go into setting prices are out of the control of clients but not all of them. As with Auto Insurance and other lines of coverage, there are some direct steps one can take to reduce the premium paid for this important protection.

Shop Around

The Homeowners Insurance field is an extremely profitable one for the insurance industry. In fact, it is one of the most profitable types of insurance in the industry markets. In 1988, over \$17 billion worth of premiums were collected in the United States alone. This provided very large profit for the insurance companies. One of the duties of an insurance professional is to recognize this fact and try to obtain the best coverage for the most affordable premium for clients.

Consumers should put the competitive marketplace to work for them. By guiding the consumer to obtain at least 3 competitive bids for the needed protection, the insurance professional is providing badly needed service to clients. It is important to obtain quotes from financially secure companies by using *Best Insurance Reports*.

Do Not Over Insure

A large part of what clients pay in premiums is determined by the amount of coverage selected. Some significant dollars can be saved by taking a close look at the following:

The Size of the Deductibles - *The basic Homeowners Insurance deductible is usually \$250. If one can afford to pay a higher deductible amount in the event a claim occurs, a large savings can be had.*

The Size of the Liability Protection - *If the basic Liability Protection is sufficient to suit needs; it would be prudent not to pay for higher levels of protection.*

The Amount of Money to Replace the Dwelling - It would be wise to be insured for an amount sufficient to rebuild the dwelling should it be destroyed. However, many people make the mistake of insuring in an amount equal to the entire value of the property, including the land. Thus, they are paying more than they have to for protection.

Investigate Discounts

There are several discounts available to consumers of Homeowner's Insurance.

Multiple Policy Discount - If one used the same company to write Homeowner's Auto and Umbrella Policies, a discount should save as much as 15% on the premiums.

Safety Device Discount - If the house is fitted with smoke detectors, the consumer should be sure to inform the insurance company. The same goes for burglar alarms.

Smoker's Discount - Smokers have a high likelihood of seeing their homes go up in smoke than non-smokers. Some companies recognize this fact by reducing premiums if one does not smoke.

Fire-Resistance Material Discount - A house constructed of fire-resistant materials can significantly reduce the chance of fire. This may result in reduced premiums.

Mature Homeowners Discount - Some companies reward longevity by reducing the premiums on Homeowner's Insurance.

Loyal Customers Discount - Usually the insurance industry is impersonal when it sets rates, however, some company's reward longtime customers with discounts.

Excluding Coverage for Wind and Hail - In some areas of the country, the danger from wind and hail is substantial. In these locales, a significant amount of homeowner's premiums go to cover these perils. If the consumers want to take a chance, one can save on premiums by agreeing to exclude these coverages.

A Word On Endorsements - Endorsements allow consumers to add to coverages in order to protect individual needs. As we have seen, the basic policy covers a wide range of insurance protection. However, it is not complete. One may wish to add the following protection through endorsement.

Home-Office Coverage - The basic Homeowner's Policy will cover \$2,500 worth of business equipment. If a client works out of their home and has business equipment in excess of the amount, he/she may wish to increase this protection.

Personal Articles Floater - The basic coverage for Personal Property Loss is sometimes inadequate to fully protect valuables such as jewels, fur coats or antique furniture. If one has valuables such as these, they may wish to specifically identify them with the company and establish their value. As noted, this is done by appraisal or using purchase receipts. It would be prudent to keep receipts, photographs, schedules or other proof of value of Personal Property in

a safe and secure place. A bank safety deposit box is ideal; however, many individuals would rather keep that material at home. If this is done, it is wise to store it in a fireproof safe or container.

Increased Blanket Coverage - *If the total of an individual's Personal Property is worth more than the policy's basic coverage that will apply to a loss, one can increase the Blanket Coverage. To determine the value of property, an individual should obtain a Personal Property Inventory Form.*

Buy Replacement Cost Insurance - *Unless clients make other arrangements, if they suffer a loss to Personal Property, they will be paid what it is worth as of the date of the loss. This is often less than replacement cost as depreciation is deducted from the payment. If a client chooses, he can pay for coverage that will replace the lost items regardless of their actual worth on the date of loss.*

Building Code Coverage - *Many older homes no longer meet current building and safety codes. In such cases, if the home is substantially damaged, local law may require that the entire building be demolished and rebuilt. The only problem is that the policy coverage will not be enough for this demolition and rebuilding process, leaving homeowners with coverage GAG. If such a situation does apply, one should investigate purchasing an endorsement that will pay for the cost of rebuilding as dictated by local building and safety codes.*

How Much Coverage Is Needed?

It is important to buy enough insurance to cover the cost of rebuilding the home. That may bear little relation to its market value. A finely crafted 19th century house in a run down 20th century neighborhood could cost far more to rebuild than it cost to buy. A modest home on a prime piece of real estate might be rebuilt for a fraction of its purchase price. If the limit of the Homeowners Coverage is based on the mortgage, one should be sure that it is enough to cover the current cost of rebuilding.

To determine the rebuilding cost, it would be prudent to work with a client to calculate the current cost of construction for a house similar to the clients. Another option would be to hire a professional appraiser to do it. A general way to estimate home rebuilding cost would be to multiply the square footage of the home by the current building cost per square foot for similar homes in the area. Usually, a real estate agent, or builder association can provide this vital information.

Most insurance companies recommend that the homeowner insure the home for 100% of the rebuilding cost, including the foundation. Though very few homes are totally destroyed it does happen, as victims of the 1991 fire in Oakland, California can attest, as foundations melted in the 200° heat. If the home is not covered for 100% of its replacement, a homeowner might not receive enough insurance money to replace it with a house of similar size or quality in the event of total loss.

All homeowners should buy insurance for at least 80% of the home's replacement value. If less is purchased, the homeowner forfeits the right to collect the full replacement value of the insured property, even for a partial loss. **Example:** *if the replacement cost of a home is \$100,000 and there is a fire in the kitchen that causes \$10,000 in damage, the homeowner will collect \$10,000, as long as they have at least \$80,000 in insurance.*

The safest bet is to buy a Guaranteed-Replacement Cost Policy, which will generally pay up to 20 or 50% more than the face value of the policy to rebuild the home. With such a policy, the insurer automatically adjusts the amount of insurance each year to keep up with rising construction costs in the area. The policy also protects against the unexpected, such as a sudden increase in construction costs due to shortage of building supplies (a problem for hurricane Andrew victims). Companies that offer this option usually require that the homeowner insure the home for 100% of its replacement cost to begin with. Owners of high-risk or older homes may not be eligible for this type of policy.

Inflation

Homeowners should have a policy that automatically adjusts the amount of coverage to reflect rising construction costs in the area. This is called an **Inflation-Guard Clause**. Some insurers offer this protection free; others charge \$2 to \$5 a year.

Personal Property

It is important for the homeowner to establish the value of property in order to

simplify the claim process. All homeowners should take an inventory of their personal possessions by going from room to room and listing the valuable items that are owned. The insurance agent should provide an inventory form. Some information that is needed would be serial numbers (usually found on the bottom or back of appliances), the approximate purchase dates and prices paid. It also is a good idea to photograph or videotape possessions as well. Of course, the proper storage place for any inventory, appraisals and pictures of videotapes would be in a safe place away from the home, such as in a safe-deposit box.

Once the homeowner estimates Personal Property, the next step is to total all estimates and find a precise number that it would cost to replace such possessions. Most policies cover personal possessions for 50% of the insured value of the house. **Example:** *the house is covered for \$100,000; the insurer will pay up to \$50,000 for loss or damage of its contents. For a higher premium, it would be possible to increase that coverage to 75%.*

Replacement Cost Coverage on Contents

There are 2 ways to insure Personal Property. An Actual Cash-value Policy pays the amount needed to replace the item, minus depreciation. **Example:** *a fire destroyed a sofa that costs \$1,000 five years ago, only \$750 would be paid, assuming it had a 10-year life and would cost \$1,500 to replace at today's prices. A Replacement Cost Policy would pay \$1,500.* For most people, Replacement Cost Coverage on property is worth the extra 10 to 15% that companies typically charge for it.

Other Structures and Landscaping

Most policies cover a structure that is detached from the house, such as a gazebo or free standing garage for up to 10% of the total insured value of the home. To qualify as "separate", a structure must be separated from the main house by a clear space connected, at most, by a fence or utility line. Any structure that is connected by something more substantial, such as a shared roof, is not considered separate, and should be figured into the total value of the house. Trees, plants and shrubs are generally covered for no more than 5% of the insurance on the house. They also are not covered for as many perils; wind damage, for instance, is usually excluded.

How Much Liability Coverage is needed?

The Homeowners Policy offers Liability Protection for Bodily Injury and Property Damage that covers injuries or damage caused by the homeowner, a member of the family or a pet. The insurance covers the injured persons claim and the cost of defending the homeowner if he/she is sued. The protection applies not only at home but also elsewhere in the United States and Canada.

Most policies provide \$100,000 in Liability Insurance but some companies offer \$200,000 or \$300,000 in coverage as part of their basic policy. To increase the limits from \$100,000 to \$300,000 would only increase the premium by approximately \$10 per year. If the homeowners' assets are much greater than the liability limits of

his/her Homeowner's Policy, it would be prudent to purchase an additional "Umbrella" Policy that will extend the Liability Coverage to \$1 million or more. It starts paying after the regular policy has reached its limit. Umbrella Policies also extend the Liability Coverage to the Personal Auto Policy.

Umbrella Policies provide broader coverage than Typical Homeowner's Policies. In addition to Bodily Injury and Property Damage, they cover false arrest, wrongful eviction, libel, slander, defamation of character and invasion of privacy. Such policies usually cost about \$150 to \$200 a year for \$1 million in coverage.

HO-3 and HO-15 Endorsements

Homeowner's insurance is probably the broadest coverage most clients will ever buy. Therefore, it is imperative to buy the right amount and keep it up-to-date with changes in the value of one's property.

As a general rule, the insurance professional would be providing a much-needed service to his/her clients by making the following recommendations to clients.

X Replacement Cost on Dwelling and Contents. *Can be satisfied through the purchase of a HO-3 policy and HO-15 Endorsement. A HO-3 pays all losses except those specifically excluded by the policy at Replacement Cost. It does not define the perils the policy will pay.*

As noted, the Replacement Coverage Provision on the homeowner's form is important

to the insured because it encourages keeping insurance coverage in line with increasing home value. Homeowners Comprehensive Form HO-15 provides a Special Personal Property Coverage Endorsement. Form HO-15 provides Open Peril Coverage on contents and is used with form HO-3 to provide such coverage on both the building and the contents.

Receiving a Fair Settlement

A tree crashed through the living room; a fire cooked the kitchen; a burglar swiped the silver! How does the homeowner get a fair settlement from the insurer?

Report any Burglary or Theft to the Police

- Most policies require that the homeowner present a police report in order to be reimbursed for the loss. Homeowners Policies generally cover possessions even if the homeowner is not in the house, so it is important to file a police report if, for example, bags are stolen from a hotel room.

Make Temporary Repairs - If the home has been damaged in a storm or fire, use plastic or boards to cover up any holes in the roof or walls to prevent further weather-related damage. Most insurance companies will reimburse the homeowner for the cost of temporary repairs, so save any receipts for materials. Also, the homeowner should not make permanent repairs before consulting with the agent or claim adjuster.

Contact the Insurer - When the homeowner reports the loss, the insurer will either send a "proof of loss" form to complete or arrange

for an adjuster to visit the home. Either case, the homeowner should document the loss as thoroughly as possible. If an inventory is pre-pared before the loss, the task will be easier.

The homeowner should make a list of everything stolen or damaged, including a detailed description of each item, the date of purchase and what it would cost to replace, any relevant receipts, bills, photographs or serial numbers from appliances and electronic equipment will help establish the value of the losses. The adjuster may want to see all damaged items, so do not throw anything out.

Also, the homeowner should take photographs or videos of any damage to the house or other buildings on the property. The homeowner should make a list of everything to show the adjuster, from cracks in the walls to the missing roof tiles. Generally, the homeowner has a year to amend the claim if additional damages or losses are found.

Read Your Policy - It is important for a homeowner to know his coverage to receive all he is entitled to.

Verify The Adjuster's Estimate - Before the homeowner accepts a settlement for repairs to the home, it is wise to get a written bid from a licensed contractor to make sure the adjuster's estimate is realistic. The homeowner should bring in a public adjuster (one who is not affiliated with any insurance company) to make an estimate. The public adjuster would then negotiate with the insurer's adjuster for the homeowner.

Keep Careful Records - The homeowner should make copies of all information given to the insurer in connection with the claim. Also, it would be prudent to hold onto everything the insurer gives the homeowner. It is also a good idea, for the homeowner to take notes of all meetings and conversations the homeowner has with the agent, insurer or claims adjuster.

Do Not Settle for Unfair Settlements - If the homeowner cannot reach an agreement with the adjuster, contact the agent or the insurer's Claim Department Manager. If this action does not satisfy the homeowner, the next step is to ask for an independent appraisal or arbitration process to resolve the dispute. This decision is usually binding. It does not close the door to mediation or litigation on other issues, such as bad faith.

If the homeowner relied on the insurer or agent to set the policy limits and to keep those limits updated, only to find him/her under-insured when filing a claim, it is possible to have the policy upgraded retroactively. If any questions persist during the settlement process, the homeowner may consult with a lawyer specializing in Insurance Law or contact the State Department of Insurance.

Chapter 8 - Review Questions

1. For the most part, homeowners really do not give their Homeowners Coverage any thought until:
 - A. premiums arrive
 - B. claim occurs
 - C. both A and B
 - D. neither A or B

2. Section I, in the Homeowners Policy, provides coverage on the insured's:
 - A. Automobile
 - B. Lawn ornaments
 - C. Own property
 - D. None of the above

3. The "Special" Homeowner's Policy that protects the client's home against all perils except those specifically excluded by contrast is known as:
 - A. HO-2
 - B. HO-3
 - C. HO-6
 - D. HO-1

4. What peril is generally not covered by any of the Standard Homeowners Policies?
 - A. Fire
 - B. Wind
 - C. Ice
 - D. Earthquake

5. All of the following are good ways to lower Homeowners Insurance costs except:
 - A. shop around
 - B. increase the deductible
 - C. lower the deductible
 - D. all of the above

ANSWERS

1. C
2. C
3. B
4. D
5. C