CO Homeowners Insurance

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CO Homeowners Insurance

I. Property Insurance Concepts

When it comes time for a consumer to purchase a homeowners' insurance policy, those involved in the insuring process should have an idea of the home's replacement cost. Part of calculating the insurance premium is knowing the replacement cost of a home. The Colorado Division of Insurance has implemented new regulations in accordance with HB 13-1225, which modifies Colorado Revised Statutes (C.R.S.) 10-4-110.8, Section 3 & Sec 6-12. After January 1, 2014, all producers with a property or personal lines line of authority must complete three (3) hours of homeowner continuing education addressing homeowners' insurance valuation (CRS 10-2-301). The regulations establish new levels of care for agents and insurers as follows;

- Resident fire and casualty broker-agents and personal lines broker-agents are to satisfactorily complete a three-hour course on homeowners' insurance valuation prior to estimating the replacement value of structures in connection with, or explaining the various levels of coverage under, a homeowners' insurance policy;
- Insurers, agents and brokers that provide replacement cost estimates to applicants and insureds must document who created the estimate and the sources or methods used to create the replacement cost estimate.
- All replacement cost estimates communicated to applicants or insureds must be complete, based upon specifically enumerated standards set forth in the regulations.

Significant Knowledge

In order to successfully meet the requirements under C.R.S. 10-4-110.8, Section 3 & Sec 6-12, a Property and Casualty Broker-Agent, or Personal Lines Broker-Agent must have significant knowledge in the proper methods of estimating the replacement value of structures. Insurance professionals should be able to explain various levels of coverage under a homeowners' insurance policy, have an understanding of the elements that comprise the value of a dwelling and be able to convey this information to the insured and make recommendations of the appropriate levels of coverage.

Property insurance provides protection against most risks to property, such as fire, theft and some weather damage. This includes specialized forms of insurance such as fire, flood, earthquake, and homeowners coverage. Property is insured in two main ways – open perils and named perils. Open perils cover all the causes of loss not specifically excluded in the policy. Common exclusions on open peril policies include damage resulting from earthquakes, floods, nuclear incidents, acts of terrorism and war. Named perils require the actual cause of loss to be listed in the policy for insurance to be provided. The more common named perils include such damage-causing events as fire, lightning, explosion and theft.

Correct Replacement Valuation

The significance of the replacement value being accurate is particularly important given that other than a limited number of homeowners who qualify for guaranteed replacement coverage offered by only a small number of insurers, the vast majority of homeowners have one of three kinds of insurance coverage on their home;

- **Limited Replacement Cost Coverage With an Additional Percentage-** This pays replacement costs up to a specified amount above the policy limit.
- **Limited Replacement Cost Coverage With No Additional Percentage-** This pays replacement costs up to policy limit only.
- **Actual Cash Value Coverage-** This pays the fair market value of the dwelling at the time of the loss, or the cost to repair, rebuild, or replace the damaged or destroyed dwelling with like kind and quality construction up to the policy limit.

It is important to have an accurately estimated, periodically updated replacement value. The seeds of underinsurance are sown by a failure to adequately consider the components of replacement value.

Two Kinds of Risk

Insurance of property is coverage for two kinds of risk; physical loss to the property and liability for bodily injury or property damage caused by the insured's negligence. If the insured is liable for damage, the insurer will pay up to the policy limits those sums that the insured is legally obligated to pay. The typical first-party homeowners policy does not define "physical loss." Consequently, courts have had to develop a definition for the term. The property damaged must have a material existence, be formed out of tangible matter, or be perceptible to the sense of touch. The physical loss must generally be to the property insured. If the property insured has not sustained physical loss, the claim will not fall within the insuring agreement and there will be no coverage. Physical loss does not require that the insured property be destroyed; only damaged and structural damage is not required. That the insured property may be threatened with future physical damage is insufficient. For example, where a policy insured the dwelling, but not the land, the court ruled there was no coverage for damage to the dwelling and its supporting land absent physical damage to the insured dwelling.

Liability insurance is a compulsory form of insurance for those at risk of being sued by third parties for negligence. Frequently encountered classes of mandatory policies cover the drivers of vehicles, those who offer professional services to the public, and those who manufacture products that may be harmful and those who offer employment. The reason for such laws is that the classes of insured are deliberately engaging in activities that put others at risk of injury or loss. Public policy requires that individuals and organizations should carry insurance so that, if their activities do cause loss or damage to another, money will be available to pay compensation.

Homeowners Insurance

This is the type of property insurance that covers private homes. It is an insurance policy that combines various personal insurance protections, which can include losses occurring to one's home, its contents, loss of its use (additional living expenses), or loss of other personal possessions of the homeowner, as well as liability insurance for accidents that may happen at the home. The cost of homeowners insurance often depends on what it would cost to replace the house and which additional riders—additional items to be insured—are attached to the policy. The insurance policy itself is a lengthy contract, and names what will and what will not be paid in the case of various events. Typically, claims due to earthquakes, floods, acts of God, or war (whose definition typically includes a nuclear explosion from any source) are excluded. Special insurance can be purchased for these possibilities, including flood insurance and earthquake insurance.

Term Insurance

The home insurance policy is a form of term insurance. Term insurance satisfies claims against what is insured if the premiums are up to date and the contract has not expired, and does not expect a return of premium dollars if no claims are filed. This way, auto insurance will satisfy claims against the insured in the event of an accident and a home owner policy will satisfy claims against the home if it is damaged or destroyed by explosion or fire. Whether or not these events will occur is uncertain, and if the policy holder discontinues coverage because he has sold the insured car or home the insurance company will not refund the premium. This is purely risk protection. The payment the insured makes to the insurer is called the premium. The insured must pay the insurer the premium each term. Most insurers charge a lower premium if it appears less likely the home will be damaged or destroyed: for example, if the house is situated next to a fire station, or if the house is equipped with fire sprinklers and fire alarms.

Mortgage Protection

Most homebuyers borrow money in the form of a mortgage loan, and the mortgage lender always requires that the buyer purchase homeowners insurance as a condition of the loan, in order to protect the bank if the home were to be destroyed. Anyone with an insurable interest in the property should be listed on the policy. In some cases the mortgagee will waive the need for the mortgagor to carry homeowners insurance if the value of the land exceeds the amount of the mortgage balance. In a case like this even the total destruction of any buildings would not affect the ability of the lender to be able to foreclose and recover the full amount of the loan.

Homeowner Policy Development

Homeowners policies are widely used to insure homes, condominiums and personal property of individuals and families. Homeowners policies are divided into two major sections. Section I covers the property of the insured, which can include the home or condominium, other structures, and personal property. Section II provides personal liability insurance to the named insured and family members. It also covers the medical expenses of others who may be injured by an insured or animal of the insured.

In the insurance industry of the 19th century, the only peril which could be insured was fire. Gradually, more and more causes of loss became insurable. Now homeowners can obtain policies that cover all risks of direct loss to the home. Unfortunately, the industry may have oversold the extent of modern homeowners coverage in its attempt to promote the benefits of its product. While the typical policy does cover all risks of direct loss, it does not cover specific causes of loss that are excluded. The reality is that homeowners policies cover all risks of direct loss that are not excluded. Catastrophic risks like flood, earthquake, power outages and war generally are excluded. Some of these, however, can be bought back by endorsement or by a separate policy such as earthquake and flood insurance. Some exclusions attempt to encourage good risk control, like those excluding damage caused by not protecting property from further damage after a loss has occurred or damage caused by deficient maintenance of the property, like not maintaining heat in the home to prevent pipes from freezing or not exterminating termites. Also, home heating oil pollution and mold are becoming an excluded or limited type of loss because of recent developments.

The homeowners forms are carefully underwritten. Eligibility requirements are fairly strict. A homeowners policy on a private dwelling can be written only on an owner-occupied dwelling that does not contain more than two families (three or four families in some states). Generally, each family is limited to a maximum of two boarders or roomers. Separate homeowners forms are written for renters and condominium owners. Minimum amounts of insurance must be purchased under all forms. The insurance contract is essentially a fill-in-the-blank form. Yet problems understanding it arise. That is why it is important for the agent to be familiar with the concepts behind the contract.

Colorado HB13-1225

House Bill 13-1225 created the "Homeowners Insurance Reform Act of 2013" and made several changes to the regulation of homeowners insurance, primarily for single-family homes used as a primary residence by the owner. It requires insurers to provide to homeowners insurance policyholders a specific disclosure, at least once a year, regarding the homeowners policy limits, replacement value, and the importance of preparing an inventory of the contents of the home and outbuildings. In addition, the bill outlines changes to the language, documentation and coverage requirements of homeowners insurance. After January 1, 2014, the bill makes void any provision in a homeowners policy that requires the policyholder to sue the insurer, in the case of any dispute, within a shorter period of time than allowed for by the applicable statute of limitations.

This bill changed the laws regulating homeowners insurance for owner-occupied single-family homes other than mobile homes, condominiums, and manufactured homes:

- Requires insurers to offer extended replacement cost coverage and law and ordinance coverage, with an explanation of the terms of this coverage;
- Requires insurers to include at least one year of additional living expense coverage and to offer a total of 24 months of additional living expense coverage, with an explanation of the terms of this coverage;
- Requires homeowners insurance policies, endorsements, and summary disclosure forms be written in plain language and revised for use after Jan. 1, 2015, to comply with this requirement;
- Requires an insurer to consider an estimate from a licensed contractor or licensed architect submitted by the policyholder as the basis for establishing the replacement cost;
- Specifies that policyholders have the right to a written notification, at renewal, describing changes in their insurance contract language that are applicable to the renewal period;
- Requires insurers to provide an electronic or paper copy, as specified by the policyholder, of the policyholder's insurance policy, including the declaration page and endorsements, within three business days after a request from an insured;

With respect to contents coverage in total loss claims, requires insurers to:

- Offer to pay 30 percent of contents coverage reflected in the policy declaration, subject to policy limitations, without requiring a contents inventory;
- Provide the basis for depreciation when applicable; and
- Allow the policyholder up to 180 days after a total loss claim to submit an inventory of lost or damaged property, or 270 days if the Governor declares a disaster that results in the total loss of multiple dwellings; and
- Allow a policyholder up to 180 days after expiration of alternative living expense coverage to replace property and receive recoverable depreciation on that property.

Requires a summary disclosure (shown at the end of this book) to be given to policyholders annually, including statements that:

- The policyholder is responsible for selecting the amount of coverage;
- The policyholder is responsible for assessing improvements to the home and notifying the insurer;
- The policyholder may purchase additional coverage with appropriate documentation; and
- The policyholder should update the inventory of contents regularly and store the inventory off-site.

This legislation implements a continuing education requirement for insurance producers offering homeowners insurance policies to take at least three hours of continuing education on homeowner coverages during a two-year period.

II. Property/Casualty Law Fundamentals

Insurance contracts are unique. Of course, the contract has the same basic requirements as any other contract. There must be an offer, acceptance, consideration, legal capacity and legal purpose. Beyond these are features associated with the insurance contract that distinguish them from all other contracts. Courts across the United States have recognized the distinctive features of the insurance contract often enough that their understanding is necessary for an understanding of the agreement. Differences include the concepts of indemnity, subrogation, utmost good faith, and adhesion. Insurance contracts are aleatory in nature, but so is gambling. We will look at these ideas in this chapter. Other features associated with contract law sometimes take on a life of their own when applied to the insurance contract. Most property and casualty policies are contracts of indemnity. Insurance contracts are based on utmost good faith. Policyholders must maintain an insurable interest. The insurance contract is unique among contracts and the courts treat it differently from other contracts.

Distinctive features of the insurance contract

Normally, insurance contracts are ended by <u>performance</u>. Each party to the contract does what they said they would do. The insurer pays claims if a loss occurs while the insured remits premiums in a timely manner. For most insureds no catastrophic loss occurs and the insurer does its job by standing ready to pay claims. This is a difference between insurance and everyday business transactions; insurance is not an option, not a matter of choice. Coverage is frequently required by law, such as with auto insurance. In a market economy, with no government-provided social safety net, the dangers of loss that threaten most middle and working class people and property must be addressed by the individual. One is derelict, if not downright foolish, not to obtain insurance coverage.

As a result, society acknowledges that the insurance business is a business affected with the public interest; the recognition manifests itself in mandates from legislatures and courts. Insurance is a big factor in the economic planning of people and businesses. The insurance industry cannot market and maintain its product in the same manner as those industries in products far removed from the economic heartbeat of the microeconomic system. The insurance product is not like an automobile or a loaf of bread. The contract uses arcane language (even in the "plain English" versions) that render it difficult for the average consumer to understand precisely what they have bought. Because of this, the branches of government will invoke the "public interest" when assuring that the insured ends up with something close to what he or she intended to buy. The insurance contract is viewed as having sweeping scope and authority. The reliability of the insurance product is of vital importance to the public. Insurance involves an obligation that affects the public interest. As such, it is subject to certain restrictions. Sometimes this involves interpreting ambiguous policy language to the detriment of the insurer. This could even go to the extent of disregarding the written agreement entirely in order to satisfy the purported needs and expectations of the insured. Although differing from other types of contracts, basic contract law applies to that special form of agreement known as the insurance policy. Most contracts involve an even exchange between the contracting parties, but an insurer's promise to pay involves a much larger sum than the premiums being received.

The insurance contract is enforceable only under certain conditions that probably will not occur, or else the policy would not be written. A contract, such as the insurance contract, in which losses and advantages to the parties depend on uncertain events, is called an aleatory contract. Insurance companies offer standardized policies to make possible the spreading of risks over a large volume of business. The prospective insurance buyer is in a position of accepting a given policy or doing without insurance. An insurance contract is described as a contract of adhesion. An adhesion contract provides for one party to determine the provisions of the contract. The other party has little opportunity for bargaining.

Generally, the person to be insured is regarded as the offeror in an insurance contract. The contract is created when that offer is accepted by the insurance company. If the policy differs from that presented to the prospect, the insurance company is making a counter-offer which the applicant may or may not accept. An insurance contract is a unilateral contract in the sense that it involves a promise for an act. The act is the payment of premiums by the policy holder. The promise is that of the insurer to pay for specified losses.

Property/Casualty Contract Design

As with all insurance contracts, the typical property/casualty contract is designed to create a binding agreement between two parties that will be clear and understandable. The purpose of the contract is to transfer the exposure to loss of one party, the insured, to a second party, the insurer. Such a simple concept, yet the agreement contains arcane language that at times can befuddle the most astute linguist. The insurance company is staffed with well-trained lawyers whose job it is to explain in precise language the purpose and intent of the insurance contract. This striving for exactitude at times sacrifices clarity.

The first time most people look closely at the language in their insurance policy is after a loss has been sustained. In this situation, the most important problem for the insured is trying to collect on the claim. To get an idea of whether a claim will be paid, the insured must think about the following questions;

- Did the loss occur during a covered time period?
- Is the loss caused by a covered peril?
- Is the property covered?
- Do any exclusions apply to the coverage?
- Are there any policy clauses or conditions that limit the amount of coverage?
- Is the person sustaining the loss covered?
- Is the location of the loss covered?

Standard versions of the most widely used property and liability insurance contracts are prepared by insurance rating organizations. Most American insurers use forms prepared by the Insurance Services Office or the American Association of Insurance Services. These services also provide standard rates to be used with their policies. Standardized insurance policies provide all parties to the contract with advantages. They are more economical for the insurer to print and use. These savings should be reflected in lower insurance rates. It is more economical to calculate an insurance rate for standardized policies than for numerous different individual insurance policies, since there is a larger statistical base. That is, because numerous insurers use the same policy, their loss data and other statistics can be combined. Such would not be the case if each company covered different perils or had different conditions in their individual contracts. The meaning of standardized policies becomes widely known by those in the insurance business and by some consumers. This knowledge reduces litigation about the interpretation of these policies.

Components of the Contract

Property/Casualty insurance contracts have several elements in common;
①Insuring Agreement- The insuring agreement gives force to the insurance policy. In broad terms, it describes the insurer's and the insured's rights and duties. Typically, the insurer indicates it will provide the insurance described in the policy, and the insured agrees to abide by the conditions of the policy. Here are some examples-

The Homeowners Insuring Agreement:

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

The Personal Auto Policy reads somewhat differently. A policy master agreement is set forth, followed by subagreements for any coverages the insured purchases. The master agreement reads:
"In return for payment of the premium and subject to all terms of this policy, we agree with you as follows:"

②Definitions- What does a particular word mean in the context of a type of insurance policy? The definition of a unique term is given at times in a glossary included with the insurance policy. They may also be found in the body of the text, explained as the policy terms unfold. Definitions must be succinct and relevant to the contract at hand. In the insurance contract, the insurer agrees to assume a risk of loss in exchange for premium payments. The extent of this risk assumed by the insurer, the policy coverage, is defined and limited by the language in the insurance policy. A primary goal of insurance contract language is to avoid ambiguity. There is a good reason for this. The general rule covering contracts of adhesion (i.e., insurance contracts) is that any language a court decides is ambiguous or open to doubt will be construed against the drafter of the contract. If the contract does not adequately define a word, the courts will.

③Declarations- This is the part of an insurance policy containing information regarding the insurance risk for which the policy was issued. It is a statement relative to underwriting made by the prospective insured at the time of the application. The policy declarations identify the insured, the nature and amount of coverage, the basis by which the premiums are determined, and any supplemental information provided by the insured.

④Exclusions- The clauses related to exclusions would list any type of risk, hazard, specific property or condition in the contract that are not covered by the policy. Policies try to clearly identify losses not covered by the policy. Usually excluded are losses that could arise from a catastrophic event or losses associated with a moral hazard, such as a theft committed by the insured. The insured has no right to collect payment for the specified losses, if they occur. The relationship between exclusions and coverage issues will be examined in the next chapter.

⑤Conditions- Include prerequisites or requirements or possible future events that will trigger the duty to perform a legal obligation. In the insurance contract, they are the limiting and defining provisions that state the rights and duties of the insured or the insurer. A condition might state how the contract is terminated or define what would exclude coverage under the contract. A foundation is provided for the policy by the conditions listed. They enumerate the relationships, rights, and duties between the insurer and the insured.

New York insurance law has served as a model for much insurance regulation all over the country. Other states have laws with similar, if not identical, requirements. The illustration following has relevance in every state. The 1943 New York Standard Fire Insurance Policy (SPF) serves as an example of comprehensive conditions. It is shown separately as Unit 1-1. Follow the bold print down the page. Line 1 is "Concealment, fraud"; line 7, "Uninsurable and excepted property"; line 11, "Perils not included"; line 25 "Other Insurance"; and so on... These headings are the components of the insurance contract as mentioned above.

This policy served as the mainstay of all property insurance forms for three decades and has been tested and interpreted by the courts. It has been replaced today by updated forms written in "plain" English, but still serves as a good example of conditions associated with policies.

⑥Endorsements or Riders- These are written modifications of an insurance policy that change the original, often standardized, contract of insurance. Endorsements may broaden or narrow the original policy language. Strictly speaking, a rider is documentation attached to an existing policy that augments or deletes from policy provisions. It is generally used to extend coverage for some specific reason. Endorsements are themselves often standardized. Basically, endorsements or riders are the documents used to shape the standardized policy to fit individual needs. At least one form must be added to the insuring agreement and the terms and conditions in order to structure a complete contract. One form that would complete the policy is the general property form. This is a form developed by the Insurance Services Office (ISO). It is intended to bring additional standardization to the fire policy. The form includes provisions for covering the building and permanently attached machinery of an insured as well as covering personal property for the insured. Another frequently utilized endorsement is the extended coverage endorsement. For an extra premium, the insured adds coverage for perils including explosion, riot, civil commotion, smoke, windstorm and hail.

Unit 1-1; Standard Fire Insurance Policy

Concealment fraud This entire policy shall be void it, whether before or after a loss, the insured has wilfully concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof, or the interest of the insured therein, or in case of any fraud or false swearing by the insured relating thereto.

Uninsurable and excepted property. This policy shall not cover accounts, bills currency, deeds, evidences of debt money or; securities; nor, unless specifically named hereon in writing, bullion or manuscripts.

Perils not included. This Company shall not be liable for loss by fire or other perils insured against in this policy caused, directly or indirectly, by (a) enemy attack by armed forces, including action taken by military, naval or air forces in resisting an actual or an immediately impending enemy attack, (b) invasion, (c) insurrection (d) rebellion; (e) revolution; (f) civil war; (g) usurped power; (h) order of any civil authority except acts of destruction at the time of and for the purpose of preventing the spread of fire, provided that such fire did not originate from any of the perils excluded by this policy; (i) neglect of the insured to use all reasonable means to save and preserve the property at and after a loss, or when the property is endangered by fire in neighboring premises, (j) nor shall this Company be liable for loss by theft.

Other Insurance Other insurance may be prohibited or the amount of insurance may be limited by endorsement attached hereto.

Conditions suspending or restricting insurance. Unless otherwise provided in writing added hereto this Company shall not be liable for loss occurring

(a) while the hazard is increased by any means within the control or knowledge of the insured; or

(b) while a described building, whether intended for occupancy by owner or tenant, is vacant or unoccupied beyond a period of sixty consecutive days; or

(c) as a result of explosion or riot, unless fire ensue, and in that event for loss by fire only.

Other perils or subjects Any other peril to be insured against or subject of insurance to be covered in this policy shall be by endorsement in writing hereon or added hereto.

Added provisions. The extent of the application of insurance under this policy and of the contribution to be made by this Company in case of loss, and any other provision or agreement not inconsistent with the provisions of this policy, may be provided for in writing added hereto, but no provision may be waived except such as by the terms of this policy is subject to change.

Waiver provisions No permission altering this insurance shall exist, or waiver of any provision be valid, unless granted herein or expressed in writing added hereto. No provision, stipulation or forfeiture shall be held to be waived by any requirement or proceeding on the part of this Company relating to appraisal or to any examination provided for herein.

Cancellation of policy This policy shall be cancelled at any time at the request of the insured, in which case this Company shall, upon demand and surrender of this policy, refund the excess of paid premium above the customary short rates for the expired time. This policy may be cancelled at any time by this Company by giving to the insured a five days' written notice of cancellation with or without tender of the excess of paid premium above the pro rata premium for the expired time, which excess, if not tendered, shall be refunded on demand. Notice of cancellation shall state that said excess premium (if not tendered) will be refunded on demand.

Mortgagee interests and obligations If loss hereunder is made payable, in whole or in part, to a designated mortgagee not named herein as the insured, such interest in this policy may be cancelled by giving to such mortgagee a ten days' written notice of cancellation.

If the insured fails to render proof of loss such mortgagee, upon notice, shall render proof of loss in the form herein specified within sixty (60) days thereafter and shall be subject to the provisions hereof relating to appraisal and time of payment and of bringing suit. If this Company shall claim that no liability existed as to the mortgagor or owner, it shall, to the extent of payment of loss to the mortgagee, be subrogated to all the mortgagee's rights of recovery, but without impairing mortgagee's right to sue; or it may pay off the mortgage debt and require an assignment thereof and of the mortgage. Other provisions relating to the interests and obligations of such mortgagee may be added hereto by agreement in writing.

Pro rata liability. This Company shall not be liable for a greater proportion of any loss than the amount hereby insured shall bear to the whole insurance covering the property against the peril involved, whether collectible or not.

Requirements in case loss occurs The insured shall give immediate written notice to this Company of any loss, protect the property from further damage, forthwith separate the damaged and undamaged personal property, put it in the best possible order, furnish a complete inventory of the destroyed, damaged and undamaged property, showing in detail quantities, costs, actual cash value and amount of loss claimed; **and within sixty days after the loss, unless such time is extended in writing by this Company, the insured shall render to this Company a proof of loss,** signed and sworn to by the insured, stating the knowledge and belief of the insured as to the following: the time and origin of the loss, the interest of the insured and of all others in the property, the actual cash value of each item thereof and the amount of loss thereto, all encumbrances thereon, all other contracts of insurance, whether valid or not, covering any of said property, any changes in the title, use, occupation, location, possession or exposures of said property since the issuing of this policy, by whom and for what purpose any building herein described and the several parts thereof were occupied at the time of loss and whether or not it then stood on leased ground, and shall furnish a copy of all the descriptions and schedules in all policies and, if required, verified plans and specifications of any building, fixtures or machinery destroyed or damaged The insured, as often as may be reasonably required, shall exhibit to any person designated by this Company all that remains of any property herein described, and submit to examinations under oath by any person named by this Company, and subscribe the same; and, as often as may be reasonably required, shall produce for examination all books of account, bills, invoices and other vouchers, or certified copies thereof if originals be lost, at such reasonable time and place as may be designated by this Company or its representative, and shall permit extracts and copies thereof to be made.

Appraisal In case the insured and this Company shall fail to agree as to the actual cash value or the amount of loss, then, on the written demand of either, each shall select a competent and disinterested appraiser and notify the other of the appraiser selected within twenty days of such demand The appraisers shall first select a competent and disinterested umpire; and failing for fifteen days to agree upon such umpire, then, on request of the insured or this Company, such umpire shall be selected by a judge of a court of record in the state in which the property covered is located. The appraisers shall then appraise the loss, stating separately actual cash value and loss to each item; and, failing to agree, shall submit their differences, only, to the umpire. An award in writing, so itemized, of any two when filed with this Company shall determine the amount of actual cash value and loss. Each appraiser shall be paid by the party selecting him and the expenses of appraisal and umpire shall be paid by the parties equally.

Company's options. It shall be optional with this Company to take all, or any part, of the property at the agreed or appraised value, and also to repair, rebuild or replace the property destroyed or damaged with other of like kind and quality within a reasonable time, on giving notice of its intention so to do within thirty days after the receipt of the proof of loss herein required.

Abandonment. there can be no abandonment to this Company of any property.

When loss payable The amount of loss for which this Company may be liable shall be payable sixty days after proof of loss, as herein provided, is received by this Company and ascertainment of the loss is made either by agreement between the insured and this Company expressed in writing or by the filing with this Company of an award as herein provided.

Suit. No suit or action on this policy for the recovery of any claim shall be sustainable in any court of law or equity unless all the requirements of this policy shall have been complied with, and unless commenced within twelve months next after inception of the loss.

Subrogation. This Company may require from the insured an assignment of all right of recovery against any party for loss to the extent that payment therefor is made by this Company

⑦<u>Deductibles</u>- It is a common provision in property/casualty insurance policies for the insured to pay the first dollars of an insured loss. A deductible provision in an insurance policy causes this result. A straight deductible has the insurer pay only for the amount of loss in excess of the deductible amount. Thus, if there were a $5,000 loss and a $500 straight deductible, the insured would pay $500 and the insurer would pay the remaining $4,500.

Deductibles are found in the contract provisions for two reasons. They reduce the moral hazard as the insured must pay a small part of every loss. They eliminate the expenses that would be involved in settling small claims. The savings from reduced expenses and loss claims translates into lower insurance costs for the public. As the insured's deductible becomes larger, the premium gets smaller. Many individuals and firms see the higher deductible-lower premium cost savings as a positive step towards self-insurance on low-frequency loss perils.

Distinctive Features of the Insurance Contract

The insurance contract has the basic elements of any other contract. Those elements are summarized (not in correct order) by the acronym COALL. It stands for Consideration, Offer, Acceptance, Legal capacity to contract, and Legality of subject matter. Notice should be given to the fact that <u>in writing</u> is not an element that must be present to have a valid contract. This is important where the concepts of waiver and estoppel are concerned. Here are the features that make an insurance contract different from other contracts.

Aleatory Contract

With this type of contract, the values that are exchanged are not equal. The insured may receive a value out of proportion to the value given. Most contracts are commutative contracts. <u>Commutative contracts</u> involve an equal exchange of money for goods or services. This represents an even exchange, the goods change hands at the market rate or there is some bargaining involved. The insurance contract is an aleatory contract. Its performance depends upon the occurrence of a chance event in the future. That event is the insured peril. If it does not occur, no performance on the part of the insurer is required.

Risk and the Contract

Risk is measurable. Uncertainty, by definition, is not measurable. Insurance is the financial yardstick of risk. Insurance is akin to the manufacturing process, producing certainty as the finished product and using risk as the raw material. The basic nature of the insurance contract is to put a dollar value on the chance occurrence of some fortuitous event. The insurance contract is not a gambling contract. Gambling involves a speculative risk that is created with the transaction. Insurance, on the other hand, is a way to deal with a risk or peril that already exists. The risk of financial loss due to dying or an automobile accident existed before the contract was formed. Insurance and gambling can both be described as aleatory in nature. With the insurance contract no new risk is created. With insurance, the insurer takes the chance of being required to pay the sum agreed upon; and the insured takes a chance by paying the premium or consideration without receiving anything for it if the contingency does not happen.

Time is the governing factor in gambling. Risk and time are opposite sides of the same coin. If there were no tomorrow, there would be no risk today. Time changes the perception we have of risk. Risk and its characteristics are fashioned by the time horizon. For risk practitioners, be they gamblers or insurance professionals, the future is the playing field. The gambler thinks he or she is betting on a full house, a can't-lose football team, or the best doggone dog at the track, but what the gambler is really betting on is the clock. Gamblers appeal to lady luck to suspend the law of averages so winning streaks will continue and make the reverse appeal so that losing streaks will come to a speedy end. Risk managers at insurance companies are making the same plea. Premiums are set to cover losses over the long run, but insurers maintain sufficient capital and reserves to carry on during those unavoidable periods of bad luck

Adhesion Contract

This legal concept says buyers must adhere to the preexisting terms of a standard contract. The terms signify an inequality of bargaining power as the buyer has no say concerning rates or terms. This concept often arises with any standard form printed contracts submitted on a take-it-or-leave-it basis. It got its start long ago in the process of drawing treaties between nations. When a nation wanted to join in on a treaty already drawn up by other nations, the state wishing to join would sign the treaty and adhere to the existing provisions. The entire contract must be accepted, with all of its terms and conditions. The contract may be altered by the addition of endorsements or forms, but those instruments are also always drafted by the insurer.

As a result of the forced acceptance nature of the insurance contract, if there are any ambiguities, the general rule is that the insured gets the benefit of the doubt. Ambiguities in the document are construed against the party who drew up the paperwork. This is the rule of strict construction of contracts.

Reasonable Expectations

When the terms and agreements in a contract are not made perfectly clear, the problem is called ambiguity. As a buttress to the rule concerning ambiguities, the principle of reasonable expectations states that an insured is entitled to coverage under a policy that they reasonably expect it to provide, and that it be effective. Exclusions or qualifications must be conspicuous, plain, and clear. Contracts of insurance are construed according to the terms that the parties have used. The terms are used, in the absence of ambiguity, in their plain, ordinary meanings. The noted jurist, Justice Learned Hand, put it this way, "Insurers who seek to impose upon words of common speech an esoteric significance intelligible only to their craft, must bear the burden of resulting confusion." [Gaunt v. John Hancock Mutual Life, 160 Fed. 2nd 599 (1947)]. Justice Hand rightly observes that the insurance policy is complex. Most policyholders do not read their policies or understand the terms. The policyholder usually relies on the knowledge and ability of the agent, and this has given rise to the principle of reasonable expectations. Unfortunately for insurers, this doctrine has no clearly defined limits.

Fundamental Rules of Contract Interpretation

This section looks at the interpretation rules of contracts as they are generally accepted in the legal forum. We said an adhesion contract, when ambiguous, is interpreted by the courts in favor of the person who did not promulgate the contract terms. There follows here some basic rules of contract interpretation, very basic but very important. These rules are alluded to time and again in court cases, in the media, and by those who have corner offices and speak legalese. Everyone should be familiar with these rules. Where the written words or language in which the parties embodied their agreement or contract may not be changed by parol evidence, the ascertainment of the meaning to be given to the written language is outside the scope of the parol evidence rule. The written words are sacrosanct. They are the terms of the contract. However, words are but symbols. If their meaning is not clear, it may be made clear by the application of rules of interpretation or construction, and by the use of extrinsic evidence for this purpose where necessary. As stated in one case:

"The great object of construction is to collect from the terms or language of the instrument, the manner and extent to which the parties intended to be bound. To facilitate this, the law has devised certain rules, which are not merely conventional, but are the canons by which all writings are to be construed, and the meaning and intention of men to be ascertained. These rules are to be applied with consistency and uniformity. They constitute a part of the common law, and the application of them, in the interpretation and construction of dispositive writings, is not discretionary with courts of justice, but an imperative duty." Johnson County v. Wood, 84 Mo.489 (1884).

Where the language in a contract is clear and unambiguous, extrinsic evidence tending to show a meaning different from that which the words clearly import will not be received by a court. It is the function of the court to interpret and construe written contracts and documents. Rules of interpretation are adopted in order to apply a legal standard to the words contained in the agreement by which to determine their sense or meaning.

Among the rules which aid interpretation are:

1.) A writing is interpreted as a whole and all writings that are part of the same transaction are interpreted together.

2.) All circumstances accompanying the transaction may be taken into consideration.

3.) The ordinary meaning of language throughout the country is given to words unless circumstances show a different meaning is applicable.

4.) Conduct of the parties subsequent to a manifestation of intention indicating that all of the parties placed a particular meaning upon the manifestation may require the adoption of such meaning.

5.) Technical terms and words of art are given their technical meaning unless the context or a usage which is applicable indicates a different meaning.

6.) The principal apparent purpose of the parties is given great weight in determining the meaning to be given their manifestation of intentions.

7.) An interpretation that gives and effective meaning to all manifestations of intention is preferred to an interpretation which makes a part of such manifestations unreasonable, unlawful, or of no effect.

8.) Where there is an inconsistency between general provisions and specific provisions, the specific provisions qualify and control the meaning of the general provisions.

9.) Where written provisions are inconsistent with printed provisions, an interpretation is preferred which gives effect to the written provisions.
10.) Where a public interest is affected an interpretation is preferred which favors the public.

III. Homeowners Coverage-

Insurance companies have been accused of issuing policies written in legalistic terms with little or no apparent organization. Most people avoid reading insurance policies until faced with a claim. Even the so-called "plain language" insurance policies have provided little help to the lay person to understand the coverage provided by the policy. Contrary to the initial appearance of the typical insurance policy, there is a step by step method that insurance professionals and attorneys use to analyze a policy. A goal of the insurance professional is to be able to explain that method in plain terms, explain some of the technical terms, and introduce basic insurance law concepts. Of course, every situation is unique, different companies issue different policies, and different kinds of policies may not use the exact terminology. However, agents should be able to at least begin to understand a property, inland marine, ocean marine, disability, commercial liability, or life insurance policy, or decipher communications from lawyers that seem almost as confusing as the policy itself.

There follows a set of procedures to follow in analyzing an insurance policy. It is important for agents to pass these procedures on to policyholders so that they can better comprehend, analyze, and understand the policy

1. Review the Declarations Page
2. Get the Right Policy Forms
3. Understand the Types of Insurance Forms in the Policy
4. Identify the Insuring Language
5. Review the Exclusions
6. Apply the Language of the Policy to the Claim, Keeping in Mind Legal Principles

Declarations, Definitions, Coverages, Perils and Exclusions

Most of the time, an insurance policy is really a collection of a many different forms. The first step to understanding a policy is to learn that it resembles a jigsaw puzzle, with many pieces fitting together to form one whole. The agent must also make sure that he or she has all of the pieces of the puzzle.

1. Review the Declarations Page

Most types of insurance will feature a **declarations page**. The declarations page helps answer the questions who, what, when, where, and how much. The declarations page usually contains the following information:

- Name and address of the **insured** (i.e. the person or company who purchased the policy), the **insurer** (i.e. the company that is bound by the policy); and the

insurance broker (the person who sells the policy, who may or may not be affiliated with the insurer);

- The **policy number** (most insurance companies track by number, not name, so this can be very important when a claim arises);
- The **policy period**, which are the dates the policy covers;
- A description of the types of **coverage** the insurance provides. For example, the declarations page of a property policy will describe what property is covered, generally what type of losses are covered, such as fire, crime, business interruption, etc., and usually the premium for each type of coverage.
- A list of the **forms** applicable to the coverage. Most insurance companies use standard forms for all of their insureds. The declarations page will list **code numbers** identifying the appropriate forms that make up the insurance policy.

2. Get the Right Policy Forms

After the declarations page, there will be policy forms. An important first step is to **make sure and have all of the correct forms**. Do not someone else to have sent the correct forms, or all of the forms. Agents must make sure and check to have the declarations page for the policy period in which the loss occurred. Check the declarations page, and find the list of forms and the code numbers. Most policy forms have their identifying code number in the header or footer. A lot of time, energy, aggravation and money can be saved by making sure to have all of the correct forms prior to reading them. After all, if one is going to go to the trouble of reading an insurance policy, it really ought to be the right one.

3. Understand the Types of Insurance Forms

Now that all of the forms are present, it is time to start to try to make sense of them. First, it will be helpful to identify in general terms the kinds of forms that are commonly encountered.

a. Forms Related to Premium, Cancellation and Renewal- Most policies have forms setting forth when **premium** (i.e. the cost of the insurance) falls due, under what conditions the premium can change, how premium is calculated, and what happens if premium goes unpaid. Similarly, the policy may set forth the rules governing cancellation and renewal of the policy.

b. Insuring Forms- The **insuring forms** set forth what the insurance company is promising to cover, and often set forth kinds of losses the insurance company will not cover. When a claim arises, the language in the insuring forms will be critical to determining whether the insurance company is obligated to pay. Be aware of provisions setting forth **time limits** on when to make claim and when to file suit. Many property and marine insurance policies have time limits to sue, and if the policyholder does not sue in time, his or her claim will be barred no matter what the merits. Many times these limits are one year. These dates should be calendared so that they do not get missed down the road. Lastly, even if a policyholder thinks he or she is past the time limit, they may want to contact a lawyer to be sure. Sometimes missing a date can be excused in certain circumstances, and the policyholder will need a lawyer to advise him or her whether it is too late to make claim or sue.

c. Endorsements- An **endorsement** is a form that modifies the coverage set forth in the insuring forms. Sometimes an endorsement will be called an "endorsement," other times a **"rider"** or **"special form."** Sometimes the insured may purchase expanded coverage by paying an increased premium that adds the endorsement. For example, a business might buy a policy covering the cost of repairing fire damage to its building. That business might also buy an endorsement covering lost profits during the time its facility is closed after a fire. Other times, the insurer will add an endorsement restricting coverage. For example, a disability insurer might add an endorsement saying that it will not pay for losses arising from back injuries if the insured is known to have a bad back. Because endorsements expand or restrict coverage, they can be very important to determining if coverage exists.

d. First Party Insurance vs. Liability Insurance- Insurance policies can be divided into two broad categories. **First party** insurance covers the property of the person who purchases the insurance policy. For example, a homeowners' policy promising to pay for fire damage to the homeowners home is a first party policy. **Liability insurance**, sometimes called **third party** insurance, covers the policy holder's liability to other people. For example, a homeowners' policy might cover liability if someone trips and falls on the homeowners property. Sometimes one policy, such as in these examples, may have both first and third party coverage.

The insured needs to make certain that if they have a first party loss, he or she looks at the first party provisions of the policy. Likewise, if an insured is trying to determine whether there is coverage for liability to a third party that insured needs to look at the third party coverage.

Lastly, **liability insurance** provides two separate benefits. First, the policy will cover the damages incurred by the third party. Sometimes this is called providing **"indemnity"** for the loss. Second, however, most liability policies provide a **duty to defend**. The duty to defend requires the insurance company to pay for lawyers, expert witnesses, and court costs to defend the third party's claim. These costs can sometimes be dramatic and should not be ignored when facing a liability claim.

4. Identify the Insuring Language

The insuring language states broadly what the insurance will cover. Usually this language will be found in one of the insuring forms, but might also be found in an endorsement. It can be difficult to find the insuring language. One should look for statements such as:

"This insurance covers. . . "We will pay for. . . " "Coverage is provided. . . "

Usually, the insuring language will be very broad. A typical property policy might say "we will pay for direct physical loss or damage to the property described in the declarations, so long as the cause of loss is not otherwise excluded." Taken literally, this language covers lots of kinds of losses. However, the next step is to look at exclusions.

5. Review the Exclusions

Insuring language tends to use broad sweeping statements as to what the insurance covers. Usually, however, **exclusions** will limit the types of losses the policy covers. An exclusion is just what it sounds like; it excludes certain types of losses from the all encompassing insuring language.

Take a flood case for example. A homeowners' policy might have insuring language like that above covering "all direct physical loss or damage." Flood damage would certainly fall within that definition. However, a homeowners policy might have exclusion, saying the insurance company will not pay for flood damage. The exclusion limits what the insurance company has to cover. When trying to determine if a policy covers a given loss, it is important to review the exclusions to see if any apply to the situation. An exclusion can render an otherwise covered claim not covered.

6. Apply Policy Language to the Claim

Once the policy has been sorted through regarding the insuring language and exclusions, an insurance professional or attorney will try to determine whether a particular claim is covered. What the policy says, of course, is very important. However, because sometimes situations arise that no one anticipated, or a policy is not written very well, oftentimes disputes arise between the insurer and insured. Although there is no way to set forth all of the principles of insurance law here, a few of the rules can give a perspective on how the courts treat insurance cases.

- The insured bears the initial burden of proving the loss falls within the insuring language. Generally, insuring language is interpreted broadly to find coverage.
- The insurer bears the burden of proving the loss falls within an exclusion. Generally, exclusions are interpreted narrowly, once again to try to give the insured the benefit of the doubt.
- Because the insurance company wrote the policy, and there is a broad public policy in favor of spreading risks, if a policy can be interpreted in more than one way, the tendency is to interpret the policy to provide coverage. However, a court will not strain to find an ambiguity where none exists, and should not interpret the policy in a way that violates the reasonable expectations of the parties.
- Specific provisions will control over general provisions.
- The policy will be read to try to give effect to all of the words in the policy. Said another way, the policy should not be interpreted to render some provisions meaningless.
- In a liability policy, the duty to defend can be broader than the duty to indemnify. In other words, the insurance company may be obligated to pay for lawyer costs defending a case even if it turns out there is no coverage for the claimant's loss.

IV. Basic Concepts of Property Valuation

The reader will note this section deals with value of property in a casualty loss. Further concepts regarding the assessment of real property value can be found in the course addressing homeowner valuation.

Loss Settlement Provisions

Simply put, this is the application of policy provisions to the casualty. A loss settlement provision refers to the method used to determine how much is paid for a covered loss. On a replacement cost value or actual cash value basis is how this provision usually requires the payment of claims be handled.

How It Applies

An insurance policy contemplates two types of claim settlements: (1) the actual cash value and (2) replacement cost. The policy may expressly permit, at the option of the insured, a claim for ACV with no mandate that the insured actually repair the property.

Here is example verbiage for losses on the home or other structures on the property. For Coverage A, two loss settlement provisions may be offered;

Example A

Covered loss to Buildings under Coverage A and B will be settled at replacement cost without deduction for depreciation, subject to the following methods:

1.) Settlement under replacement cost will not be more than the smallest of the following:

a. the replacement cost of that part of the building damaged for equivalent construction and use on the same premises.

b. the amount actually and necessarily spent to repair or replace the building intended for the same occupancy and use.

2.) When the cost to repair or replace is more than $1,000 or more than 5% of the limit of insurance in this policy on the damaged or destroyed building, whichever is less, we will pay no more than the actual cash value of the damage until repair or replacement is completed.

3.) At your option, you may make a claim under policy on an actual cash value basis for loss or damage to buildings. Within 180 days after loss you may make a claim for any additional amount on a replacement cost basis if the property has been repaired or replaced.

Example B

Dwelling

1. Replacement Cost Loss Settlement- Similar Construction: Pays the cost to repair or replace with similar construction materials. Until the actual repair or replacement is completed, there may be a deduction for depreciation.
2. Replacement Cost Loss Settlement- Common Construction: Pays the cost to repair or replace damaged property, including obsolete, antique, and custom-built property, with construction techniques and materials commonly used by the building trades in standard new construction. Until the actual repair or replacement is completed, there may be a deduction for depreciation.

This provision specifies that an insurer's limit of liability for losses covered under terms of the policy (or endorsements) is the maximum amount the insurer will pay for the sum of all losses.

The Effect of Underinsurance on Settlement

Underinsurance is a condition in which not enough insurance is carried to cover the insurable value. It is related to the coinsurance clause, under which the insured shares in losses to the extent that he or she is underinsured at the time of loss. Coinsurance can be described as a property insurance provision that imposes a penalty on an insured's loss recovery if the limit of insurance purchased is not at least equal to a specified percentage of the value of the insured property. The purpose of coinsurance is to avoid inequity and to encourage insureds to carry a reasonable amount of insurance in relation to the replacement value (or actual cash value, depending on which basis the policy is written) of their property. Consequently, coinsurance provisions typically are incorporated into property insurance policies.

Example

> **Coinsurance**. If a coinsurance percentage is shown in the Declarations, the following condition applies:
>
> We will not pay the full amount of any loss if the value of covered property at the time of loss times the coinsurance percentage shown for it in the Declarations is greater than the limit of liability for the property. Instead, we will determine the most we will pay using the following steps:
>
> a. Multiply the value of covered property at the time of loss by the coinsurance percentage;
>
> b. Divide the limit of liability of the property by the figure determined in step a;
>
> c. Multiply the total amount of loss, before the application of any deductible, by the figure determined in step b.; and
>
> d. Subtract the deductible from the figure determined in step c.
>
> We will pay the amount determined in step d. or the limit of liability, whichever is less. For the remainder, you will either have to rely on other insurance or absorb the loss yourself.
>
> In applying this coinsurance clause we will disregard the value of foundations of buildings which are below the surface of the lowest basement floor or, where there is no basement, which are below the surface of the ground. We will not consider the cost of removal of debris in the determination of actual cash value when applying the coinsurance clause.

If the insured purchases insurance at least equal to the coinsurance percentage (80 percent, for example), the insurer pays the full value of any loss (either replacement cost or actual cash value, depending on what the insured has purchased), less the deductible, up to the limit of insurance. If the insured does not meet the coinsurance requirement, he or she will be penalized in the event of a loss and will become a coinsurer.

To further illustrate

Underinsurance:
When:
The value of the property is $250,000
The coinsurance percentage for it is 80%
The limit of liability for it is $100,000
The deductible is $250
The amount of loss is $40,000
Step (1) $250,000 x 80% = $200,000 (the minimum amount of insurance to meet your coinsurance requirements)
Step (2) $100,000 ÷ $200,000 = .50
Step (3) $ 40,000 x .50 = $20,000
Step (4) $ 20,000 - $250 = $19,750
Insurer pays no more than $19,750. The remaining $20,250 is not covered.

Adequate insurance
When:
The value of the property is $250,000
The coinsurance percentage for it is 80%
The limit of liability for it is $200,000
The deductible is $250
The amount of loss is $40,000
Step (1) $250,000 x 80% = $200,000 (the minimum amount of insurance to meet your coinsurance requirements)
Step (2) $200,000 ÷ $200,000 = 1.00
Step (3) $ 40,000 x 1.00 = $40,000
Step (4) $ 40,000 - $250 = $39,750
Insurer pays $39,750 of the loss. No penalty applies.

The formula used to determine the amount payable when a coinsurance provision applies is;

$$\frac{\text{Insurance Carried}}{\text{Insurance Required}} \times \text{Loss} = \text{Amount Recoverable}$$

(Insurance carried, divided by insurance required, multiplied by the loss, equals the amount recoverable.)

Actual Cash Value

Actual cash value (ACV) is described by the Colorado Division of Insurance in the following way;

Actual Cash Value (ACV) is the cost to repair or replace an insured item of property at the time of the loss, less depreciation. The value of depreciation is based on the age and condition of the item. Personal property, such as contents, is typically settled at ACV unless the insured purchases Replacement Cost Coverage.

An open policy is one in which the value of the thing insured is not agreed upon, but is left to be ascertained in case of loss.

So, it is an amount equivalent to the replacement cost of lost or damaged property at the time of the loss, less depreciation. Actual Case Value Coverage pays the fair market value of the residence up to an identified policy limit. Fair market value is determined by way of an appraisal based on comparisons to other similarly situated structures, less the value of the land.
.

Coverage for actual value policies are limited to a specific amount, regardless of whether the value of the house increases. For example, a $70,000 actual cash value policy would cover only $70,000 in damages, even if the value of the house rises to $100,000. This type of coverage could end up costing the insured out-of-pocket more than they expected. Therefore, increases in limits to keep up with inflation are more important with these types of policies.

Replacement Cost Value

Replacement cost value is described by the Colorado Division of Insurance in the following way;

Replacement Cost Coverage (RCC) is the cost to replace lost or damaged property with new property of like kind and quality at current prices. For an additional premium, it is available for buildings and contents. Some insurers automatically include RCC in the homeowner policy; however, usually it is an optional coverage that must be purchased.

If a dwelling is insured with replacement cost, the amount of coverage should be equal to 100 percent of the cost to repair or replace the building. If the dwelling is not insured at the cost to replace it, penalties may apply. Some property policies include 125 percent of the RCC amount in the event the coverage limit is exhausted.

If a policy is purchased insuring a home for $200,000 when it will really cost $750,000 to replace it, the insured will get no more than the value listed in the policy, even if the policy says it covers "Replacement Cost". If that happens, it means the home was under-insured. It is the homeowners responsibility to be sure the policy they purchase includes the coverage they need.

Homeowners can hire a contractor or independent appraiser to provide an estimate of what it would cost to rebuild at their current location, if they think the insurance company has appraised the home too low. Although stating a lower value may keep the premium costs down, if a home is hit with disaster, the insurance company will not pay more than the amounts agreed upon in the insured's policy.

New for Old

The replacement cost policy is relatively new to insurance, dating from the mid-20th Century. Limiting recovery to actual cash value was a mechanism used to make this insurance coverage a policy of indemnity; a sum paid as compensation for a particular loss. The intent of a deduction for depreciation was to be certain that an insured did not derive betterment from the loss. That is, exchanged new for old. In general, replacement involves a substitution of a new asset for an old asset which, for whatever reason, has been demolished, destroyed, or otherwise rendered unusable.

Superior Coverage

Replacement value of a home can be perceived as superior coverage. Any type of depreciated coverage requires that many of the insureds that have to replace their property must obtain additional funds to pay for property replacement. Full coverage has advantages to both parties to the insurance contract; the entire loss is funded, loss adjustment is easier, and the well-being of the insured. To reduce moral hazard the following general restrictions can be found in replacement cost coverage;

- Coinsurance is required, usually 80%
- The claim is not 'fully' payable until replacement by the insured has been made (more on that follows).
- Loss is based on replacement cost of property with identical materials, for the same purpose, and normally on the same site, and the amount actually spent on replacement.

Replacements can also be distinguished by the type of substitution made. Substitution in kind, for example, of a new house identical except in age and condition, is a replacement but not an improvement. Substitution of a superior new house for an old one is a replacement not in kind, and also an improvement.

Replacement cost and actual cash value differ from **market value,** the price for which something would sell under current market conditions. Fair market value (FMV) is an estimate of the market of a property, based on what a knowledgeable, willing, and unpressured buyer would probably pay to a knowledgeable, willing, and unpressured seller in the real estate market. Market value is not used by insurers as a valuation method.

Different Types of Structures

Replacement cost will differ for antique, historic, and purpose-built homes. Older homes, especially historic homes, can be very costly to replace and the cost of rebuilding can be significantly higher than an appraised value. Housing developers offer functional living space on basic lots made affordable by simple yet all-inclusive home designs that take advantage of the concept of 'stock built' residential construction. Rather than complex assembly and craftsmanship of an earlier era, mass produced housing requires less skill and time to assemble and complete. Part of the difference comes from the term "aesthetics." The loss settlement provision makes no mention of this term. Because while "appearance" issues have nothing to do with the loss terms, they have everything to do with what the owner of an historic/antique home is going to consider as "replacement cost."

The loss settlement language in the policy states that if the co-insurance requirement is met, "we will pay the cost to repair or replace, after application of deductible and without deduction for depreciation, but not more than the least of the following amounts: (a) The limit of liability under this policy that applies to the building; (b) The replacement cost of that part of the building damaged for like construction and use on the same premises; or (c) The necessary amount actually spent to repair or replace the damaged building." So it could be that the form gives the insurer the option to repair or replace, as long as it's with "like" property. Does the work "like" mean "the same form, kind, character" or "similar" or "having the same function?" It could be argued that *replacement cost* is the cost of replacing the subject with one that has equivalent utility but is built with modern materials and to current standards of design and function. *Reproduction cost* is the cost of building a replica. When the objects in question are one-hundred-year-old engraved brass hinges or transom components, this can mean a balancing of costs and aesthetics when addressing replacement cost in an historic/antique home.

Colorado Residential Property Coverage Requirements

Home insurance policies issued after January 1, 2014 must provide the following protection if a home is destroyed or seriously damaged:

- Every "Replacement Cost" policy offered for purchase or renewal must at the minimum include an option for:
  i. Extended Replacement Cost coverage of at least 10% of the Dwelling Policy Limit (additional money in the event of the need to rebuild)
  ii. Law and Ordinance coverage in the amount of at least 25% of the Dwelling Policy Limit (also additional dollars available in the event of the need to rebuild)
- Every "Replacement Cost" policy offered for purchase in Colorado for a "Dwelling" must include at least 12 months of "Loss of Use" (Additional Living Expenses) coverage. (In the event it is necessary after a covered loss to be out of the home due to evacuation, repairs, or replacement). The new law requires insurers to offer insurance purchasers the option of buying 24 months of ALE, which is recommended, if that higher amount is within the homeowners' budget. Most people lose the use of their home for well over a year after a total loss, and 24 months of ALE has become standard in some policies and by law in some states.

Other changes to Colorado homeowners' insurance coverage include the following;

- Endorsements, disclosure forms, and policies must be written at the 10th grade reading level. Policies issued or renewed in Colorado after January 1, 2015, have to meet these standards.
- The insurer must consider an estimate from a licensed contractor or architect submitted by the policyholder as the basis for establishing the replacement cost of a dwelling.
- The insurer must provide the policyholder an electronic or paper copy of the entire policy including the declarations page and any endorsements within three business days after a loss, and upon request, a "certified copy" within 30 days.
- In the event of an insured total loss the insurer must offer a minimum of 30% of contents limits without requiring the submittal of a detailed itemized inventory list.
- The insurer must make available to the policyholder the methodology used for depreciating the value of personal property.
- Policyholders have at least a full year after a total loss to submit an inventory of lost or damaged property.
- Policyholders will have a minimum of 365 days after they use up the additional Living Expense benefits to replace property and recoup depreciation by collecting full replacement value.

At the end of the text can be found the Summary of Coverage Dwelling Fire Policy

Take Steps

Although insurance law can be complex, a step-by-step process can help the agent understand how insurance adjusters and lawyers analyze a case. Following the steps above will help to better communicate with the insureds, adjusters, brokers, and lawyers in the event that a claim is filed.

V. Important Homeowners Policy Elements

When shopping for home insurance, consumers have much more to consider than how much coverage will cost. They need to buy the right type of policy. Prospective insureds also need the proper level of protection, plus special provisions for valuables such as jewelry, computer equipment and other possessions. Additional coverage might also be needed for such things as earthquakes or flooding.

Lending institutions usually require mortgage customers to purchase homeowners insurance. Relying on the coverage levels mandated by the mortgagee's bank or mortgage company may not be wise. Those levels are designed to protect the house itself, but not necessarily the possessions inside the house. That is why it is important for homeowners to check with their agent or insurance company, to make sure they have adequate coverage.

Basic policies

There are several basic types of home insurance policies:

HO-1 Basic homeowners policy
Covers the house and possessions against 11 different perils.

HO-2 Broad homeowners policy
Covers house and contents against 17 perils, with premiums running about 5 percent to 10 percent more than an HO-1 policy.

HO-3 Special homeowners policy
Covers all perils except those specifically excluded by the policy. Costs 10 percent to 15 percent more than an HO-1 policy.

HO-4 Renters Policy
Covers 17 named perils and includes liability coverage. It does not insure the dwelling itself.

HO-5 Extensive homeowners policy
Covers damage from practically everything except earthquakes, wars and floods.

HO-6 For owners of co-ops or condominiums
Provides personal property coverage, liability coverage and specific coverage of improvements to the owner's unit. Insurance provided by the owner's association normally covers most of the actual structure.

HO-8 Policy for older homes
Covers the same perils as HO-1 but pays only for repair costs or actual cash value, since replacement cost could make the policy costly.

In Texas

The policies above are standard except in Texas, where the state insurance board specifies three types of policies listed below.

HO-A
Covers the home and possessions against named perils only, for actual cash value.

HO-B
Covers the dwelling for all perils unless excluded against all risks and contents against named perils. The house is covered for replacement cost up to policy limits, while contents are covered for actual cash value unless the insured purchases additional replacement cost coverage.

HO-C
Covers house and contents against all risks not specifically excluded by the policy. Again, the house is insured for replacement cost up to policy limits, while contents are covered for actual cash value unless additional coverage is purchased.

There are variations on these policies as well. For example, landlords can buy coverage that insures only their buildings and not the tenant's personal property (which is what a renters policy would cover). Special policies to cover mobile homes (a.k.a. manufactured housing) can also be purchased.

Differences Between Homeowners and Dwelling Property Policies

Dwelling Policy Up to Four Units

A **dwelling policy** is designed for a residence that is owned but not lived in by the owner. A Dwelling policy covers residential property of up to four units, whether occupied by the insured or not. An insured purchases individual coverages on an *a la carte* basis. That is, fire perils separately from extended coverage perils, and coverage for buildings separately from outbuildings and contents. The dwelling policy doesn't automatically include coverage for belongings/personal property; that must be purchased separately. The home itself will also have less coverage on a dwelling fire policy. A dwelling policy is suited more for rental properties, seasonal properties and vacant properties.

Homeowners Policy- Owner Occupied

A **homeowners policy** is for an owner-occupied residence. This type of policy is designed for a residence lived in by the owner. Homeowners' policies are less expensive and provide broader coverage than dwelling policies. These policies are designed to cover contents, liability, and medical claims. However, even if it is an individual's primary residence, older and poorly-maintained homes may not qualify for a homeowners policy. Buyers of classic "fixer-uppers" who are in the market for a homeowners policy would be wise to upgrade outdated electrical and plumbing systems before launching other extensive repairs to the home. The condition of these systems could be one of the reasons why a company would refuse to issue anything other than dwelling coverage.

Starting an application

When a prospective insured applies for homeowners insurance, a great deal of information will be provided to the insurance company. The insurance company will ask about current occupation and employment history, marital status, previous addresses, date of birth and Social Security number. The insurer will check criminal, credit, and insurance history to see if the prospective insured is a "good risk." The insurance company also will look at the "loss history" to see what kinds of home insurance claims the applicant has made in the past. Then the homeowner will have to decide what type of homeowners policy he or she wants, the deductible, and how to pay for the coverage. The agent or insurance company will concur with or determine how much it would cost to replace the home and many of the items inside. For more expensive property, such as jewelry and computer equipment, special coverage may be needed in addition to the basic policy.

Analyzing the home- Many factors go into determining the premiums for a homeowners policy. The age of the home, the materials used to build it, where it's located, the square footage, and the number of rooms all play a role.

How is the home heated? What's the overall condition of the house? How many people live in the home? How close is the home to the nearest fire station and fire hydrant? The answers to these questions also help determine how much will be paid for the homeowners policy.

Ways to save- If the home is equipped with an alarm system, smoke detectors and deadbolt locks, it could save money. Those items help make the house safer and more secure. If the home has an in-ground pool or a trampoline, it might mean higher premiums. One can also expect to pay more if the house is located in a higher risk area, such as a coastline. The insurance company will also want to know if the homeowner plans to use the home for any business purposes, of if there are plans to rent all or part of the house, both of which can increase liability. Armed with all this information, insurance companies can determine how much to charge for insurance, sometimes in a matter of minutes.

Dollar limits are important- If a house is insured for $100,000 that is the maximum paid out if the house is destroyed, even if it would cost more to replace it. The Declarations Page on the front of the policy shows how much coverage an individual has. Insureds should talk with their agent or company representative if any questions about the insurance limits should arise. A common issue among insureds is to wait for a claim to learn their policy's limit.

Replacement cost coverage for personal property

Before purchasing homeowners insurance, it is important to understand the difference between 'replacement cost' and 'actual cash value.'
Replacement Cost- Payment based on the replacement cost of damaged or stolen property is usually the most favorable figure from the homeowners point of view, because it compensates for the actual cost of replacing property. If a camera is stolen, a

replacement cost policy will reimburse the homeowner for the full cost of replacing it with a new camera of like kind. The insurer will not take into consideration the fact that frequent use of the camera, causing a considerable amount of wear and tear.

Actual Cash Value

(ACV) This is also known as market value, is the standard that insurance companies arguably prefer when reimbursing policyholders for their losses. Actual cash value is equal to the replacement cost minus any depreciation (ACV = replacement cost - depreciation). It represents the dollar amount one could expect to receive for the item if it were sold in the marketplace. The insurance company determines the depreciation based on a combination of objective criteria (using a formula that takes into account the category and age of the property) and subjective assessment (the insurance adjuster's visual observations of the property or a photograph of it). In the case of the stolen camera, the insurance company would deduct from its replacement cost an amount for all the wear and tear it endured prior to the time it was stolen.

What Does "Replacement Cost" Mean?-The term "replacement cost" is defined or explained in the policy. Simply stated, it means the cost to replace the property on the same premises with other property of comparable material and quality used for the same purpose. This applies unless the limit of insurance or the cost actually spent to repair or replace the damaged property is less. Insureds need to be directed to the language of his or her policy for the exact definition and explanation of replacement cost.

What is "Actual Cash Value"?-The term "actual cash value" is not as easily defined. Some courts have interpreted the term to mean "fair market value," which is the amount a buyer would pay a seller if neither were under undue time constraints. Most courts, however, have upheld the insurance industry's traditional definition: the cost to replace with new property of like kind and quality, less depreciation. Courts have varied in their rulings as to whether or not depreciation includes obsolescence (loss of usefulness as a result of outmoded design, construction, etc.).

What the Difference Means- The only difference between replacement cost and actual cash value is a deduction for depreciation. However, both are based on the cost today to replace the damaged property with new property. Note that accounting or "book" value has no relevance to either of the previous methods of valuation. The depreciation rate reflected in "book" value would yield a terribly inadequate settlement. Another problem with using "book" value is that it may reflect only the items that are "capitalized." To determine adequate limits, one must add "expensed" items into capitalized items.

Other Kinds of Valuation

Certain property may be subject to a special valuation basis other than replacement cost or actual cash value. The value reported should match the applicable valuation basis. For example, if the property policy is endorsed with a selling price endorsement for finished goods, the proper value to insure for finished goods is the cash selling price, less any customary discounts and expenses that otherwise would be incurred.

Most homeowner policies contain replacement cost coverage on the home and actual cash value coverage on personal property. Homeowners policies automatically cover household contents - furniture, clothes, appliances, etc. - up to 40 percent of the amount for which the house is insured. This means if a house is insured for $100,000, its contents are insured for up to $40,000. More coverage can be had by paying a higher premium. This automatic coverage pays only the actual cash value of damaged, stolen, or destroyed household goods. Actual cash value is an item's replacement cost, minus depreciation. Replacement cost policies give more protection than actual cash value coverage. For example, suppose a burglar steals a six-year-old television set. With actual cash value coverage, the insured only gets what one would expect to pay for a six-year-old television set. With replacement cost coverage, the insurance company pays to replace the TV with a new set similar to the stolen one. Insurance companies generally want proof the item was replaced before paying the claim in full. An insurer might offer to replace the items instead of paying cash, but the choice is with the homeowner.

Take inventory- Many people learn after a fire or storm they did not have enough personal property coverage. Taking inventory will help homeowners decide how much insurance is needed. It also will simplify claims. The inventory should list each item, its value, and serial number. A photograph or videotape should be made of each room, including closets, open drawers, storage buildings, and the garage. Keep receipts for major items in a fireproof place.

Other protections the policy provides- Homeowners policies regularly provide other types of coverage, including off-premises theft protection and unauthorized use of credit cards. Insureds should make efforts to understand which provisions are included in the standard coverage purchased and which might require supplemental premiums.

Supplemental coverage- Homeowners policies cover specific risks. Depending on what is owned and where a person lives, he or she might need to supplement the insurance policy with special coverage.

Flood insurance- Homeowners policies do not cover flood damage. The National Flood Insurance Program (NFIP) offers flood coverage in many areas. Local insurance agents sell NFIP flood policies and can give information about the program in and how it works in the area in question. Information is available from NFIP at 1-800-427-4661, or online at www.floodsmart.gov.
If a mortgage lender determines a home is in a special flood hazard area, the borrower might be required to purchase flood insurance.

Earthquake insurance- If concerned about earthquakes, the homeowner can get coverage with a separate policy.

Extra coverage (Endorsements) - The insured might want more coverage for certain items than a standard policy provides. For an extra premium, the insured might be able to buy endorsements that expand or increase the coverage on these items. Some of the most common endorsements cover jewelry, fine arts, camera equipment, coin or stamp collections, computer equipment, and radio and television satellite dishes and antennas.

Personal umbrella liability insurance- If the homeowner wants more liability coverage than a homeowners policy provides, he or she can buy a separate umbrella policy.

Because policies vary, one must make sure the agent or company fully explains the coverage.

Higher deductibles, lower premiums- Deductibles allow insurance customers to cut the cost of insurance, by assuming some of the risk. If someone has a $250 deductible on their homeowners policy, he or she agrees to pay $250 to cover any losses, before the insurance company pays the rest of the claim. By increasing that deductible to $1,000, an insured might save 20 to 30 percent on the premiums. A person must decide whether lower deductibles or lowering the premium is right for them.

Bad credit and Insurance

Some insurance companies might charge higher premiums if a person has problems with his or her credit history. Insurers say past experience has shown people with financial problems pose a greater risk. Insurance scores are confidential rankings based on credit history information. They are a measure of how a person manages his or her financial affairs. People who manage their finances well tend to also manage other important aspects of their lives responsibly, such as driving a car. Combined with factors such as geographical area, previous crashes, age and gender, insurance scores enable auto insurers to price more accurately, so that people less likely to file a claim pay less for their insurance than people who are more likely to file a claim. For homeowners insurance, insurers use other factors combined with credit such as the home's construction, location and proximity to water supplies for fighting fires.

Insurance scores predict the average claim behavior of a group of people with essentially the same credit history. A good score is typically above 760 and a bad score is below 600. People with low insurance scores tend to file more claims. But there are exceptions. Within that group, there may be individuals who have stellar driving records and have never filed a claim just as there are teenager drivers who have never had a crash although teenagers as a group have more accidents than people in other age groups. Most people benefit from insurance scoring because most consumers manage their debt well and therefore have good credit scores. Credit-related activities within the last 12 months are given most weight.

Homeowners Policy; Terms

The homeowners' policy contains two sections. Section I provides property coverages (A, B, C and D) while Section II provides liability coverages (E and F):

- Section I
  - Coverage A - Dwelling
  - Coverage B - Other Structures
  - Coverage C - Personal Property
  - Coverage D - Loss of Use
- Section II
  - Coverage E - Personal Liability
  - Coverage F - Medical Payments to Others

There are differences in the property coverage that may necessitate differences in coverage levels. Various coverage options are available.

Coverage A - Dwelling

Coverage A provides major property coverage that protects the house and attached structures if damaged by a covered peril.

Coverage B - Other Structures

This coverage provides protections to other structures on the residence premises that are not attached to the dwelling. Items covered include detached garages, tool sheds, etc. Coverage B is normally limited to 10% of the coverage A limit. However, the homeowner may purchase more coverage for an additional premium.

Coverage C - Personal Property

This coverage provides protection for the contents of a home and other personal belongings owned by the insured and other family members who reside in the home. Coverage C is limited to a percentage (perhaps 50%) of coverage A or is subject to an established amount agreed upon by the insured and the insurance company. Coverage is limited on certain types of property that are especially susceptible to loss, such as:

Jewelry
Furs
Fine Arts
Silverware
Antiques
Collectibles
Firearms
Money

Additional amounts of insurance may be purchased. It may be prudent to schedule these items separately. An insurance professional can provide specifics.

Coverage D - Loss of Use

This coverage will help with additional living expenses if the home is damaged by a peril insured against to the extent that the insured cannot live in the home. These expenses include, but are not limited to, housing, meals and warehouse storage. Coverage D is normally limited to 20% of Coverage A.

Payment on Loss

The Underwriting of homeowners insurance includes many different forms of coverage which seek to fit the insurance needs of a diverse population. The homeowner policy is a "MULTI-LINE POLICY" - it combines property (fire) coverage with casualty (personal liability & theft) into a SINGLE CONTRACT. Use of coverage is restricted to single or two unit residential properties only and the owner must reside at the property location.
Coverage A, Dwelling: The dwelling that is described in the declarations and structures attached to that dwelling are covered. Materials and supplies located on or adjacent to the premises used for construction, repair and alteration of the dwelling or other structures on the premises are covered. This coverage is not available in the HO-4 contract and the HO-6 carries only a $1,000 coverage amount.
Coverage B, Appurtenant (Other Structures): - Provides protection for structures on the premises which are detached from the dwelling. Exclusions include structures used for business purposes and any structure rented to anyone other than a tenant of the

dwelling. This is not included in either the HO-4 or HO-6 contracts. This coverage is generally limited to 10% of dwelling coverage amount (Coverage A).

Coverages A and B, dwelling and other structures, are insured on a **"replacement cost"** basis. If, at the time of loss, the insurance coverage amount upon the dwelling is no less than 80% of the cost of replacing the building, replacement cost is paid for losses. Replacement cost means the exact dollars needed at the time of loss to replace the item which requires replacement. Physical depreciation is not deducted from the cost as it is with actual cash value coverage.

In evaluating whether or not the insured qualifies for this 80% requirement, the cost of excavations, wiring, pipes and foundation below the basement or ground level may be deducted from cost. Replacement cost only applies to the buildings and not to personal property. Personal property is covered on an actual cash value basis. This is no replacement cost coverage for carpeting, appliances, awnings and outdoor equipment. When the buildings are insured for less than the required 80%, then payment will be the greater of
1) actual cash value
2) replacement cost in proportion of the loss based on the amount of insurance is in relation to 80% of the replacement value of the buildings.

When the loss is more than a specified dollar amount ($2,500 for example) or 5% of the insurance amount, then the building must be repaired/replaced before the insured can collect on a replacement cost basis. Insurable value and market or loan value do not necessarily translate into the same dollar amounts. Market value of real estate is based upon supply and demand factors of a specific area, not to mention variable economic relationships. Market value of a dwelling also includes the value of the underlying land, while insurance value does not.

Allowing for Inflation

The main threat to retaining full replacement cost coverage is probably the continuous encroachment of inflation in the economy. As prices of goods rise in general, the real estate market usually hedges upward in value as the greatest single asset most Americans will enjoy. Without adjusting insurance coverages on dwellings to meet increases in value, plus the goods and services it would cost to replace the items it takes to create the value, underinsurance will occur. An inflation endorsement can be added to the homeowners policy to automatically increase the coverage. The amount will increase by a fixed percentage of the face coverage amount on an annual basis.

Personal Property

Coverage C, Personal Property: Provides protection for personal property which is owned or used by the insured anywhere in the world. Personal property of others may be covered while it is on the premises if selected by the insured. Maximum coverage is up to 10% of the Coverage C limit on personal property with worldwide protection with a $1,000 minimum for property usually situated at a residence of the insured which is not shown in the declarations.

Otherwise **the coverage amount is 50% of the Coverage A limit.** On the HO-4 and HO-6 forms, it is available not as a percentage of Coverage A but rather as a flat dollar amount. Under Forms HO 2 AND HO 8 the minimum Coverage A amount is $15,000 and the personal property coverage amount is $7,500. The HO 3 dwelling minimum is $20,000 and the personal property amount is $10,000. The simple contract wording for all forms of the homeowners Coverage C amount is:

> "We cover personal property owned or used by any insured while anywhere in the world."

Coverage D, Loss of Use: Coverage D insures the homeowner for temporary living expenses for a certain period of time while a damaged home is repaired or rebuilt. The maximum is generally 20% of Coverage A. Additional or miscellaneous coverages are also listed. An evolving issue with this coverage concerns electronic data. For example, a lightning strike may physically ruin a computer, but is stored data a separate issue and is it tangible property?

Personal Property Exclusions and Limits

Personal property which is not covered includes:

1) animals, birds, fish,
2) aircraft and parts,
3) automobiles or motorized vehicles unless the vehicles are used to service the premises,
4) any recording or sound reproducing devices while in a motor vehicle, including tapes, records and discs
5) boarder's and roomer's property when the individuals are not related to the insured, any property in an apartment which is regularly rented if it is away from the insured premises,
6) business property out of the way from the insured premises, business property of a business which is conducted on the premises, business property carried or held as samples for later delivery after sale.

Homeowners policies set specific dollar limits for particular categories of personal property in a section entitled Special Limits of Liability. Note that for some categories, the policy specifies a limit only for theft, not for damage or destruction. The reason is that items such as jewelry, firearms, and furs are especially susceptible to theft, and insurance companies want to limit their exposure to these fairly common incidents. The damage or destruction of these items is less common, and insurance companies are willing to cover them up to their actual cash value.

Below are some examples of the *standard* limits for particular categories of personal property. Depending on the policy's type, limits and endorsements, these figures may or may not be accurate:

- $200 for money, bank notes, bullion, gold, silver, coins, and metals
- $1,000 for securities, accounts, deeds, letters of credit, notes other than bank notes, manuscripts, personal records, passports, tickets, and some other related items
- $1,000 for the theft of jewelry, furs, watches, and precious and semi-precious stones
- $2,000 for the theft of firearms

- $2,500 for the theft of silverware, silver-plated ware, goldware, gold-plated ware, and pewterware
- $2,500 for property at the residence used for business purposes
- $250 for property used away from the residence for business purposes

Additional coverage
Chances are, the value of many of the homeowners personal belongings may exceed the limits in the policy. That is why the insured has the option of increasing these specific limits by purchasing either a Scheduled Personal Property endorsement or a floater. For example, an increased jewelry limit may also be necessary for covering engagement or wedding rings. If the insured purchases a personal property rider, he or she must be able to verify the cost and condition of the item. Photos or a video can be used to inventory the property. However, one should be sure to keep the inventory away from the premises (i.e., safe deposit box). Professional appraisals are needed for certain items, such as jewelry, antiques, or camera equipment (beyond a basic camera).

VI. Other Provisions and Terms

INSURABLE INTEREST - Insurable interest exists as to any individual when damage or destruction of property will result in a financial loss to that individual. Insurable interest extends beyond mere ownership and even tenants have insurable interest in their own belongings within a building owned by another person. Under insurable interest, the insurance applicant must:
a) face a personal risk of loss; or
b) have a legitimate interest in preserving the property being insured. Otherwise, he or she will not receive a potential for gain due to the insurance applied for. **In a property or casualty contract, insurable interest <u>must exist at the time or loss</u>**.

DUTIES OF THE INSURED are imposed upon the insured, **in the event of loss**, is "reasonable compliance" in these five areas:
1) <u>Immediate Notice</u> - written notice is specified, but telephoning the agent is now deemed to meet this criterion.
2) <u>Prevent Further Loss</u> - of property from damage under reasonable conditions. Further damage due to neglect by the insured is not covered.
3) **<u>Damaged and Undamaged Property must be separated</u> to determine loss.**
4) **Inventory loss** - compile a complete list of destroyed, damaged and undamaged property.
5) <u>Claim Verification</u> through checking banks statements and records of the insured must be made available to the company.

DUTY OF THE INSURANCE COMPANY - the obligations of the insurance company, according to the contract, are stated in the agreement. **As long as the insured makes timely payments and meets other requirements of the contract, the insurance company is bound to pay in the event of loss.**
Pair and Set Clause - When loss to an object, which is part of a pair or set occurs, the insurance company can employ either of the following options:
1) To pay the difference between actual cash value of the property before and after the loss.

2) Repair or replace any part of the property in order to restore it to its value before the loss occurred.
It is the purpose of the pair and set clause to prevent the insured from collecting fully upon a loss which is only partial and not total.

Mortgagee Rights- a mortgagee interest allows a mortgage holder to receive loss settlement up to the value of the lender's interest in the property (unpaid principal on a mortgage loan). **When canceling, a company must provide 10 days notice to a mortgagee.** If the insured fails to provide proof of loss, a mortgagee has 60 days from receiving notice of the failure of filing a proof of loss to file the loss themselves. New commercial forms now have a **mortgage holder condition** requiring the mortgage holder to be given a 10 day notice of nonrenewal or cancellation for nonpayment of premium, and a 30 day notice of cancellation for any other reason.

APPRAISAL - Each party to the insurance contract selects a disinterested appraiser. Each appraiser chooses an umpire/referee (who will cast the deciding vote when the appraisers disagree) or one is appointed by a court of record. Actual cash value of loss is estimated and sent to the umpire/referee who then sets an amount that is agreed upon by at least one of the two appraisers. That amount is binding for all parties submitting to the appraisal process.

ARBITRATION - National panels make a decision to which both parties, in a claim settlement dispute, agree to be bound. This process saves time and money and is very similar to the appraisal concept, above. In modern ISO polices, the Arbitration clause is only found in the automobile policy forms, as part of uninsured motorist coverage.

Nature of the Contract- Void and Voidable

Two contractual terms which are critical to the status of a contract's effect are **"void" and "voidable".**
1) A "void" contract is an agreement which has no legal effect whatever. It means no contract even exists.
2) A "voidable" contract is an agreement that does exist, but whose legal effect can be put aside by a court of law. It would be a binding agreement unless the party who has the right to have it voided (or set aside) wishes to do so.

Also of great importance in the contract formation stage are the ideas of **Warranties, Representations and Concealment.**
1) A Warranty is a fact which is sworn to such that a breach of warranty can lead to voiding a contract. A warranty is a much stronger statement than a representation. Breaching a warranty on even a minor point can be cause for setting aside an agreement. In modern insurance contracts, the strict warranty standard is only held against an insured in the ocean marine form of coverage.
2) Representations are considered to be statements of fact, in the opinion of the person making the statements. In order to void a contract on a basis of misrepresentation a party must show that a material fact was misrepresented. A material fact is one that would have changed the underwriting basis of a policy, had the company known of the material fact. Any minor points which may have been misrepresented will not enable the other party to void an agreement. This is the standard to which virtually all insureds are held.

3) Concealment is the failure to disclose a known fact. It is hiding something that should not be hidden even when the particular fact was not specifically asked about. In order to void a contract the concealment must be intentional.

Important Contract Conditions

VACANCY AND UNOCCUPANCY are conditions limiting coverage when the insured develops a lack of concern about property protection. It is essentially an insurer's protection against a morale hazard.
1) Vacancy exists when a property is both unfurnished and not being used by anyone for business purposes or as a dwelling**.**
2) Unoccupancy refers to the fact that a property is furnished or has possessions in the physical structure but no one is using the property for business purposes or as a dwelling.

LIBERALIZATION- is a property insurance clause which states that if the insurer makes any changes in the current edition of a policy which broadens coverage without premium charge, such changes are automatically made a part of all existing policies.

CANCELLATION allows both the insured and the insurance company to cancel coverage, according to contractual conditions. **The insurance company must give some specified written notice (as required by state statute), but the insured can request immediate cancellation.** When the **insured is the party canceling** the policy, any **refund** of unearned premiums **is calculated on a short rate basis** (unless state law says otherwise)**.** The short rate basis enables the insurance company to recoup some of the cost of underwriting and processing the policy.

When the **insurance company cancels,** unearned premiums (refunds amounts) are paid to the insured party on **pro rate (pr pro rata) basis.** This **means the insured gets back all of the money which has not been used or applied to premium cost.**

NONRENEWAL - **Nonrenewal is notice given by the company** to the insured that the insurance company does not intend to renew the policy upon the normal termination date. Nonrenewal notice affords an insured the opportunity to replace coverage and not have a gap in coverage when the existing policy terminates. The number of days notice required by a company exercises the nonrenewal option is normally 30 days or more.

PROOF OF LOSS - must be filed by an insured within 60 days (mortgagees have an additional 60 days to file loss if insured does not if there is an outstanding mortgage loan).

NOTICE OF CLAIM or notice of loss provision means the insured must take certain steps in the event of loss or occurrence in order to lead to a filing a successful claim (receiving a loss payment) under the terms of the agreement. **The insured is bound to notify the insurance company of loss as soon as reasonably possible.** Furthermore, the insured may be required to notify the police if a violation of the law has occurred (i.e. burglary or theft).

ASSIGNMENT - Assignment is **the transferring of some or all rights from one party to another.** Assignment of rights held under property contracts is normally valid only with the written permission of the insurance company.

SUBROGATION (also called Transfer of Recovery rights) is a clause whereby the insurance company, by assignment from the insured as stipulated in the insurance contract, has the right to recover from third parties any recoverable loss which was reimbursed by the insurance company to the insured during the settlement of the claim. Subrogation allows the company to step into the shoes of the insured for purposes of recovering losses which have been paid to the insured by the company due to the liability of the third party. Subrogation is a concept related to indemnity, or the prevention of the insured to profit. In this case, the insured cannot collect for sustained damages twice.

EVENT OF THE INSURED'S DEATH - when an insured dies, the contract allows the legal representatives of the deceased insured to assume coverage on any insured property.

Comparison of Coverage Forms

The Homeowners Broad Form provides insurance for damage to the building, personal property and to the loss of use that results from the damage of any peril insured against. **Coverage for personal property under <u>all</u> the homeowners** forms include the same sixteen perils which are listed below:

1) Fire and lightning
2) Windstorm or hail
3) Smoke
4) Explosion
5) Vehicles
6) Aircraft
7) Riot and civil commotion
8) Falling objects
9) Theft
10) Vandalism or malicious mischief
11) Weight of snow, sleet or ice
12) Sudden and accident damage from artificially generated electrical current
13) The freezing of plumbing, heating, air condition or automatic fire protective sprinkler systems or household appliances
14) Accident discharge of water or overflow of water or steam from within a plumbing, heating, air conditioning, fire protective sprinkler systems or household appliance
15) Sudden accidental tearing apart, cracking, bulging or burning of a steam or hot water heating system, air condition, automatic fire protection sprinkler system or appliance for heating water
16) Volcanic eruption

The fire and lightning peril covers a fire which burns down a building or causes other damage. Although there is coverage for fire in the contract, the term itself is not defined in the policy. The court system has taken care of the general definition: **fire is a combustion proceeding at a rate rapid enough to generate flame, glow or incandescence.** In order for there to be coverage under the fire concept, there must be light. Smoke scorching is not solely indicative of fire without the presence of light. The fire coverage extends to coverage for hostile or unfriendly fires. A "friendly fire", which is one that is supposed to remain within its intended confines, would burn where it is supposed to be burning.

Windstorm and hail coverage excludes any damage that is caused by rain, snow, sleet, sand or dust which occurs to the inside of a building unless the outside of the building or roof was damaged due to the direct action of the wind or hail. Any damage that would occur to the inside of the building due the neglect of the insured would be excluded.

Riot and civil commotion covers any damage done by rioters, with very limited exclusions. Pillaging and looting are covered if they happen at the time and place of the general riot. There is some problem in the **distinction between the definition of a "riot" and "insurrection", however.** Losses caused by war are excluded in the homeowners form. The idea of an insurrection may not meet the definition of a riot, which is a tumultuous disturbance of the peace by three or more persons. An insurrection has, as its center of intent, the idea of overthrowing an existing legal government.

Aircraft coverage is provided to the insured property against any self propelled missiles or space craft parts that might damage the property. This includes damage that is the result of direct physical contact with the insured property by an aircraft and it also could include aircraft noise, such as a sonic boom.

Vehicle damage is covered even if the insured owns or operates the vehicle causing the damage. The only exclusion would be the fences, driveways or walks damage done by owned vehicles of the insured.

Smoke damage from a hostile fire is also a peril covered. Exclusions to the smoke peril are smoke damage that is a result of agricultural or industrial smudging operations.

Vandalism or malicious mischief is damage done to the property of others due to willful and malicious destruction of the property. If a building has been vacant for more than 30 days, the vandalism peril will not be covered. The logic behind this denial of coverage is that if the insured is present continuously, vandalism or malicious mischief is less likely to occur. The attitude of the insurance company seems to be: if the insured is not present and doesn't seem to care, neither does the company. Any dwelling that is being built at the time of construction is not considered to be a vacant property.
Theft coverage forms are identical in all the homeowners policies except for form 8. The theft peril provides **coverage for "theft, including attempted theft** or loss of property from a known location when it is likely that the property has been stolen".

Such language relieves the insured of the burden of showing that the loss actually happened due to theft, especially when there is not adequate proof available. The only requirement under the contract is that the insured must immediately notify the police when property has been stolen. **General exclusions to theft include:**
1) When the insured commits the theft.
2) When a dwelling which is under construction has materials and supplies that are used in the construction are stolen before the dwelling is completed and occupied.
3) If a residence is rented by an insured to anyone except another insured, all theft would be excluded under this condition.

Peril Exclusions

1) Loss caused by the enforcement of any law or ordinance that regulates the building, repair or demolition of any building is excluded.
2) Earth movement - This eliminates coverage for losses caused by the earth moving except when direct loss is from fire, explosion, theft or the breaking of glass. The policy specifically defines the movement of the earth as "earthquake, including land shook waves or tremors before, during or after a volcanic eruption: landslide: mine subsidence, mud flow, earth sinking, rising or shifting".
3) Water damage - Water from floods and backup of sewers and drains and overflow of sump pumps is excluded as is water which is below the surface of the ground which seeps through basement walls, foundation walls, etc.
4) Power failure - Coverage is excluded when loss results directly because of the interruption of power and utility services when the interruption takes place away from the resident premises. Therefore as long as loss takes place as a result of the power failure on the actual premises, coverage will exist.
5) Neglect - Any loss that results directly and indirectly due to neglect of the insured, he uses reasonable means to prevent the loss, is excluded. This prevents the insured from collecting for damage that they had a reasonable chance to avoid.
6) War - All loss due to war in any form including undeclared wars, insurrection, rebellions and revolutions is excluded. And any nuclear weapon which is discharged, even accidentally, is still excluded under the contract language.
7) Nuclear hazard stipulates that losses from nuclear hazards are not covered and this includes nuclear reactions, radiation and radioactive contamination.
8) Intentional loss which is defined as loss by "by or at the direction of the insured" "with the intent to cause a loss".

Broad Form and Special Form

The main difference between the Broad Form and the Special Form (HO-3, in Texas HO-C), is that the Special Form **coverage is on an open perils basis for dwelling and other structures.** Open perils **means that a set of exclusions are listed and if the cause of loss is not one of those exclusions it will be covered.** Although the real property is insured on an open perils basis, **personal property is insured on a named perils basis.** Other than this open perils basis coverage difference, the form 3 and form 2 are exactly the same.

EXCLUSIONS

Open perils exclusions in the Special Form are:
1) Wear and tear or deterioration
2) Inherent vice, latent defect or mechanical breakdown
3) Rust, mold, wet or dry rot
4) Smog, smoke from agricultural smudging or industrial operations
5) Release, discharge or dispersal of contaminants or pollutants unless caused by one of the named perils for which personal property is insured.
6) Settling, cracking, shrinking, bulging or expansions of pavements, patios, foundation walls, floors or ceilings.
7) Damage caused by birds, rodents, vermin or insects.
8) Domestic animals owned by the insured.

An exception to these exclusions is that, if one of the excluded perils is the basis for leaking water from plumbing, heating, air conditioning or fire sprinkler systems or appliances, then the damage would be covered.

Concurrent Causation

Recent Special Form language includes three related exclusions referred to as concurrent causation exclusions. The first part of concurrent causation deals with any loss caused by weather conditions that will contribute to a peril which otherwise is not covered. For instance, in order for there to be coverage, the loss has to be directly caused by a weather condition that is covered or not excluded. The second part of the exclusion deals with loss caused by any actions or decisions of any person, group, organization or governmental body. This also includes the failure to act or to decide by the above named individuals. The last part of concurrent causation excludes loss caused by faulty or inadequate design, maintenance or the use of faulty materials, including defective activity, such as poor planning, in the construction of the covered dwelling.

There is also a general exclusion referred to as "dwelling and other structures" exclusions. The first exclusion in this area deals with the collapse peril. Under additional coverage, the collapse peril is a named perils coverage, however the intent of the language has been to exclude from collapse coverage any collapse resulting from excluded perils such as flood, earthquake or planning and design error. The other exclusions can be found in the discussion under HO2 (freezing of plumbing when the building is vacant, freezing, thawing, etc.).

Renter's Insurance

The Contents Broad Form is often referred to as renter's insurance. The theory is that the renter is using real estate on a contractual basis and no real property ownership exists. This will eliminate the need for any coverage on the dwelling or structure and instead focus the coverage needs on personal property liability coverage. There is a difference in the insuring agreement of Contents Broad Form and the Homeowners Broad Form in that there is building additions and alterations coverage which applies to the tenant and is usually referred to as tenants' improvement and betterments. These improvements can include building additions, alterations, fixtures, improvements or installations made by the insured in a rented apartment or dwelling. The coverage amount on the building additions and alterations is limited to 10% of the coverage on contents.

The Homeowners Special Personal Property coverage endorsement offers open perils coverage on contents and is added to Form 3 to provide open perils coverage on the building and the contents. The Special Personal Property (In Texas, HO15) rider to the Special Form open perils coverage was designed to replace the HO5 form from earlier ISO contract language. This special personal property endorsement eliminates the perils covered for coverages A, B and C and instead uses the following language "We insure against risks of direct loss to property described in coverages A, B and C only if that loss is a physical loss to property".

The exclusions are the same open perils exclusions applying to the dwelling under an unendorsed Special Form. Such exclusions apply to all coverages of Section I. Another set of exclusions applies to the dwelling and other structures and is comprised of the usual exclusions of vandalism, malicious mischief, glass breakage, 30 days limitation on vacancy, repeat seepage or leaking of water taking place over a period of time and collapse. The last group of exclusions deals with the personal property coverage. **These are new exclusions which do not pertain to other forms including:**

1) Breaking eyeglasses, glassware, statues, marble, porcelains and fragile articles, unless they are caused by a specifically named peril.
2) Damp atmosphere, extreme temperatures, unless the direct cause of loss is in fact weather, snow, sleet or hail.
3) Refinishing, renovating or replacing property except for jewelry, furs, etc...
4) Collision except for collision with land vehicles or sinking, swamping or stranding of watercraft including their trailers, furnishing equipment or outboard motors.
5) Destruction and confiscation or seizure by order of any governmental or public authority.
6) Acts or decisions including the failure to act or decide of any person, group, governmental body, or organization.

The theft coverage language under the Homeowners Special Personal Property form is unique among coverage forms. **Theft is not covered as a named peril but due to the broad open perils coverage of HO15 coverage for loss of real or personal property by theft is included.** There is **just one exclusion** found under the form 15 and that is **if theft is in a building that is under construction and prior to the completion and occupation of the structure.** Typically a named perils form set of exclusions includes theft by the insured, theft from unlocked vehicles or watercraft while insureds are away from the premises and theft to second homes. However under Form 15 they are not excluded and are covered. Besides theft, the coverage applies also to loss by lost or misplaced property as well as having it stolen.

Insurance for Condominiums

The HO6 applies to owner's of condominium units. The risk of loss to the condominium owner is unique due to the manner in which ownership of the real property exists. A condominium is a structure made up of many individual dwelling units shared by different owners. While everyone has their own space or living quarter, there are also common areas (hallways, walkways, etc.) to which all unit owners enjoy real property ownership as tenants in common. While the individual owner of a condominium will have a concern similar to a renter, because they need contents coverage and protection from liability in their living space, there is also the risk of loss inherent to real property ownership

The real property of the condominium owned in common with the other owners is insured through a condominium association to which all occupants or condo owners pay fees for the upkeep. The fees are not only for the upkeep of the exterior and common areas but they also apply to property insurance and liability coverage which is purchased for all the condominium owners for the common area.

BASIC ENDORSEMENTS TO HO 6

In order to enjoy greater coverage, this endorsement includes:

1) open perils coverage on personal property.
2) Rental unit coverage - This covers a situation where the condominium unit is rented by the owner to another person.
3) Open perils coverage on unit owner's building items.
4) Assessment coverage - Here loss assessment is automatically included as an additional coverage in form

Older and Historic Properties

The HO8 contract was created to provide a coverage form under homeowners that would allow the owners of unique types of older property to obtain coverage that they otherwise would not be to get. Many older homes were built in a time when the materials and labor was quite expensive by today's standards. Modern dwellings are built in a cost efficient and effective manner, almost cookie-cutter fashion in some cases. The intensive labor and expensive materials which went into dwellings of the past are not economically feasible today. To modernize the insurance approach for these older homes, the HO8 has a unique clause called **functional replacement cost.** Other homeowners contracts as contain a normal or standard replacement cost provision allowing the replacement purchase to be made in actual present dollars. Functional replacement cost allows the insurer to repair damage, but they will pay more then what it costs for common construction materials used today, as opposed to replacing the materials and methods used years ago when the home was built. For example, if the original structure had walls which were made of plaster, then dry wall would be the replacement... Another reduced type of coverage under this form is the theft coverage which is limited to $1,000 per occurrence and is only valid on the premises.

Special Risk Concerns

It is possible for the homeowners forms to be augmented by **endorsements for water backup, earthquake and sinkhole collapse**. Since homeowners forms exclude any water damage including water that backups through sewers and drains and overflows from sump pumps, many people still have a need to have coverage for this possibility. The water backup and sump overflow endorsement **will insure the party for up to $5,000 for direct loss not caused by the negligence of the insured.** Sump pump damage coverage will exist even if the water damage was due to mechanical problems with the sump pump. There is a $250 deductible associated with this endorsement. The **earthquake endorsement** will pay for loss to the insured's property that results from an earthquake or volcanic eruption. However losses due to floods or tidal waves that are a result of earthquake or volcanic eruption are excluded from coverage. The real estate itself or the land is not covered. Commonly there's a 5% deductible on the value of every item insured under the contract. In areas where earthquakes are more prominent there can be a 10% deductible applied

Sinkhole collapse coverage is available on all homeowners form except for HO4 and HO6. In the event the insured property is damaged because of sinkhole collapse caused by underground erosions of limestone or common sedentary rock caused by water damage. Filling a sinkhole is not covered under this endorsement.

Development of Special Risk Policies

This provides open perils coverage on specifically designated items and has its own contract language as to insuring agreement and requires a separate premium payment. The normal categories of coverage include silverware, camera, stamp and coin collections, jewelry and furs available under an open perils basis. Antiques and fine arts can be insured on an evaluated basis. Personal property under homeowners coverage is normally covered under an actual cash value basis. An optional personal property replacement cost endorsement is available on all property on a replacement cost basis.

Four types of property are specifically excluded from replacement coverage under the personal property replacement cost endorsement and they include:
1) Antiques and fine arts.
2) Collector's items, souvenirs, etc.
3) Property that is not in workable condition.
4) Articles which are obsolete and are being stored and are not being used.

Broad Form to Special Form

When a property insurance policy is written on a basic form, the insured only receives coverage for items if they are damaged by a covered cause of loss listed on the insurance policy. There are 11 causes of loss, as follows: fire; lightning, explosion, windstorm or hail, smoke, aircraft or vehicles, riot or civil commotion, vandalism, sprinkler leakage, sinkhole collapse, or volcanic action. If the damage to the insured's home is caused by something other than those 11 things, there will be no insurance coverage. In addition, it's important that insureds be made aware they need to check the policy for the definition of those 11 causes of loss because the insurance company can limit or exclude how the insurance applies. For example, if the home is damaged because the homeowner did not maintain the sprinkler system properly there would be no coverage; however, if a fire causes the sprinkler system to be damaged or go off, the policy would pay to repair the damage caused by the sprinkler.

When property insurance is written on a Broad Form, the insured receives coverage for the 11 causes of loss mentioned in the description of the basic form, with the addition of three new causes of loss: falling objects, weight of ice, sleet or snow, and accidental water damage. One will not find many exclusions on this form except for those designed to further define how the 14 causes of loss are applied.

Note that with both the Basic and Broad Forms the insurance company has the duty to specifically *include* coverage. If it is not included on the list, it is not covered.

The most common property insurance form is the Special Form, formerly referred to as "all risk." When a property policy is written on a Special Form, the insurance company has a duty to specifically exclude coverage. Simply put, if the insurance company does not exclude coverage in writing, the damage to the insured's property will be paid for. There are many common exclusions. Examples include: government action, nuclear hazard, war and military action, water damage (i.e. flood), fungus, and pollution. At the end of the day, however, the Special Form gives the insured much more comprehensive insurance protection than the Basic or Broad Forms.

As the insured moves from basic form to Broad Form to Special Form they will find the coverage broadens. An insured may select an insurance type that varies on coverage as well as premiums payable. Under the dwelling program, dwellings containing 1 to 4 families or apartments and dwellings housing 1 to 5 roomers, or boarders, are eligible under each of the three policy types for coverage. A mobile or trailer home which is permanently located may be insured, but only under the basic form (DP1). Townhouses or "row" house are eligible if a separate structure contains no more than four occupied units. Farm dwellings are not eligible for dwelling coverage.

The Dwelling Form provides **"Replacement Cost Coverage"** - the building is restored at today's cost as long as the insured keeps the coverage amount at least 80% or more

of the full replacement cost (DP2 AND DP3 ONLY). However, the DP1 coverage form provides an "Actual Cash Value" basis of recovery and not replacement cost.
The dwelling form is available to a real property owner who is ineligible for a homeowner (HO) policy due to the age of the building, location, value or number of living units. This coverage form is usually issued to cover non-owner occupied buildings. The owner of a building housing more than 4 units must seek a commercial form of coverage. The three dwelling coverage forms are similar to the Homeowners Forms 1, 2, and 3. However DWELLING FORMS DO NOT:
1) cover the peril of theft (it must be endorsed)
2) cover personal liability (it is an optional endorsement)
3) cover money or valuable papers
4) have special limits of liability for certain types of personal property
5) cover boats (except rowboats and canoes)
6) cover property away from the insured premises for more than 10% of the premises limit for all three forms.

Boats and Other Watercraft

Since the homeowners policy provides only $1,000 for watercraft and equipment, the need for additional coverage is required. The boatowner will need one of the types of watercraft policies available because the homeowners contract only covers a very limited amount of liability applying to smaller watercraft. The two basic types of policies available include: the boatowner policy and the yacht policy which is used to insure very large boats. The difference between the boat policy and the yacht policy has become minimized over the years but yacht policies are considered ocean marine coverage. The boatowners policy is developed to combine liability coverage with the inland marine form. This course will emphasize the boatowners policy for study purposes.

Boatowner Package

The boatowner policy is a package contract and is quite similar to the auto policy because it provides coverage for concepts of liability, physical damage, medical payments and uninsured watercraft. The boatowners policy available in most markets includes: Section I for physical damage coverage and Section II for liability coverage.

Physical Damage

Coverage A of the boatowners policy provides for physical damage on the boat. **Coverage is on an actual cash value basis for scheduled boats, motors, equipment and accessories manufactured for marine use as well as any trailers described in the declarations.** Coverage is based on an open perils concept and exclusions which include: wear and tear, gradual deterioration, inherent vice and mechanical breakdown. Depending on the company the policy is held with, other exclusions can include:
1) when a boat is used to carry persons for hire
2) while the boat is rented to others
3) while the boat is being operated in a race or speed contest.
When it comes to **valuing the boat, it can vary from company to company.** An agreed value basis means that the face amount of insurance is payable in the event of

loss. Other options include: replacement cost coverage which is similar to replacement cost under a homeowners form.

Boatowner Liability

The three types of coverage under the boatowners policy in Section 2 are quite similar to the coverages of a personal auto policy including:

1) **Watercraft** - Watercraft coverage is protection up to a specified limit for any claim or law suit against an insured for damages caused by the insured to another's body or property. The party who is considered to be an insured under this coverage is quite broad and includes: family members and other people who are operating the watercraft with the permission of the insured. The liability exclusions include:

a) Bodily injury or property damage, which is intentional.

b) Liability of any person who uses the watercraft without the permission of the owner.

c) Any damage to the property owned by or in the care, custody or control of the insured.

d) Injury to persons who are eligible to receive benefits under workers compensation claims.

e) The liability of a person engaged in the business of selling, storing, moving or repairing a watercraft.

Depending on the company, exclusion might include: any sailboat or watercraft that is used in an official race or speed test. Two other normal exclusions for watercraft liability would include: war and nuclear exclusions.

2) Uninsured boaters - The uninsured watercraft coverage is available as an option under the boatowners policy. The normal amount of coverage is $10,000 for any insured or family member who suffers bodily injury caused by an uninsured boater. This uninsured boaters coverage is very similar to the automobile insurance coverage for uninsured motorist coverage which is discussed in a previous section.

3) Medical Payments - The medical payments coverage will pay for medical expenses resulting from boating accidents when a person who includes the named insured and family members are injured "in, upon, getting into or out of the insured watercraft". Some policies even include medical payments coverage for an individual who is water skiing.

Territorial Limitations

Policies normally limit the watercraft and insured only in specified territories. Vary broad policies will normally cover a watercraft which is operated on any inland body of water within the continental United States and Canada, including coastal waters up to a limit of 10 to 25 miles. On the other hand, very narrow policies provide coverage only on a specified body of water or only within a very narrow boundary around a particular area. Between broad and narrow coverage, exist policies that will provide coverage to inland lakes or in certain areas with the option to extend coverage to certain areas including: the Caribbean, Bahamas, etc., if the boatowner frequents these locals. However many policies will not provide coverage for offshore waters including the Gulf of Mexico.

Selecting the Right Coverage

In addition to price differences between companies there can be a difference in insurance costs based on the elements of risk to the individual insured's property. Normally a premium rate is based on a unit of insurance and is generally based on a cost per $100 or $1,000 of coverage. The rate per $100 or $1,000 is then multiplied by the amount of insurance purchased. For real property, much of the premium rate will be based on the type of construction. For instance, fire insurance for a wood building would have a greater cost than for a building built with brick.

Analyzing Price

Rates can also be different based on the actual actuarial experience of each location. Fire protection can vary from city to city and the Insurance Services Office has an evaluation of each fire department and water supply on a rating from 1 to 10. Number 10 is the highest rated with number 1 being the lowest rated. Dwelling property and homeowners programs have rates based on three main factors including: type of construction, fire protection of the city and the number of families living at the location. With a homeowners program the same three considerations exist as in the dwelling property but the homeowners contract has the concept of package policy using indivisible premium by which the premium is the cost of the entire package without regard to a different premium based on various sections of the contract.

Deciding on Forms

When evaluating a homeowners policy and considering the difference between the Broad Form (HO2) versus a Special Form (HO3), it would seem silly economically to choose the Broad Form. For a slight amount of extra premium, the special from will provide open perils coverage rather the named perils coverage associated with the broad from. In the event an insured just cannot afford this slight extra premium, it should be suggested to select a higher deductible under the homeowners contract and elect to purchase the Special Form. It is commonly accepted that a Special Form with a higher deductible is a much more desirable contract than a broad from with a smaller deductible. The reason for this is that an insured should elect much broader coverage and have a higher deductible as opposed to having a lower deductible on more narrow coverage.

Balancing Cost of Coverage and Risk

Most people, when purchasing insurance on their dwelling and its contents, make a mistake on the amount of insurance coverage they purchase. A dwelling should be insured based on its replacement cost. If it's an older building, developing the concept of replacement cost can be more complicated than if it's a relatively new building. When older property is involved, the replacement cost can be more easily determined with the aid of a replacement cost estimator, available from various insurance companies and agents. The replacement cost estimator is easy to use and provides a reasonable value of an insured's dwelling by applying available cost factors to the various items of construction.

When considering the purchase of replacement cost coverage it is very common for people to purchase at least 80% of the full replacement cost to avoid a co-insurance penalty. However, it is ideal for the insured to purchase 100 % of replacement cost value in addition to purchasing an inflation guard endorsement. Coverage based on these two concepts will result in obtaining enough insurance in the event of total loss. Contents coverage in a homeowners contract is equal to 50% of the value of the dwelling. Whether or not this is adequate coverage depends on the individual insured involved. In the event the insured has items of high value they should make arrangements to avoid being uninsured in the event of a big loss. If actual cash value is applied to contents coverage then perhaps a conversion to replacement cost is desirable. In the event the insured has specific items of personal property that are not covered under their homeowners policy or have very minimal coverage, they should definitely either seek to insure them with the appropriate endorsements or increase the amount of coverage available. Another endorsement that should be considered is earthquake damage assumption. For a very limited amount of money in most areas, the catastrophe of an earthquake can be covered for a very minimal premium.

Summary of Coverage

Summary of Coverage
Dwelling Fire Policy

THIS DOCUMENT IS A SUMMARY OF YOUR DWELLING FIRE COVERAGE. THE INFORMATION IN THIS DOCUMENT DOES NOT REPLACE ANY POLICY PROVISION. COVERAGE IS SUBJECT TO THE TERMS, CONDITIONS, SPECIAL LIMITS AND EXCLUSIONS OF THE POLICY AND APPLICABLE ENDORSEMENTS. PLEASE READ YOUR POLICY FOR DETAILS! IN THE EVENT OF A CONFLICT BETWEEN THE POLICY AND THIS SUMMARY DISCLOSURE FORM, YOUR POLICY PROVISIONS SHALL PREVAIL.

General information:	The coverage amount listed on your attached declaration page is only an estimate of the replacement cost value of your insured property. It may not be sufficient to replace your property in the event of a total loss. If you have concerns about the estimated replacement cost amount used to derive your coverage, you should take an opportunity to discuss this with us to ensure your property has enough coverage in the event of a total loss. It is important that you review and discuss your coverage with your agent or company representative on an annual basis. Any changes to your insured property, i.e. remodeling or building code updates, may require an increased coverage amount for your insured property.
Your declaration page lists the specific limits of your policy for each of these coverages:	**DWELLING:** The dwelling is the main residential home. We offer different types of policies; please see the attached chart. You may want to consider a replacement cost policy or an actual cash value policy. If you insure your dwelling on a replacement cost basis, we will encourage you to choose a coverage limit equal to the estimated cost to rebuild it. • **Replacement Cost** is the amount it takes to replace your damaged or destroyed property, subject to the limits shown in your declaration page and policy. Please refer to your policy for additional information. • **Actual Cash Value** is the cost of repairing or replacing damaged or destroyed property with property of same kind and quality less depreciation, subject to the limits shown in your declaration page and policy. **OTHER STRUCTURES:** Buildings and other structures not attached to the dwelling such as fences, sheds and detached garages. These are subject to the "other structures" limit identified in your declaration page. If additional coverage is needed, discuss it with us. **PERSONAL PROPERTY:** Personal items used, such as appliances, in the occupancy of the dwelling and, owned by you, are covered under this policy. Renters or tenants should consider purchasing a separate policy. **LOSS OF USE/FAIR RENTAL VALUE:** Covers fair rental value during the time required to repair or replace the damage to your dwelling if a covered loss renders it uninhabitable. This coverage may be subject to time and expense limitations. Please review your policy. **PERSONAL LIABILITY:** This coverage is not included on this policy. Please contact us to discuss available options to protect your liability. **MEDICAL PAYMENTS TO OTHERS:** This coverage is not included on your policy. Please contact us to discuss available options.

Items that may affect your premium:	• Deductible: That part of the covered loss for which you are responsible for paying. Please review your policy declaration page. Deductibles may be a fixed amount, a percentage of the dwelling limit, or a combination of both; • Multiple policy discounts; • Claim history (discount or surcharge); • Age of home (discount or surcharge); • Roof age or type (discount or surcharge); • Smoke/fire/burglar alarms.
Additional coverages you might want to consider, for an additional premium:	• **Ordinance or Law Coverage:** Covers increased costs of demolition, construction, renovation or repair associated with the enforcement of building ordinances and law. • **Water and Sewer Back-up:** Pays up to the limit specified in the coverage form for damage caused by overflow or sump pump discharge. • **Personal Umbrella Policy:** Provides additional liability coverage to supplement the protection provided by property and automobile insurance policies. • **Earthquake:** Provides coverage for certain earth movement related losses that are typically excluded from a dwelling fire insurance policy. **[Insurers include only if offered.]**
General Exclusions:	**Your policy does not provide coverage for all possible losses. The following are examples of some of reasons a loss might not be covered. Please refer to your policy for specific exclusions:** **Property Exclusions:** • Loss or damage that you intentionally cause; • Flooding*, earth movement, settling, cracking, bulging, shrinkage or expansion of the structure, other structures, or of pavements, driveways, or sidewalks; • Pollution and contamination; • Land; • Birds, vermin, or house pets; • Mold or fungi; • Wear and tear. * Flood insurance may be purchased through the National Flood Insurance Program (www.floodsmart.gov)
Reasons for cancellation, non-renewal *or* increase in premium:	**Cancellation and Nonrenewal:** You may cancel your policy at any time by writing to us or your agent and indicating the date the cancellation is to take effect. We may choose to cancel or non-renew your policy. If your policy is cancelled or non-renewed, we will send you advance notice. Some examples of reasons for cancellation and non-renewal include, but are not limited to: 1. Failure to pay your premium when it is due; 2. Knowingly making a false statement or a material misrepresentation on your application for your policy; 3. Knowingly making a false statement or material misrepresentation regarding a claim; 4. Frequency or type of claims; 5. A substantial change in the use or occupancy of the premises. **Increase in Premium:** Conditions that may increase your premium include, but are not limited to: 1. A loss resulting in a paid claim; 2. A general rate increase. This results from the loss experience of a large group of policyholders rather than from a loss suffered by an individual policyholder. A general rate increase applies to many persons in the group, not just those who had losses. 3. Adjustment for inflation. We include inflation coverage in your policy. This coverage may automatically increase the amount of your insurance coverage as inflation pushes up the cost of replacing your home. The increases may be based on a construction cost index and may be reflected in the premium on each renewal date. **[Insurers should include this paragraph only if it is applicable.]** 4. Change in credit-based insurance score. **[Insurers should include this only if the insurer uses credit-based insurance scoring in the rating methodology.]**

IMPORTANT: *In Colorado, there is potential for large and even total losses due to fires, tornadoes, other natural disasters, or other causes of loss. It is extremely important to conduct an annual review of your property coverage to ensure you are adequately insured. If you have questions or concerns regarding your insurance coverage, be sure to discuss them with your insurance agent or company representative. Please maintain a copy of this document and your entire policy in a safe and secure location away from your property.*

Comparison of Dwelling Fire Policy Forms

Perils Covered			
Coverage	**DP-1**	**DP-2**	**DP-3**
Dwelling and Other Structures	Modified Basic[1]	Broad[2] (Without Theft)	Open Peril[3] (Without Theft)
Personal Property	Modified Basic[1]	Broad[2] (Without Theft)	Open Peril[3] (Without Theft)
Fair Rental Value	Modified Basic[1]	Broad[2] (Without Theft)	Open Peril[3] (Without Theft)
Loss Settlement			
Dwelling and Other Structures	Actual Cash Value[4]	Replacement Cost[5]	Replacement Cost[5]
Personal Property	Actual Cash Value[4]	Actual Cash Value[4]	Actual Cash Value[4]

1. "**Modified Basic**" means fire, lightning and internal explosion.
2. "**Broad**" means fire, lightning, windstorm or hail, explosion, riot or civil commotion, aircraft, vehicles, smoke and volcanic eruption.
3. "**Open Peril**" means coverage for property for all risks of direct physical loss that are not specifically excluded by the policy.
4. "**Actual Cash Value**" means the cost of repairing or replacing damaged or destroyed property with property of like kind and quality less depreciation, subject to the limits shown in your declaration page and policy.
5. "**Replacement Cost**" means the amount it takes to replace your damaged or destroyed property, subject to the limits shown in your declaration page and policy. Please refer to your policy for additional information.

IMPORTANT: This document is a summary of coverage available under your dwelling fire policy. The dwelling fire policy is a contract between you and us. Each of us has duties, rights and responsibilities under this contract. Please review your policy carefully. If you have any questions or concerns you may also contact the Colorado Division of Insurance.

Statement Included with Replacement-Cost Homeowners Insurance Policies

THE SUMMARY DISCLOSURE FORM MUST INCLUDE THE FOLLOWING CLEAR AND CONSPICUOUS STATEMENT:

THE POLICY LIMIT ON THE DECLARATION PAGE REFLECTS THE INSURER'S ESTIMATE OF THE COST TO REPLACE THE COVERED STRUCTURES. THERE IS NO GUARANTEE IT WILL BE SUFFICIENT TO REBUILD YOUR HOME. YOU, AS THE POLICYHOLDER, ARE SOLELY RESPONSIBLE FOR DETERMINING WHETHER THE POLICY LIMIT, TOGETHER WITH THE OTHER TERMS OF THE POLICY, PROVIDES SUFFICIENT COVERAGE TO REBUILD THE COVERED STRUCTURES IN ACCORDANCE WITH CURRENT BUILDING CODES.

DO NOT CONFUSE MARKET VALUE OR APPRAISED VALUE WITH THE COST TO REPLACE THE COVERED STRUCTURES BY REBUILDING. REPLACEMENT COST MAY EXCEED THE MARKET VALUE. YOU ARE RESPONSIBLE FOR ASSESSING IMPROVEMENTS TO YOUR HOME AND NOTIFYING THE AGENT OR COMPANY IN ORDER TO UPDATE THE COVERAGE AMOUNT.

YOU MAY PURCHASE ADDITIONAL COVERAGE WITH APPROPRIATE DOCUMENTATION.

WE STRONGLY ENCOURAGE YOU TO PREPARE AN INVENTORY OF THE CONTENTS OF THE HOME AND OUTBUILDINGS, AND UPDATE IT REGULARLY. IT IS ADVISABLE TO STORE THE INVENTORY OFF-SITE OF THE INSURED PROPERTY. VIDEOTAPING OR PHOTOGRAPHING IS THE MOST RELIABLE WAY TO ASSURE ADEQUATE RECOVERY.