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I. Property Insurance Basics

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

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

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

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

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

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

B. Insurable Interest is the potential for financial or economic loss in a person or in a loss of property. Insurable interest (ownership) must exist at the time of the loss in property and casualty contracts. Indemnification can occur only when there is insurable interest.

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

D. Hazard is anything that increases the chance of a loss, such as:

- **Physical Hazard** – dirty windshields, broken headlights or severely worn car tires.

- **Morale Hazard** – carelessness of attitude or irresponsibility. This would include failing to lock the front door of a house, or failing to lock a drawer containing cash and other valuables, because any loss would be covered by insurance.

- **Moral Hazard** – arises from people’s habits and values. Dishonesty. Examples of poor moral risks include: intentionally setting a fire in order to collect the insurance, filing a false claim, having excessive speeding tickets, or having a poor credit report.

- **Legal** – arises from liability losses or court actions against an individual or business. Insurance producers purchase Errors and Omissions insurance to protect themselves from this exposure. Doctors purchase Malpractice insurance for this protection.
E. Peril is anything that causes a loss, i.e., fire, wind, hail. A property policy may have Named Perils or Special Perils.

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

- **Special perils** was formerly known as all perils or open perils and these policies cover everything that is not specifically excluded in the policy.

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

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

- Suppose Mr. X was injured when a furnace exploded as the result of a poorly tightened gas line. The peril was explosion; the hazard was a poorly tightened gas connection.

F. **Fire** is combustion accompanied by a visible light (a flame or glow). A *friendly fire* is intentionally set and remains within its container or intended limits. A *hostile fire* is one that escapes its intended limits. A fire in a fireplace is a friendly fire, but when a spark ignites nearby curtains, it starts a hostile fire. *Only hostile fires are covered under fire policies.*

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

**Peril – Property – Pay**

<table>
<thead>
<tr>
<th>Is the Peril a covered peril on that policy?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes... Move to the next question.</td>
</tr>
<tr>
<td>No... STOP, no payment will be made.</td>
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<th>Is the Property covered property on that policy?</th>
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<tr>
<td>Yes... Move to the next question.</td>
</tr>
<tr>
<td>No... STOP, no payment will be made.</td>
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<tr>
<th>How does the Carrier Pay?</th>
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<tbody>
<tr>
<td>This information is in the insuring agreement.</td>
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G. Loss Valuation (a.k.a. loss settlement):

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

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

c) Stated Value Coverage, a.k.a. Agreed Value... Property is insured for a set value. The value is determined on the policy date, not at the time of the loss. This is usually accomplished by scheduling a particular item on the policy.

d) Valued Policy: A policy that states that in the event of a total loss, a specific amount will be paid, and that is set as the limit of the policy. It is generally used to insure fine arts, jewelry and furs. This term also applies in some states that have a valued policy law. In case of a total loss the company cannot dispute the amount to be paid under most circumstances except for the normal exceptions such as fraud, etc.

e) (Fair) Market Value is a concept which does not usually apply to insurance settlements. Market value means the selling value of the property. The (fair) market value on real property would not be a good indicator of the insurable value for fire insurance. In a down market, a home might sell for less than it cost to be rebuilt.

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

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

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

- Proximate Cause: Direct loss caused by a specific peril does not necessarily mean that the peril was the only factor damaging insured property. When a specific peril is the proximate cause of a loss, courts have held that the specific peril in question caused the loss. So loss from water damage and firefighters breaking down the walls or doors is a direct loss caused by fire.
I. An Indirect Loss (a.k.a. consequential loss) is a loss which is a result of a direct loss and which occurs as a consequence of the direct loss. An indirect loss usually involves money, whether from loss of income, loss of business, or expenses for lodging and meals after a house fire. An indirect loss is paid only if the “direct loss” is caused by a covered peril.

J. Representation, Misrepresentation, Warranty, Concealment, and Fraud:

1. **Representation** is a statement by the insured which he believes to be true. Statements made on an insurance application are deemed to be representations.

2. **Misrepresentation** is lying about information asked on the application. If the misrepresentation is material, it can void coverage. Material information has direct bearing on the decision to issue or not to issue an insurance policy.

3. **Insurance fraud** is any act committed with the intent to obtain a fraudulent outcome from an insurance process. This may occur when a claimant attempts to obtain some benefit or advantage to which they are not otherwise entitled, or when an insurer knowingly denies some benefit that is due. Fraudulent claims account for a significant portion of all claims received by insurers, and cost billions of dollars annually.

4. **Concealment** is the withholding of facts from the insurance company. If the concealment is material, coverage may be voided if concealment is found to be of fraudulent intent.

5. A **Warranty** is a written guarantee (in all respects and details) in the policy. A breach of a warranty may cause a suspension of the policy and may void all claims.

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

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

M. Cancellation vs. Non-renewal... **Cancellation** means termination of an insurance policy by the insured or the insurance company during the policy period. **Nonrenewal** means that coverage will be continued through to the policy's expiration date, but not beyond. To cancel or non-renew, a policy requires a written notice to the insured and mortgagee.

N. Vacancy vs. Unoccupancy... **Vacancy** means the absence of people and property from a building. **Unoccupied** means the absence of people only.
O. Monoline vs. Package Policies... One coverage policies are monoline policies and those with more than one line of coverage are package policies. (a.k.a. multi-line policies). A Homeowners Policy covers the building(s) and the liability and is a package policy. However, a Dwelling Policy covers just the building(s) and is considered a monoline policy.

P. Deductible is the amount that an insured pays first before the insurer pays. This can be a dollar amount or a percentage.

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

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

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

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

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

✓ **In filling out the application, if an error occurs, a single line should be drawn through the error.** If the error is discovered before being sent to the insurance company, the producer should take the application back to the insured for the correction. **Neither the producer nor the company can make a change in an application without the written approval of the applicant.**

S. Underwriting and Premium (Rate) Determination

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

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

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

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

**Rate Development:** Insurance companies look at various characteristics to determine the premium that an individual is charged. Auto insurance premiums are based on factors such as where you live, your age, and your driving record. Dwelling and Homeowners insurance premiums are based on factors such as where you live, the value of your home and its contents, type of construction of the home, previous losses, etc. Each insurance company determines premiums differently since the rating plans differ.

- **Types of Building Construction** – Refers frame, masonry, metal, brick veneer, fire resistive, etc. The better the construction the lower the fire rate.

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

**T. Reporting and Non-reporting Forms...** Dwelling, Homeowners’ and Auto Policies are non-reporting form policies. Non-reporting policies usually have a fixed or flat premium. Reporting form contracts are issued when it is difficult to determine in advance the amount of coverage that needs to be purchased. Instead of a flat or fixed premium, a reporting form requires an advance premium or deposit premium, and then a report must be submitted to the insurer on which the correct premium will be calculated. This may result in a refund of premium or an additional premium being required. The insurer has the right to audit the reports given by the insured at any time to verify the figures.


**Property Insurance Basics**

**U. Liability** means being legally responsible or negligent for someone else’s loss. This is also known as third party coverage. Most liability insurance claims result from an alleged violation of tort law. A tort is a civil wrongdoing or wrongful act, whether intentional or accidental, from which injury occurs to another. Torts include all negligence cases as well as intentional wrongs which result in harm.

- **Civil law** deals with disputes between individuals. In criminal law, the government prosecutes an individual in the interest of society for violating laws written to protect the public. Criminal and dishonest acts of an insured are NOT covered under insurance policies.

Types of liability include absolute, strict, vicarious (a.k.a. imputed), and negligence. These terms will be discussed in more detail in the casualty section of the text.

1. **Negligence** is failure to use the proper care that is required to protect others from an unreasonable chance of harm. It is through negligence that someone becomes responsible or legally liable for someone else’s loss.

   ✓ The **Prudent Person Rule** is a theory that says you are negligent when you have failed to do what a prudent person would do in similar circumstances.

   ✓ The negligent act is the **proximate cause** of loss. The proximate cause of a loss is an action that, in a continuous sequence, produced the loss. This sequence is unbroken by any other factors or events, and the loss would not have occurred without the proximate cause.

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

3. **Bodily Injury** means bodily harm, sickness or disease caused to a third party. Bodily injury includes: required care, loss of services and death resulting from the bodily harm.

4. **Property Damage** is defined as physical injury to tangible property, including all resulting loss of use of that property.

5. **Personal Injury** includes false arrest, malicious prosecution, libel (in writing), slander (verbal), defamation of character, invasion of privacy, and wrongful eviction or entry.

**V. Variations in Writing Limits**... Insurance limits may be written in a variety of ways. The **limit of liability** is the most the insurer is responsible to pay under the policy. The following terms refer to the manner in which the limits of insurance apply:
✓ **Specific Coverage** provides a specific amount of insurance for specific types of property. (A homeowner policy may cover personal property for a **blanket limit** of $50,000, however, cash has a **specified** coverage limit of $200 total.)

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

✓ **Blanket Coverage** provides a single amount of insurance that may apply to different types of property.

✓ **(Combined) Single Limit**: one figure shows the maximum the company will pay for all BI & PD liability arising from one occurrence, i.e., $100,000.

✓ **Split Limit**: three figures show the maximum the company will pay for liability resulting from one occurrence, i.e., 100/300/50 which means: $100,000 BI limit for each person, $300,000 BI total coverage for the accident, and $50,000 for PD.

✓ **Occurrence Limit** is the maximum amount available per accident.

✓ **Aggregate Limit** is the maximum amount available for the policy period.

**W. Insurance Services Office (ISO)**... A not-for-profit organization established by insurance companies to write policy forms, compile rating information, etc. ISO is the principal rate-making organization for property and casualty insurers. *Our book is based on ISO standards.*

**X. Insured vs. Named Insured vs. First Named Insured**... An insured is anyone who may be covered by the insurance. The **named insured** is the person, persons or business **actually named** as the named insured in the policy declarations. A **named insured** is responsible for meeting the **conditions** of the policy. Some commercial policies use the term **first named insured** since there could be many named insureds. For example, a commercial cancellation notice would be sent to the first named insured instead of all of the named insureds.

**Y. Dwelling Property and Homeowners (Property Forms):**

**Dwelling Policies** (a.k.a. Landlord Policies) are generally used to insure residential property that is rented to others or for homes which are under construction. The three dwelling property forms are **Basic, Broad and Special**.

A **Homeowners’ policy** is a **package** policy because it combines property and casualty coverage in the same policy. Two major differences between the dwelling and homeowners policies are that homeowner forms provide slightly broader coverage and the combination of property and liability coverage is automatically included as part of the policy.
**Z. Risk Management** is an approach to the problem of dealing with the *pure risks* faced by individuals and businesses. A person can manage the risk of serious financial loss. Methods of risk management include:

1. **Avoid the risk**... To avoid a car accident, don’t drive a car.

2. **Prevent the loss or limit the severity**... of loss from occurring. For example, by putting a smoke alarm or sprinkler system in a home, it would limit the severity of a fire.

3. **Risk retention**... Going with a high deductible or self-insuring a risk (such as your car) is a form of risk retention.

4. **Transfer the risk**... to another party. This is insurance. If you were to get into an auto accident or have a fire loss, you would transfer the financial impact of the loss to an insurance company.

5. **Share the risk**... literally means share the expected potential losses among two or more parties.


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

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

c) **Conditions** section describes the responsibilities and privileges of each party to the contract, such as cancellation or renewal rights, payment of claims, etc. For example:
1. **Insured’s Duties After a Loss:**
   - ✓ Notice of Claim... Notify the insurer immediately after a loss.
   - ✓ Protect the property from further damage.
   - ✓ Submit a proof-of-loss and inventory of damages within **60 days**.
   - ✓ Make the property available for inspection.
   - ✓ Submit to an examination under oath, if required.
   - ✓ Notify the police if a law has been broken.

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

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

e) **Definitions** section shows the insurance company’s uses of words and how it defines them (i.e., “yours,” “ours,” “bodily injury,” and “residence”).

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

g) **Supplementary Coverage** is coverage that supplements or adds to the existing policy by paying out more money above and beyond the policy limits. Your company has a ‘duty to defend’ which means they will supply attorneys to defend you if you are sued. Keep in mind, this is only until the policy limits are paid out. Once that happens, duty to defend is over. The company will also pay pre-judgement and post-judgement interest on a claim, bail bonds, etc.
BB. **Theft** is any loss of property by stealing, including both robbery and burglary. Less obvious events also are covered when the circumstances at least show the likelihood that property was *stolen and not merely misplaced*.

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

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

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

CC. **Miscellaneous Provision and Clauses, Other Insurance**

1. **Primary vs. Excess Insurance**: Primary coverage pays first until its limits are exhausted. Excess coverage, usually, is triggered when the primary coverage is exhausted. i.e., Umbrella Insurance.

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

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

   For example; a commercial building is insured for 5 million dollars with one company, 3 million with a second company, and 2 million with a third insurance company. If a loss occurs, each policy will pay 1/3 of any covered loss.

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

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

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

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

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

8. **Waiver of Rights:** A waiver is the voluntary surrender of a known right. When written in an insurance contract, it is considered an express waiver. Example, a waiver of premium clause is a provision in an insurance policy that permits the waiver of premium payments upon the disability of the insured.

9. **Liberalization:** A clause in property and casualty insurance contracts which states "if we make a change which broadens coverage under this edition of our policy without additional premium charge, that change will automatically apply to your insurance as of the date we implement the change in your state."

10. **Automatic Increase in Insurance (a.k.a. Inflation Guard Provision):** A provision that gradually and continuously increases the limit of insurance by a specified percentage. Usually, every renewal on personal lines homeowners and dwelling policies.

11. **Schedule Personal Endorsement/Personal Article Floater:** There is some personal property, such as jewelry or musical instruments, that have low coverage limits compared to what they may be worth, because most people don’t have such property so they shouldn’t have to pay the premium for it, and because it is difficult to verify the value of such items.

12. **Pair and set clause:** States that in the case of loss or damage to a pair or a set, the insurer can either repair or replace any part to restore the value if the set or pay the difference between the actual cash value of the property before and after the loss.

13. **Ordinance or Law Coverage / Endorsement:** Coverage for loss caused by enforcement of ordinances or laws regulating construction and repair of damaged buildings. Older structures that are damaged may need upgraded electrical; heating, ventilating, and air-conditioning (HVAC); roofing materials; fences; and plumbing units based on city codes. Many of these losses are excluded by standard property policies.

Many communities have a building ordinance(s) requiring that a building that has been damaged to a specified extent (typically 50 percent) must be demolished and rebuilt in accordance with current building codes rather than simply repaired. Unendorsed, standard commercial property insurance forms do not cover the loss of the undamaged portion of the building, the cost of demolishing that undamaged portion of the building, or the increased cost of rebuilding the entire structure in accordance with current building codes.

However, coverage for these loss exposures is widely available by endorsement. Standard homeowners policies include a provision granting a limited amount (e.g., 10 percent of the dwelling limit) of building ordinance coverage; this amount can be increased by endorsement.