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INSURANCE COMPARISON

Property And Liability Insurance Issues Are Frequently Ignored

THIS ARTICLE IS WRITTEN TO THE financial adviser and addresses three major property-casualty subjects: liability scenarios typically overlooked by even the most sophisticated adviser, property frequently ignored for coverage and premium issues, given that there is no such thing as product differentiation in this industry. A perspective on how the insurance underwriter views the adviser's client is outlined as an aid to avoiding problems.

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A few years ago, on the basis of an adviser's recommendation, a customer's uninsured liability coverage was increased threefold. Soon thereafter he was hit by an uninsured drunk driver. The accident left his wife a paraplegic, who to this day requires costly home based private nursing care. The uninsured liability coverage has allowed funding for this care, preventing the erosion of their nearly $3 million net worth.

The adviser plays an important role for people who do not read much of their mail, let alone their insurance policies. Even for the most diligent, an insurance policy review is a most tedious experience.

The intent of this article is to provide the adviser to the wealthy with a suggested way to view clients' property-casualty insurance exposures.

Liability

For the clear majority of the affluent, risk of a liability loss represents the most catastrophic potential of their property-casualty form. Unless their property coverage wades well into the multi-million dollar range, loss of a liability suit is the major exposure of one's assets. The fact that defense costs (without any cap) are paid by the carrier in addition to the policy's liability limits further illustrates the magnitude of potential loss. Bill Clinton's initial defense of the Paula Jones complaint is a high profile example where the liability insurer(s) paid legal defense costs. For most affluent, not having to pay legal bills to defend themselves and not having to risk loss of assets due to a large judgment is clearly a number one priority.

Here are some scenarios typically overlooked by even the most sophisticated adviser:

- Your client lives in the city, has no automobile and does not have an auto policy or an umbrella liability policy. He feels that the $500,000 liability part of his home/condo/coop policy is satisfactory. Should he borrow a friend's car, he has no liability protection other than that "which goes with the car." The friend may have unusually low liability limits, say $100,000 per person and $300,000 per accident for bodily injury. Your client is exposed to any excess liability judgments.
- Your client is satisfied that his automobile liability limits of $100,000 per person/$300,000 per accident meet the underlying requirements of his umbrella carrier. He thus has a feeling of reasonable security in the event of an at fault accident. However, since most umbrella providers fail to provide uninsured/underinsured motorists coverage (which allow the insured to file a claim against his policy should the at fault party have no insurance, or less insurance than the insured), your client again is exposed to a potential substantial loss.
- Your client has purchased land and subsequently puts a structure (tool shed) on the land. "Raw" land, that is, land without any structures is covered under the individual's liability. Erecting

any type of structure, no matter how small provides problems. Unless the land is now specifically listed on the insurance policy, liability is not extended, causing the umbrella policy's underlying requirement (usually a range of $100,000 to $500,000) to become the deductible.

• Your client moves from a state where workers' compensation coverage for his domestic employee help is a required part of the homeowner's policy to a state where it is not. Unknowingly, he does not secure a separate workers' compensation policy and is consequently exposed to a potential liability payout.

• Your client's wife operates an interior design company where her employees come on the household premises to work. Clearly excluded by every homeowner's policy in the land (umbrella also) are business pursuits. Your client is exposed big time. Basic exposure categories consist of business general liability, workers' compensation liability, business property losses and professional liability (errors and omissions).

Property

There are two basic issues in insuring property. Is the item covered in the event of loss? Is the item insured for the correct amount? While many insurance advisers are concerned with insurance to value, experience has shown that affluent consumers do not deliberately underinsure their property. If anything, they over-insure.

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It may be helpful to state two elementary facts. First, in the case of a single family home, the value of the primary dwelling differs from the market value of the home, which in many cases will be higher, as land is included. Second, the primary dwelling and other structures on the property are included under the home policy's generic "guaranteed replacement cost" coverage, the essence of which is that loss settlement for the buildings on the property are at replacement cost without deduction for depreciation. Payment for full loss can exceed the stated coverage on the policy declaration page. In other words, the insurance company agrees to pay the entire cost of rebuilding a home even when replacement costs exceed the amount of coverage in the homeowner's policy. It has always been prudent not to lowball the dwelling insurance amount because to the claim handler, insurance amount raises the presumption of accurate valuation. Now that some carriers have begun to cap the amount they will pay in excess of the policy's stated value, a correct insurance to value is even more important.

Here are four major property insurance considerations:

• A frequently ignored coverage is "dwelling" cover for condominiums and cooperatives. The rule of thumb is that in the event of loss, the unit will be put back together the way it was when the first buyer bought it. Thus, improvements and additions, defined as permanently installed interior features (examples are floor, wall and window coverings plus other built-ins including appliances) constitute the dwelling part of a condo/coop insurance policy. A review of the association's master policy will clarify what coverage is provided for improvements made to the original unit in the event of a loss. The answer is usually nothing.

• Part of any amount analysis is the term of loss settlement. Some "high-end" homeowners' policies currently in the marketplace define reconstruction cost as the amount required at the time of loss to re-

Is "all risk" contents an important variation of the high-end homeowners policy?

Referred to as contents, coverage is usually afforded for specific "named perils" such as fire, theft, vandalism, etc. Some policies provide for an "all risk" contents endorsement, usually adding approximately 11 percent to the policy premium. For instance under all risk contents coverage is provided for wine or paint ruining carpets or furniture. The all risk form of some carriers provides for earthquake cover.

Is a simple way to view the auto product merely to look at coverage and pricing?

There are four major areas of coverage in auto insurance. By far the most significant area is liability. Liability includes uninsured and underinsured motorist coverage. An adequate limit is important to protect you against a lawsuit and to allow you to file a claim against your policy should the at fault party have no insurance or less than you. The three remaining areas are physical damage to your car (referred to as either comprehensive or collision), loss of use (rental reimbursement) and personal injury protection (PIP), a state specific mandated coverage in most states.

There are three main variables that affect the pricing of your auto insurance. First is the vehicle type, use and location. Generally, an expensive car used frequently and garaged in an urban area will be charged a higher rate. Incidentally, the color of the car is not a factor. Second, youthful drivers' higher premiums can be mitigated with drivers training and/or good grades. Third, driving records of all household members influence your premiums.

pair or rebuild the house, whichever is less, at the same location, with the *same quality of materials and workmanship* which existed before the loss. This can be an important term when your client resides in upscale construction.

• It is significant to ensure that fragile articles have coverage. Even on the typical high-end policy with an "all risk" contents section, there is an exclusion for the breakage of fragile articles. A separate listing (schedule) of these articles is necessary. An added benefit is the schedule, which specifically insures fine arts and other such valuables, clearly establishes the value of the items.

• The home policy contains some significant exclusions. Coverage is restricted for a vacant house (no furniture, no people), for-profit business pursuits, contents taken off premises and large watercraft. No coverage is provided for flood and limited, if any, coverage is provided for earthquake. Finally, unreported home renovations can restrict your client's coverage. If he makes improvements of a certain threshold and fails to notify the carrier, there may be a retraction of the guaranteed replacement cost benefit. An example of policy wording is "addition or alteration to the residence premises which increases its replacement cost by $5,000 or more and failure to notify the carrier within 90 days." Some policies place a limitation on the replacement clause if the homeowner moves out of the house and commences construction, even if he notifies the carrier.

Premiums

The home line, not quite the full commodity like auto insurance, has two major considerations:

Policy Parity. In the personal lines, part of the property-casualty insurance industry, one could say that there is no such thing as product differentiation. Since no copyright exists for policy terms, others are free to duplicate. However, some carriers offer homeowners policies that include extras such as "all risk" contents, higher special limits for jewelry and cash, water damage from backup of sewers or drains, personal injury so that libel and slander are included, and enhanced structure replacement wording. Enhanced structure replacement ensures that in the event of loss, reconstruction cost is paid even if greater than the amount of coverage shown in the policy. Also, reconstruction allows the same quality of materials and workmanship, and compliance with local building codes.

> This claims frequency flags two culprits which underwrites desperately seek to avoid: the homeowner without discipline and the homeowner intent on premium refund via periodic claim activity.

Tiered Pricing. Carriers frequently have different underwriting companies. Each has rules that pertain to risk characteristics such as the home's protected status and the insureds' loss history. Just as frequently, carriers have underwriting companies that vary premiums based on the agent's commission. At each renewal, the customer should verify that he is in the most favorable tier for which he qualifies.

In order to avoid problems, it may be helpful to understand how the underwriter views your client.

Consider for a moment that approximately 75 percent of the personal lines property-casualty insurer's premium income goes back out the door in claims. Just as preventing problems is more valued than solving them after the fact, the proper selection (underwriting) of business is significant.

The underwriter looks at your client and his property from three major points of view.

• For the personal picture, occupation marks the beginning of a risk profile followed by indicators of a lifestyle discipline, which have a correlation to insurance claims. Poor motor vehicle records and poor credit records frequently manifest themselves in claims frequency. This claims frequency flags two culprits which underwriters desperately seek to avoid: the homeowner without discipline and the homeowner intent on premium refund via periodic claim activity.

• For the property picture, condition of structures, protection from the perils of fire and burglary and location are the main considerations. A well maintained property with central station alarms and backup systems is clearly a good risk. Location is important given the possibility of a catastrophe such as a hurricane, flood, hail storm, ice storm, brush fire or earthquake. In December of 1997, a State Farm representative was quoted as saying that the $3.6 billion State Farm paid in Florida claims from Hurricane Andrew (1992) were more than State Farm's homeowners premiums received in the U.S. since the late 1920s. For this same catastrophe, Prudential Property and Casualty Co. paid out Florida claims nearly equal to its entire U.S. property-casualty in-force premiums. Such events have caused insurers to evaluate coverage terms given their potential for loss in a particular location.

• Finally, circumstances that may increase the risk of liability claims concern the underwriter. On premises businesses, dangerous animals as pets and high-risk avocations, all contribute.

Your client wants competent technical insurance advice in addition to correct price, simplicity in securing product and exclusivity (claims leverage). Given the dearth of objective, educated, personal insurance providers, you may need to help your client address critical property and liability insurance issues.