CPCU SOCIETY
INSURING YOUR SUCCESS
1944–2004
Celebrating the Past, Shaping the Future

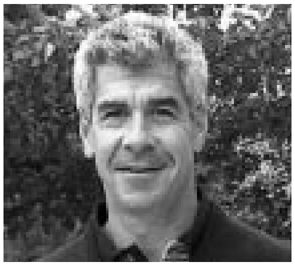
Personally Speaking

PL

Volume 6 Number 3 September 2004

Chairman's Corner: Rookies of the Year

by Dale M. Halon, CPCU, CIC



Dale M. Halon, CPCU, CIC, is a national account executive with ChoicePoint Precision Marketing where he is responsible for direct sales and consultation for insurance companies' marketing programs. Halon has addressed numerous industry groups on predictive models, databases, and underwriting tools and marketing programs. He has published articles for insurance trade publications and industry groups on predictive modeling, the use of consumer credit in insurance, and multi-channel marketing. Halon serves as the chairman of the CPCU Society's Personal Lines Section Committee.

If you don't like reading shameful boasting, you might want to stop reading now. That's because I wanted to take this opportunity to pat some of my colleagues on the back. It might get kind of gooey. If so, I apologize in advance.

You can guess it's hard to find people who will donate their time for an insurance education cause. We all go to the bank every day and take out 24 hours. We then have to choose how to allocate that time. In fact, people have asked me why I do this (chairman of the Personal Lines Section Committee) and I have no answer beyond the fact that I'm very caught up in it by way of working with such good people. That's not B.S. What other motivation would one have? There is no profit motive. The altruism we signed up for when matriculating is nice, but this is going overboard.

This is exactly why I wanted to pat our three rookies of the year on the back. Each in his own individual way has jumped in and taken a significant project by the reigns. George L. Bowen, CPCU, and Roger G. French, CPCU, CIC, ARM, AU, AIS, have been coordinating two smash seminars for the upcoming Annual Meeting; and Richard T. Lang, CPCU, despite having no previous web content experience, has made the section web site a reality.

While the rest of the committee members also deserve kudos for their contributions (you know who you are and you will get your chance . . . trust me), the three gentlemen whose short bios are following this article demonstrate a "jumping in with both feet" attitude. I'm proud to be associated with them and thankful for their energy. ■

What's in this Issue?

Spotlight on the "Rookies of the Year"

George L. Bowen, CPCU
Senior Vice President
California Casualty Management Co.
San Mateo, CA

George L. Bowen, CPCU, is senior vice president of California Casualty Management Co. He has a wealth of experience and knowledge. George is currently responsible for personal lines marketing, overseeing the affinity marketing relationships, establishing and overseeing general agency operation, and product marketing and development (commercial casualty, surplus and admitted lines, domestic and London markets). George joined this company in 1979 and has held various leadership positions prior to his current assignment.

A graduate from Excelsior College, he earned his CPCU in 1997.

George is a recipient of the Carl G. Brown Jr. Award of Excellence, an annual employee award presented by California Casualty Management Co. to its outstanding employees.

George keeps active in his community by serving on a variety of community organizations such as the Insurance Industry Charitable Fund, Board of Governors, Employer's Group, Advisory Board, and the Valley Community Church where he served as the chairman of the Board. He has also participated in the Children's Reading Program for Valley Humane Society, Pet Therapy.

George and his wife Jane have been married for 26 years and are the proud parents of three children. Daughter Kate is pursuing graduate studies at Columbia University in New York and sons George and Andy are attending Cal State Long Beach and Cal State Sacramento, respectively. George and Jane enjoy walking their two yellow labs, reading, mountain biking, and muscle cars. They frequently travel and have visited six continents for adventure and birding. George and Jane also are active members at their church leading a small group of individuals who mentor younger married couples.

Roger G. French, CPCU, CIC, ARM, AU, AIS
Underwriting Training Instructor and Underwriting Training Department Manager
Commerce Insurance
Springfield, MA

Roger G. French, CPCU, CIC, ARM, AU, AIS, underwriting training instructor and underwriting training department manager for Commerce Insurance, is responsible for providing a thorough foundation of the basics of underwriting skills and knowledge, launching training curricula, tools, and other resources to assist underwriters, and evaluating and selecting profitable risks.

Upon graduating and receiving his B.A. from Albany State University in 1967, Roger taught English for three and one-half years. In 1971 he entered the insurance industry and over the years has accumulated a wealth of knowledge and experience having held various positions including sales representative, branch brokerage manager, and agency manager. Roger has held his current position with Commerce Insurance since 1994.

Roger has received several insurance designations since joining the insurance industry. He holds the designations of CPCU, CIC, ARM, AU, AIS, testimony to his in-depth knowledge in the insurance industry field. Roger joined the CPCU Society's Buffalo Chapter immediately after his conferment. As his jobs and assignments lead to different places, Roger has continued to be connected to CPCU Society chapters. He was a member of the Western Massachusetts Chapter and served as the chapter president. Roger is now an active member of the Central Massachusetts Chapter and serves as its "webmaster." Roger has taught parts of the New York State pre-licensing course, Risk Management for Non-Risk Managers, IIA, and CPCU programs since 1988.

Serving on the Personal Lines Section Committee is his first national service with the CPCU Society.

Active in the community, Roger is in his second term on the Board of Directors of Worcester County Insurance Institutes and is the president of the Board. This non-profit organization provides insurance education (IIA/CPCU) in western and central Massachusetts.

In his leisure, Roger enjoys time with his family, long walks, weekend gardening, golf, tinkering with computers, and reading history novels and history-related material (a deep interest shared with one of his grandsons).

Roger and his wife, Lucille (Lou) have been married for 36 years and have two children—a son who has made them the proud grandparents of three grandsons, and a daughter who just became engaged.

Richard T. Lang, CPCU
Casualty Claim Examiner
Bear River Mutual Insurance Co.
Murray, UT

Richard T. Lang, CPCU, received his bachelor of science degree from Weber State University in 1993. He then moved to Denver, Colorado, where he attended the Denver Paralegal Institute and became a certified paralegal. Upon graduation, Richard returned to Utah and began working as a paralegal in the personal injury field. In 1998, he joined Bear River Mutual Insurance Company where he is a casualty claim examiner handling all aspects of third-party auto and home bodily injury losses. In addition to handling claims, he has been involved in an underwriting task force and numerous other projects for Bear River.

Since earning his CPCU designation in 2003, Richard has supported the CPCU Society's Utah Chapter as the candidate development chairman and a member of various committees such as the I-Day Committee. He also serves the national CPCU Society as member of the Personal Lines Section Committee.

Richard is married and has two boys ages 1 and 4. Last year he had the pleasure to volunteer for the Utahan's Against Hunger at the Taste the Nation event at Solitude Ski Resort in Utah. He enjoys attending various sports activities with his family and friends such as the Utah Warriors Indoor Football, Stingers Baseball, Utah Freeze Soccer, and of course the Utah Jazz NBA games. Recently, Richard has made efforts to swing a golf club but his game is more like a bad comedy routine than one of finesse. In addition to sports, he enjoys motorcycle riding, camping, and playing with his two boys. ■

Tenants' Misconceptions Abound Regarding Contents Insurance

by Robin K. Olson, CPCU

Robin K. Olson, CPCU, is a member of the CPCU Society's Personal Lines Section Committee.

Editor's note: The following article originally appeared on IRMI.com at www.irmi.com/insights/Articles/2004/Olson01.aspx and is reprinted here with permission.

A 2003 survey indicated that more than 64 percent of tenants do not have homeowners insurance. There are many misconceptions about this important coverage: it is not necessary, it is too expensive, it is narrow in scope, it is not worth the commission to pursue. These misconceptions are cleared up and marketing tips provided for selling this important coverage.

A recently published national telephone survey of 1,000 tenants indicates that 64.4 percent of these respondents do not have homeowners coverage. Approximately 2 percent were not sure if they had a homeowners policy or not. The survey was conducted last year by International Communications Research (ICR)—an independent survey firm based in Media, Pennsylvania—for the Alexandria, Virginia-based Independent Insurance Agents and Brokers of America (IIABA).

It is amazing to think that nearly two-thirds of the estimated 81 million people in the United States who are tenants do not have the proper insurance coverage. This equates to vast amounts of uninsured assets and personal liabilities, as well as huge commission losses for agents and brokers.

There are a number of reasons why these respondents do not procure homeowners coverage. They are discussed below.

Myth #1: Coverage Is Expensive

Many of these uninsured respondents believe that this insurance coverage is too expensive. However, renters or contents insurance, often written on the Insurance Services Office, Inc. (ISO) HO 4 Contents Broad Form, or the American Association of Insurance Service's (AAIS's) similarly titled Form 4, is quite inexpensive.

According to the IIABA, the average premium is $12 per month for $30,000 in property coverage, $6,000 in loss of use coverage, and $100,000 in liability coverage.

This premium is actually far less than the price of three vente frappuccinos per month at Starbucks. Tenants can often save even more money on premium by choosing a higher deductible, such as $1,000.

Myth #2: Exposure Is Already Covered

Another reason many tenants do not procure a homeowners contents policy is that they believe that their landlord's insurance covers their personal property. However, the apartment owner's policy covers only the apartment building itself and common areas, and the apartment owner's liability. It does not cover the tenant's personal property or liability exposures. If the tenant's apartment burns to the ground, the apartment owner is not responsible for damage to any occupant's personal property.

This is why a homeowners contents policy for the tenant is essential. This policy provides nearly identical coverage for personal property as compared to the Homeowners 3 Special Form, commonly used to insure single family residences.

Some tenants, such as older college students, may also mistakenly believe that their personal property is automatically covered by their parents' homeowners policy. (This is normally the case for younger students living in college dorms because a dorm room is usually considered a temporary location.) However, if the older student's apartment is his or her permanent address, even though his or her parents may help support him or her, he or she generally is not considered an insured under the parents' homeowners policy.

Myth #3: Coverage Is Unnecessary

Many uninsured tenants are young people who may not realize the high value of their clothing, furniture, computers, stereos, and often extensive CD collections. This is particularly true as they get older and gradually accumulate more personal property. In addition, many tenants own valuable jewelry, which can be endorsed onto the homeowners contents policy via the scheduled personal property endorsement.

Myth #4: Coverage Is Narrow in Scope

This policy also covers loss of use in the event of a destructive fire or another major loss. If there is a loss and the apartment is uninhabitable, the insurer would pay for the necessary hotel costs until the insured moves into another apartment.

In addition, the policy provides personal liability coverage. For example, if the insured, while operating his or her low horsepower outboard motor boat, negligently injures another boater, coverage applies under the liability section of the homeowners contents policy. Another type of personal liability claim might entail a guest tripping and falling inside the insured's apartment. Note that the liability coverage of a homeowners contents policy is nearly always identical to that of the homeowners special form.

Also, some tenants make improvements to their apartments, such as the addition of drapes and built-in cabinets. With the homeowners contents policy, up to 10 percent of the personal property limit for additions or alterations to the dwelling made or acquired at the insured's expense are covered. Thus, if the insured has $30,000 in personal property limits, he or she automatically receives $3,000 in coverage for any improvements or betterments he or she makes to the apartment.

The Benefit for Insurance Agents

This substantial uninsured populace is a reminder about an agent's lost opportunity to earn more commissions and gain customer loyalty. It is true that the premium and resulting commission is low for the homeowners contents policy. But it is also true that the administrative costs are low, since the policies are standardized and do not normally require much servicing. (There are also fewer losses paid under these policies, since the building itself is not covered.)

In addition, selling a homeowners contents policy can often lead to additional sales, such as the tenant's personal auto policy, life insurance policy, and health insurance policy. Furthermore, if the tenant later purchases a home, the agent is in a great position to write this expanded coverage.

At right are some ideas for an insurance agent to consider in expanding his or her marketing opportunities to apartment dwellers. ■

Contents Insurance Marketing Tips

Get to know some of the apartment managers in your community. By showing the manager some of the misconceptions about homeowners contents insurance and some of the benefits of procuring this coverage, you may be developing an important advocate. Be sure to leave several of your business cards with the manager in case he or she gets inquiries about this product.

Consider asking the apartment manager to allow you to hold a meeting with uninsured tenants regarding the same misconceptions and benefits of this insurance.

For prospects or clients living in apartments, make sure you inquire about their insurance needs and promote the benefits of the homeowners contents policy. For existing personal auto insurance clients, a list of apartment dwellers can often be culled from your agency database. Remember that this cross-selling will assist you in improving your overall retention percentages.

Industry Outlook 2004

Editor's Note: National Marketing Services headed by Principals Larry and Jeff Neilson, offers a full-service approach to all aspects of marketing personal and commercial lines insurance. The company was founded in 1988. The following article is a summary of key findings from a survey conducted with numerous insurance executives. It is reprinted with permission from National Marketing Services.

Industry Outlook 2004 is a survey conducted by National Marketing Services to identify new trends in insurance. One hundred twenty-five insurance executives from the United States and Canada were interviewed by telephone between March and May 2004. Each was asked more than 40 questions, focusing on these areas of interest:

1. Confidence in the economy, government, the market, and the industry.
2. Challenges facing carriers and reinsurers and how they are responding.
3. Impact of interest rates, mergers, and a softening market.

Major Findings

Major findings of Industry Outlook 2004 include:

- Executives are more confident this year in the investment climate and in their ability to write new lines.
- Thirty-one percent of the industry executives polled think pricing has displaced terrorism as the top issue facing the industry. Mold has declined as an area of concern even though 80 percent expect the number of mold claims to remain the same or increase. Only 4 percent cited "softening market" as the industry's biggest problem.
- When asked for the most formidable challenge facing their companies in 2003, a plurality of executives say it is maintaining growth. Pricing and competition remain important second-tier concerns. But despite their concern with growth, 78 percent of the executives surveyed say they are determined to maintain pricing discipline throughout a softening market.
- Most executives say they expect smaller premium increases through this year than in 2004, but fewer than 10 percent expect rates to actually decline in property/casualty. As in 2003, the largest increases are expected in liability.
- Executives are divided on the impact that mergers and acquisitions are having on the industry, with a plurality leaning toward a "beneficial" effect. About 1 in 4 say they are having a "harmful" impact. Contrary to comments we have reported by Brian Sullivan and other analysts, most (89 percent) expect M&A activity to continue or even increase over the next year.
- Eighty-nine percent expect M&A activity to continue or even increase over the next year. ■

Hurricanes, Fires, and Other Catastrophes: Are You Underinsured?

by Greg Nelson, CPCU, AIM

Editor's Notes: This article was researched and written by Greg Nelson, CPCU, AIM. A past president of the CPCU Society's Orange Empire Chapter, he has been on the Board of Directors of the chapter since 1988, and has served as the Research Committee chairman for the last eight years. In that period, he has written four research papers that have been recognized by the CPCU Society for Excellence in Research. He is presently the senior vice president for Safeco Financial Institutions Solutions, a specialty division of Safeco Insurance Company, which provides insurance products and services to financial institutions.

"Catastrophes cause billions of dollars of insured property damage each year to homeowners in the United States. . . . Every homeowner needs to take a serious interest in buying the proper type and amount of insurance or risk or chance that they will find themselves without enough coverage to rebuild their home in the event of a major loss."

Excerpts of the Orange Empire Chapter research will be shared in a series of three articles and will address this very issue. Part I in our current issue will explore homeowner coverage and contract. Upcoming parts will address the proper amount of insurance and replacement cost issues and provide suggestions and tools that are available for determining the proper replacement value of a home.

The research in this article reflects the view of the CPCU Society's Orange Empire Chapter Research Committee and Greg Nelson, CPCU, AIM. It does not necessarily reflect the view of the CPCU Society or its affiliate chapters. The CPCU Society and its affiliate chapters hereby disclaim any liability that may arise from reliance upon any of the thoughts or ideas expressed in this publication.

Turn on the television at any time and you will see reports of major catastrophes both in the United States and around the world. Every spring, tornadoes wreck havoc on many communities in the midwest. By summer, residents of Florida, the Gulf and East Coasts, watch anxiously as hurricanes rise in the warm waters of the central Atlantic Ocean then churn west toward the United States. Landfall of one of these hurricanes almost always results in serious wind and flood damage. Every fall, the tinder-dry brush lands of the western states ignite in major fires. Driven by high winds, the fires are almost impossible to stop, and ultimately consume thousands of acres of land and many homes as well. Catastrophes cause billions of dollars of insured property damage each year to homeowners in the United States. Most homeowners prepare for these catastrophes by buying insurance to protect their homes. Knowing that their property is protected by an insurance policy gives many homeowners a sense of relief, even when they suffer a total loss.

Unfortunately, for many homeowners, this is a false sense of security. Often, homeowners discover after the loss that although they have an insurance policy, they have not purchased enough coverage to properly and completely rebuild their home. Due to many factors, a large number of homeowners do not purchase adequate amounts of insurance to rebuild their homes. This is very apparent when large catastrophes such as hurricanes, fires, and tornadoes destroy many homes at the same time. Shortly after these events, many homeowners express their dismay when they find out that their insurance policy will not fully rebuild their homes. News reports seem to be filled with accounts of unfortunate homeowners that are inadequately insured for the total losses that they have just experienced.

A major catastrophe is not necessary for a homeowner to find out they are grossly underinsured. Anyone who suffers a major fire, water, or other loss may discover that he or she does not have enough coverage on his or her home. If the loss is serious enough to require major reconstruction of the home, the owner may find that because of inflation, building code changes, location of the property, and other factors, that he or she simply has not bought enough coverage to rebuild his or her home.

Protecting the American Dream

The American Dream has always included the element of owning a home. For many Americans, it involves setting a budget, denying yourself some of the pleasures of life, and saving for years. Once you have saved enough to make a decent down payment, many people spend weeks or even months looking for the right house. Locating the right house is just the start of a long and stressful process of actually buying the home. This process involves many hours of paperwork and meetings, finding a mortgage company, moving funds out of bank

Continued on page 8

Hurricanes, Fires, and Other Catastrophes: Are You Underinsured?

Continued from page 7

accounts, and then finally getting approval to buy the property and sign the paperwork. There is no doubt that buying a home can be one of the most stressful events in life.

Once you have struggled through the process and stress of finding and buying the right home, you obviously want to protect the home in the event of some type of accident or disaster. Most people will take all kinds of preventive actions to protect their homes. Typical actions to protect a home include installing dead bolts, fire alarms, security systems, putting up fences, adding additional lighting, and installing sprinkler systems just to name a few. But in spite of all of the actions that a homeowner might take to prevent a loss to his or her property, there is always the chance that a loss will occur. There is simply no way to avoid all losses. Because of this, most residential property owners usually purchase a homeowners policy to protect their property. Most homeowners policies offered today by insurance companies provide very comprehensive coverage for the exposures faced by the normal homeowner. The homeowners policy offers the benefits of providing physical damage coverage for the property and liability coverage for the activities of the property owner. The property perils that are covered under the policy are very extensive. All perils except for those excluded by the policy are covered by the homeowners policy. Liability coverage is also quite broad, only listing a limited number of situations as excluded under the policy. Homeowners policies provide a convenient way for property owners to protect this "piece" of the American Dream.

The homeowners policy is fairly standard in terms of the perils and types of property that it covers. The homeowner usually does not have many decisions to make in selecting the coverage on the policy since most of the coverage will be the same for the majority of homeowners. There are a few coverage options such as adding extra coverage for special items like jewelry, guns, and artwork, but the basic coverage provided is the same from

one homeowner to the next. One item, however, that is different for each homeowner is the amount of coverage that should be purchased to cover the property. Initially, it may seem easy to identify what the proper amount of coverage should be. Many would think you should purchase coverage equal to the purchase price of the property. But the decision on the proper amount of coverage is not that simple. There are many factors that need to be considered in choosing the right amount of coverage.

Most people may not realize it, but there is also a contractual obligation to purchase a minimum amount of coverage when you secure a mortgage from a lender. When you sign the mortgage documents, you agree to maintain insurance on the property for a specified amount. However, if you buy insurance to meet the requirements of your mortgage contract, it still might not be enough to protect your interest in the property. The amount of insurance required contractually by the mortgage agreement may be a very different amount than what it would cost to fully rebuild the property.

Finally, you must remember that the mortgage amount usually includes the cost of the structure and the land. Unless the property suffers an unusual type of loss that results in the destruction of the land itself (such as a flood that washes it away), or contamination that prevents rebuilding on the land, the amount of insurance needed to protect the property usually does not include the value of the land.

With all of these elements, it can be difficult to identify the proper amount of fire or homeowners insurance to buy to protect your home and meet the contractual requirements of your mortgage agreement. It is extremely important for a person to make a diligent effort to identify the proper type and amount of insurance to buy for their home. After major catastrophes, many homeowners have discovered that they are woefully underinsured and face serious challenges in getting their homes rebuilt. It is essential to the well-being of all homeowners that they take a sincere interest in determining the proper amount of insurance for their homes in order to avoid the potential shock of not having enough insurance to recover from a total loss to their home.

Homeowners Coverage

Today, the most common form of homeowners coverage is the HO 3 policy as developed by the Insurance Services Office (ISO). Eighty percent of the homeowners policies sold in the United States are based on the form created by ISO.[1] ISO developed a standard form of homeowners policy several decades ago, but has continued to update it, as changes were needed. Most homeowners policies are similar to the HO 3 so we will focus on that particular form. The HO 3 policy is a "special form" version of the policy. It provides coverage for "risk from direct physical loss." Only those types of losses that are specifically excluded are not covered by the policy. Since this coverage provides coverage for most expected losses to a home, it is often called "all-risk" coverage although it actually does not cover all potential risks. It does, however, provide protection to the insured from a wide variety of both property and liability losses that might typically occur to a homeowner.

As part of the coverage under this policy, the insurance carrier pays replacement cost on any loss if the insured maintains coverage equal to 80 percent of the value of the property. With replacement cost coverage, if the insured repairs or replaces the property in the event of a loss, the insurance carrier will pay for the full replacement cost of the property up to the limit of the policy. If an insured does not maintain the proper amount of coverage on the property, a "coinsurance" penalty will be assessed. This basically means that the insurance carrier will pay for some but not all of the loss. The insured will pay for some of the loss as well since the insured did not buy enough insurance on the property. The loss settlement provisions of the policy state the following:

3. Loss Settlement

3. B. 1. If, at the time of loss, the amount of this insurance in the policy on the damaged building is 80% or more of the full replacement cost of the building immediately before the loss, we will pay the cost to repair or replace . . . but not more than the least of the following:

(a) the limit of liability under this policy that applies to the building;

(b) the replacement cost of that part of the building damaged . . . ;

(c) the necessary amount actually spent to repair or replace the damaged building.

3. B. 2. If at the time of loss the amount of insurance in this policy is less than 80% of the full replacement cost immediately before the loss, we will pay the greater of the following amounts, but not more than the limit of liability under the policy that applies to the building:

(a) the actual cash value of that part of the building damaged; or

(b) that proportion of the cost to repair or replace . . . that part of the building damaged which the total amount of insurance in this policy on the damaged building bears to 80% of the replacement cost of the building.[2]

This clause requires that the insured purchase insurance equal to 80 percent of the replacement value of the property. Requiring all policyholders to maintain this coverage supports the rate adequacy of the homeowners policy program. If policyholders were allowed to buy less than 80 percent of the replacement cost of the property, companies would not collect enough premium to support the projected losses of the program.

Companies require policyholders to maintain at least 80 percent of the replacement cost in order for replacement coverage to apply. From the viewpoint of homeowners, the standard homeowners policy provides them insurance that protects their property from a wide range of perils and also provides them with a policy that will rebuild their property if they purchase the proper amount of insurance for their home. For most people, buying a homeowners policy is the most practical method to protect the investment they have in their homes.

The Mortgage Contract

Homeowners policies also fulfill the insurance requirements the owners agree to when they initiate a mortgage contract. Some people do not realize that their mortgage contract requires that they maintain a defined amount and type of insurance coverage. If owners do not provide the proper insurance coverage for their home, their mortgage company can purchase the proper coverage and add the amount of the premium to the mortgage balance. This requirement is actually a cornerstone of the mortgage lending industry in the United States.

In order to support the goal of home ownership for American citizens, Congress decided to assist mortgage lending by creating government support for mortgages. Therefore, Congress over the years has created several government sponsored enterprises (GSEs) that support mortgage lending. A couple of the more well known GSEs are "Fannie Mae" and "Freddie Mac." These entities help promote the goal of home ownership in the United States by lending funds to major banking entities so that they can originate mortgages.

The first entity to be created was "Fannie Mae." Fannie Mae is the popular name for a company whose complete name is the Federal National Mortgage Association. Originally, it was formed in 1938 as a government program, like Social Security or welfare. Its function was to "lend" funds to banks so that the banks could make mortgage loans. In 1968, it became a publicly owned stock company, but it has continued to make funds available to banks and mortgage companies so they can originate home loans.[3] Over the years, Fannie Mae has provided nearly $2.5 trillion dollars for mortgage financing. In a similar manner, another GSE, "Freddie Mac," also makes funds available to lenders for home loans. Formally called the Federal Home Loan Mortgage Corporation, Freddie Mac, like Fannie Mae, buys mortgage loans from banks and mortgage companies. The banks and mortgage companies then use the funds from Fannie and Freddie to

Continued on page 10

Hurricanes, Fires, and Other Catastrophes: Are You Underinsured?

Continued from page 9

originate more home loans. There are other GSEs such as the Government National Mortgage Association (Ginnie Mae), but they all operate in a similar manner.

In order for lenders to sell their mortgages to the GSEs and to get funds from them, mortgage originators are contractually obligated to maintain the proper amount and type of insurance on loans that they make. Each of these entities has different requirements, but generally the requirements are very similar. Fannie Mae requires that the loans be insured with coverage that provides protection against loss or damage from fire and other hazards covered by the standard extended coverage endorsement. The amount of coverage that must be purchased is either 100 percent of the insurable value of the improvements as established by the property insurer or the unpaid balance of the mortgage, as long as it at least equals the minimum amount. The minimum amount is usually 80 percent of the insurable value of the improvements required repair damage or loss on a replacement cost basis.[4] Freddie Mac requires the same type of coverage as Fannie Mae—fire and extended coverage perils—although the amount of coverage required is slightly different. Freddie Mac guidelines state that the amount of insurance that is required must be the higher of the unpaid balance of the mortgage up to 100 percent of the replacement cost of the insurable improvements or 80 percent of the full replacement cost of the insurable improvements.[5]

If lenders don't adhere to the guidelines for origination loans, such as securing the proper type and amount of insurance, the GSEs can refuse to supply them funds and they will not be able to continue making loans. Other GSEs and entities that provide funds for mortgages, such as private investors, have similar requirements. However, since Fannie and Freddie provide the majority of the funds for mortgage lending, this motivates most lenders to be very conscious of the insurance requirements. Most lenders track the insurance coverage for their loans and place coverage on properties when they discover that a property does not have the proper amount or type of coverage.

Type of Coverage Required

Fannie and Freddie require that the insurance purchased provides protection for fire and extended perils coverage. This type of coverage includes coverage for perils like wind, hail, aircraft, vandalism, and others. The Fannie and Freddie guidelines, however, do not specify the precise perils that should be insured. The typical homeowners policy covers all perils except for those specifically excluded, so a homeowners policy would provide coverage for the perils required by a mortgage contract. Special form fire policies also provide coverage for the proper perils. A standard homeowners or special form dwelling fire policy is usually sufficient to meet the requirements as spelled out by the GSEs. A borrower who buys a basic fire policy or a basic dwelling fire policy is not buying coverage that meets the minimum requirements of their mortgage contract.

Regulatory Requirement

There is no regulatory requirement to buy insurance in state or federal statutes. No state or federal laws dictate that a borrower must buy insurance for the home, unlike automobile insurance. Most states now require automobile owners to buy minimum limits of liability coverage in order to operate an automobile. Failure to secure coverage can result in loss of your driver's license and fines. But there is no direct regulatory requirement for borrowers to buy property or liability coverage for their homes. Home ownership does not have the same day-to-day potential to cause property damage, injury, or death to other people as owning an automobile may. There are some potential risks to other people from home ownership that could cause injury or damage to others, but these incidents are infrequent. For the few that do occur, homeowners can be held liable and be subject to a civil lawsuit should their ownership of a home result in damage or injury to others. However, since these events are rare, state governments have not created the same regulatory requirements to purchase coverage for home ownership that exist for automobile ownership.

Flood Insurance

There is one situation where the federal government has required homeowners to purchase coverage. Federal guidelines require that anyone who lives in an area designated by the Federal Emergency Management Association (FEMA) as a "flood zone" must buy flood insurance for his or her home. The requirement was created to support the National Flood Insurance Program (NFIP), which is a government program that subsidizes flood insurance throughout the United States. In order to strengthen the program, all properties located in areas designated by FEMA as flood zones must have flood insurance. If homeowners and businesses in these areas did not buy flood insurance, it would undermine the federal program,

Continued on page 12

Register Today for the CPCU Society's 60th Annual Meeting and Seminars

Reach for the stars and attend the 60th Annual Meeting and Seminars October 23-26, 2004, in Los Angeles, CA. Register online and get complete meeting details, including seminar descriptions such as those below, at **www.cpcusociety.org**.

Insurance to Value—Perspective After the Loss

Tuesday, October 26, 10 a.m. - Noon

What You Will Learn

There are a variety of issues encountered when there is inadequate "Insurance to Value." Attend this seminar to learn about total loss adjustment, unique home construction, older homes, "valuation" states, replacement exceeding market value, CAT loss issues, legal and E&O issues, un-insured loss, and insured and consumer concerns.

Developed by the Personal Lines Section.

Moderator

Dale M. Halon, CPCU
ChoicePoint Inc.

Panelists

Steve Erigero
Ropers, Majeski, Kohn & Bentley

Kent W. Schaum, CPCU
Amica Mutual Insurance Company

Insurance to Value—Getting It Right Before the Loss

Tuesday, October 26, 2 - 4 p.m.

What You Will Learn

Inadequate property limits can affect both P/C insurance professionals and their insureds. Attend this program for a better understanding of the challenges facing companies in achieving adequate limits on their homeowners business, the impact of limit inadequacies in various loss scenarios (including CAT losses, older and high value homes), and the impact on retention resulting from ITV initiatives. Attendees should come away with new ideas for achieving and maintaining adequate limits, as well as a better ability to communicate the importance of adequate limits to consumers.

Developed by the Personal Lines Section.

Moderator

Dan Blodgett, CPCU
State Farm Insurance Company

Panelists

Manny Rios
Homesite Insurance

Walt Swiztstack

Register today at www.cpcusociety.org!

Hurricanes, Fires, and Other Catastrophes: Are You Underinsured?

Continued from page 10

as not enough risks in the flood area would buy insurance. When losses occurred, the premium collected from the few policyholders would not meet the premium requirements of the program. Too few dollars would be collected for the number of incurred losses. When a flood occurs, those who purchased flood insurance have their losses paid by the flood insurance carriers. Those who have not purchased insurance often turn to the federal government for low-cost loans to repair or rebuild their properties. Requiring all property owners in a flood zone to purchase flood insurance provides more funds to pay for flood losses and reduces the amount of federal assistance that is necessary to help homeowners and businesses recover from a loss. Federal regulations do not allow Fannie and Freddie to provide funds to mortgage originators unless they require their borrowers to purchase flood insurance.[6]

So although individuals are not required to buy homeowners coverage from a regulatory standpoint, they are required to buy it contractually through their mortgage contract. People who own their own home—have paid off their mortgage—do not have to buy insurance for their home. However, for those with mortgages, most lenders require borrowers to buy certain minimum amounts of coverage and policies need to provide protection from certain types of perils. The question is: how do you determine what is the proper amount of coverage?

The general amount of coverage required by lenders is "replacement cost." How does a borrower determine what is the proper amount of coverage to meet this requirement? Insurance companies also require borrowers to buy at least 80 percent of the replacement cost in order to validate the rates of their homeowners programs. Just how do you determine what the proper amount of coverage is and how do you know how that represents a good evaluation of the real "replacement cost" of the property?

Our next issue of *Personally Speaking* will feature Part Two in the series and will begin to explore the issue of assuring the proper amount of insurance. ■

Endnotes

1. O'Neil, Caitlin, "Homeowners Insurance 101," *This Old House Online*, 2004.
2. Homeowners 3 Special Form, HO 00 03 04 91, ISO, p. 10.
3. Corporate Fact Sheet, FannieMae.com.
4. *Fannie Mae Service Guide,* January 2003, pp. 9-10.
5. *Freddie Mac Single Family Servicing Guide—Performing,* June 26, 2003, p. 2.
6. Office of the General Counsel, National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973, p. 11.

Personally Speaking
is published four times a year by and for the members of the Personal Lines Section of the CPCU Society.

***Personally Speaking* Editor**
Diane G. Baker, CPCU
Allstate Insurance Group
Building E1N
2775 Sanders Road
Northbrook, IL 60062-6127
Phone (847) 402-7998
Fax (847) 326-7843
e-Mail: dbak8@allstate.com

Personal Lines Section Chairman
Dale M. Halon, CPCU, CIC
ChoicePoint, Inc.
#325
12 Westerville Square
Westerville, OH 43081
Phone (614) 895-8806
Fax (614) 895-5327
e-Mail: dale.halon@choicepoint.net

Sections Manager
John Kelly, CPCU, API
CPCU Society

Managing Editor
Michele A. Ianetti, AIT
CPCU Society

Production Editor/Design
Joan Satchell
CPCU Society

CPCU Society
720 Providence Road
Malvern, PA 19355-0709
(800) 932-CPCU
www.cpcusociety.org

CPCU Society
720 Providence Road
Malvern, PA 19355-0709
www.cpcusociety.org