Personally Speaking

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Chairman's Corner: CPCU Personal Lines, the Auto Show, and Snow Drifts . . .

by Daniel L. Blodgett, CPCU, AIM, AIS

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I'm a project manager and work mainly in an IT shop, so many of my peers are not insurance-savvy. Many have never worked as an underwriter or in claims, nor have they worked with agents in the field as I have. So, I always take the time to promote CPCU with my peers—especially the personal lines aspect.

In our staff meetings, I'll provide a synopsis of our recent local CPCU Society monthly chapter meeting or news from the Personal Lines Section's commitments to the Annual Meeting and Seminars. New members of staff may ask me what is meant by personal lines so my quickest example is auto insurance. Most all of us own a car or truck, and the vast majority of us drive for personal use rather than business. I'm a car-guy so the auto insurance line always comes to mind first and I'm always glad to educate my peers on CPCU Society activities.

Speaking of cars, it's my love of cars that resulted in my recent trip of 100+ miles to the Chicago Auto Show. The morning temperature was a bit short of zero, later warming up to the single digits. My 10-year-old son accompanied me; it was his first auto show and he was sold on the fact that there would be cool guy-things to see and do. The planners of the auto show did not let us down. From auto simulators to actual rides in the cars, the whole program was put together well.

This was my first trip to the Chicago Auto Show (I'm a veteran Detroit-show guy) and was surprised to see three proving-ground courses set up inside the hall. The entertainment value was definitely there as the Jeep traversed a 45-degree incline, eventually bottoming out through 12 inches of water to prove the hardiness of the vehicle. The sports car section vaulted passengers from zero-pretty-darn-fast and slalomed through cones to show off performance, then took you over real ice to show traction control.

Another big hit with us were the concept cars. I love the futuristic, sleek appearance even though I know most will never see the highway. One aspect of their design that always makes me laugh is the fact that none of these cars is ever intended to drive in midwest winter conditions. The low-profile tires and non-existent ground clearance are great to look at; however the practicality leaves a bit to be desired.

Speaking of ground clearance, here in central Illinois we were hit with nearly a foot of snow recently combined with 20 to 30 mph winds. For those who live where it's always warm and sunny, I'll offer that even I considered our little blizzard pretty crummy to deal with, and I like snow. Anyway—all the "cute" cars with low ground clearance and performance tires proved their value by

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Note from the Editor

by Kellie H. Green, CPCU

Kellie H. Green, CPCU, works in the product operations area of Allstate Insurance Company, supporting personal lines risk management. Beginning in 2006, she shares editorial responsibility for the CPCU Society's Personal Lines Section newsletter, *Personally Speaking.*

Greetings for 2007 to all Personal Lines Section members!

I hope this year is off to a strong start for you, both personally and professionally. It is hard to believe that a full year has passed since I wrote my first editorial note for *Personally Speaking*. The year behind me was challenging, yet fulfilling, and I look forward to the opportunities that lie ahead in 2007. We certainly have some exciting networking and development opportunities available to us this year with the CPCU Society's Leadership Summit in Orlando and with the Annual Meeting and Seminars in beautiful Hawaii. I hope your plans allow you to attend at least one of these great events.

If you are not able to attend these meetings, or if you are looking for more great information and development throughout the year, you won't need to look any further than your issues of *Personally Speaking*. Our goal is to continue to provide you with interesting and timely information on topics pertinent to our industry and our interest section.

We kick off our publication year with a focus on emerging coverage issues within the industry:

Regular contributor **Robin K. Olson, CPCU, CRIS, ARM, AAM, ARP,** provides the first article from a three-part series that explores the coverage implications and solutions for home-based businesses. This first installment takes a look at home-based business statistics and coverage limitations under homeowner policies.

CPCU Society member and author **Jack Hungelmann, CPCU, CIC, ARe,** provides expert commentary on coverage concerns facing today's townhouse and condominium owners, an issue that may apply directly to many of our readers.

And finally, we include an article written by **Gregory V. Serio, J.D.,** and **Edward W.S. Neff, CPCU, ARM,** on the coverage and risk management challenges faced by those entrepreneurs entering the technology industry.

Also included in this issue is an article shared by fellow-CPCU **Kathleen J. Robison, CPCU,** that provides insight for all section members on the strategic recommendations for the direction of interest sections into 2007.

We round out our first issue of the year with a focus on some of our section members, and another brainteaser to get the gray matter churning!

We hope that you find this issue of *Personally Speaking* to be enjoyable and of value to you. If you have any thoughts on the articles we have included, or ideas for other interesting topics, please feel free to let us know. ■

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continually being stuck at the end of my block. I, along with my neighbors who were shoveling our driveways, helped nearly a dozen sports cars through the drifted snow in the intersection. I couldn't help but think about the high-performance sedans from the auto show, especially the concept cars with barely pronounceable names, and had to laugh at the mental image of bringing those designers to mid-Illinois for a test drive through my three-foot snow drift.

The winter season will soon pass (probably not soon enough for some) and we'll be back to detailed planning at the Leadership Summit in Orlando. The Personal Lines Section Committee members have a lot to look forward to this year—capping it all off with the 2007 Annual Meeting in Honolulu (September 8-11). I'll keep the beach at Waikiki as my mental image as I shovel the bus stop out for the kids —that should keep me energized! ■

Insuring the Home-Based Business

by Robin K. Olson, CPCU, CRIS, ARM, AAM, ARP

Robin K. Olson, CPCU, CRIS, ARM, AAM, ARP, is director of training and education for the International Risk Management Institute (IRMI) and is the editor of IRMI's Personal Lines Pilot.

Olson contributes articles on personal risk management and auto risk management to the Expert Commentary section of IRMI.com.

Olson received a B.A. degree in economics, cum laude, from Southern Methodist University in Dallas. He is a Chartered Property Casualty Underwriter (CPCU) and holds the Associate in Risk Management (ARM), Associate in Automation Management (AAM), Associate in Research and Planning (ARP), and Construction Risk and Insurance Specialist (CRIS) designations. In addition, Olson also serves as an adjunct professor at the University of North Texas where he teaches risk management classes.

Before joining IRMI in 1998, Olson was an underwriting manager for two national insurance companies where his experience encompassed both personal and commercial lines.

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The United States has experienced a rapid growth in home-based businesses in the last decade. The latest studies indicate that there are more than 11 million home-based businesses in the country, a figure that is expected to rise in the coming years. A recent survey, however, found that a majority of these businesses do not have the proper insurance coverage.

Many businessowners assume that their homeowners insurance policy protects them from any potential losses related to their home-based business. Most homeowners forms, however, provide little protection for a vast number of home-based businesses due to a variety of property and liability exclusions and limitations. When losses do occur to business operations in which no commercial insurance is available, the businessowner often looks to his or her homeowners policy to provide the necessary protection. In cases where the insurer denies coverage and the case goes to trial, the issue often hinges on the definition of "business" and the particular facts of the business and the loss. In many cases, the courts uphold the business exclusion, leaving the businessowner without coverage.

The solution to this problem is procuring the proper insurance coverage for the home-based business. The necessary insurance can often be obtained through the appropriate homeowners endorsement(s), of which there are several types. For larger home-based businesses, the solution may be a separate business owners policy (BOP). Insurance agents and brokers who focus on personal lines insurance should become aware of this growing loss exposure and utilize risk management techniques to proactively deal with it. This program should also evaluate other potential insurance gaps and needs for the business, such as automobile, excess liability, professional liability, and workers compensation coverages.

This article focuses on information and statistics concerning home-based businesses and the lack of coverage under standard homeowners policies. Future articles in this series will examine how the courts have interpreted the concept of business, available homeowners endorsements for this exposure as well as the BOP, and the additional insurance products necessary to properly handle this burgeoning loss exposure.

Home-Based Business Statistics

Home-based businesses are a rapidly expanding form of business in the United States. A February 2004 study by the Independent Insurance Agents & Brokers indicates that approximately one in 10 U.S. households operate some type of full- or part-time home-based business. These types of businesses make up about 53 percent of the small business population, and represent a broad cross-section of U.S. industrial sectors. Approximately 60 percent are in the service industries, 16 percent in construction, 14 percent in retail trade, and the remaining are scattered in transportation, communications, wholesale trade, manufacturing, finance, and other industries, according to the Small Business Administration, "Small Business Research Bulletin: The Small Business Economy 2004."

Home-based businesses tend to be sole proprietorships, employing fewer people and earning less revenue than other businesses. See Table 1 for employment percentages.

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Annual Gross Receipts Percentage

These types of businesses are of particular interest due to their potential as a fountain of economic activity. Homes can serve as business incubators, collectively providing start-ups with an entry point into the business world. According to *Fortune* magazine, Dell Computers, founded in 1984 in a university dorm room, is now the twenty-fifth largest company in the United States. The Internet, in particular, has played an important role in the development of home-based businesses. For example, eBay selling has become a popular type of home-based business. Other popular types of home businesses include massage therapy, business and career coaching, computer consulting, computer repair, elder services, financial advising, and web mastering.

This growth, however, has resulted in many coverage gaps for these business owners. A recent study conducted by the Independent Insurance Agents & Brokers of America indicated that 58 percent of home-based businesses are without business insurance. For these uninsured business owners, 87 percent did not understand why separate insurance for the business is necessary. See Table 3 for additional survey responses from uninsured home-based business owners.

The survey indicated further that these business owners assumed that insurance for fledgling home-based businesses was too expensive. And the March 1, 2004, issue of *National Underwriter Property & Casualty-Risk & Benefits Management* indicated that 11 percent of businesses without insurance experienced a loss.

Coverage Limitations under Homeowners Policies

The assumption that standard homeowners policies provide coverage for home-based businesses is a dangerous one. This policy contains an assortment of property and liability restrictions for business-related loss exposures. Note that the "business" definition is also an important provision to review when ascertaining coverage.

Table 1
Home-Based Businesses—Number of Employees

Number of Employees	Percentage
No Employees	91.6
1 - 4	7.2
5 - 19	1.0
20 or more	.2

Source: Small Business Administration, "Home-Based Business and Government Regulation," Washington DC: Office of Advocacy, February 2004, p. ES-1.

Table 2
Home-Based Businesses—Revenue Size

Annual Gross Receipts	Percentage
Less than $25,000	77
$25,000 to $50,000	19
$100,000 to $500,000	3.5
$500,000 or more	Less than 1

Source: Small Business Administration, "Home-Based Business and Government Regulation," Washington DC: Office of Advocacy, February 2004, p. ES-1.

Table 3
Uninsured Home-Based Businesses—Survey Responses

Reason for Uninsured Status	Percentage
Other insurance unnecessary since they had a homeowners policy	39
Business was too small or posed no risk	29
No reason	19
Total of all home business owners who do not realize need for separate insurance	87

Source: Independent Insurance Agents & Brokers of America, "New National Survey Finds Nearly 60 Percent of Home-Based Business Owners Without Insurance," Press Release: February 25, 2004.

Business Property Restrictions

The Insurance Services Office, Inc. (ISO), Homeowners 3–Special Form (HO 3), a commonly used form promulgated in 2000, precludes property coverage for "other structures" such as a detached garage or separate nondwelling building, from which any "business" is conducted. Thus, if the insured operates a home-based business out of his or her detached garage, this structure is not covered.

A related exclusion stipulates that any structure used to store business property solely owned by an insured or a tenant of the dwelling would be covered, provided that the stored items do not include liquid fuel. For example, if Mary stores training materials used in her home business in her storage shed in the backyard, coverage would be provided for the shed. However, if Mary stores fuel supplies for a jet ski rental business in the detached garage, coverage would not be afforded for the shed. An exception preserves coverage for the structure if the fuel is in a permanently installed fuel tank of a vehicle or craft stored in the structure.

The HO 3 also specifies a $2,500 limitation on property located on the residence premises, used primarily for business purposes. Thus, if the insured has a $4,000 computer, used primarily for her home-based graphic art business, which is stolen from her home or damaged in a fire, the loss paid is limited to $2,500.

In addition, the HO 3 contains a $500 limitation on business property located away from the residence premises. Thus, if the insured is taking the same computer to a repair shop and it is stolen out of her car, the loss paid is limited to $500. The American Association of Insurance Services (AAIS) homeowners form contains a $250 limit on business property located away from the insured premises.

Business Liability Restrictions

An even greater loss exposure concerns legal liability for a home-based business since most homeowners policies contain liability exclusions for business-related activities. The ISO HO 3 excludes bodily injury or property damage:

> arising out of or in connection with a "business" conducted from an "insured location" or engaged in by an "insured," whether or not the "business" is owned or operated by an "insured" or employs an "insured."

The policy, however, does allow an exception for businesses engaged in the:

> rental of an insured location (a) on an occasional basis if it is used only as a residence, (b) in part for use only as a residence, unless a single family unit is intended to be used by the occupying family to lodge more than two roomers or boarders, or (c) in part, as an office, studio, school, or private garage.

A second exception concerns an insured under age 21 involved in a part-time, self-employed business without any employees. The vast majority of home-based businesses, however, do not fit into these two categories.

Another important liability exclusion pertains to professional services. The HO 3 excludes any type of bodily injury or property damage arising out of the providing of or failure to provide professional services. The courts generally rule that a professional service is one requiring specialized knowledge or mental, rather than manual, skills.

The homeowners policy is intended to cover personal loss exposures, not professional exposures. For example, if John is an attorney who works out of his home, he needs to procure a separate professional liability or errors and omissions (E&O) liability policy to protect him from lawsuits stemming from his professional acts.

"Business" Definition

The next issue pertains to the definition of a "business." The ISO HO 3 defines a "business" as a trade, profession, or occupation engaged in, regardless if it is on a full-time, part-time, or occasional basis. Any other activities in which an insured participates for money or other compensation qualifies as a "business" with certain exceptions. (Note: Many insurer homeowners forms do not contain any exceptions to the business definition.) Four minor business-related type exposures are specified as non-business activities and are thus covered under the HO 3.

The first exception concerns activities that are *not* described in the next three exceptions, for which an insured receives $2,000 or less in total compensation during the 12 months preceding the effective date of the policy. For example, John works at a regular daytime job; however, he has a substantial baseball card collection, and he occasionally advertises to sell specific cards on the Internet. His revenue from this avocation in the preceding 12 months was $1,300. If a baseball card customer coming to John's house slips on the sidewalk and is injured, coverage for this loss arising from this sideline avocation is not affected by the form's business exclusions and limitations.

The second exception involves volunteer activities in which no compensation is provided other than expenses paid to perform the activity. Suppose that Frank volunteers at a local hospital. He is paid only for his gasoline expenses to and from the hospital. Assume further that he helps an elderly patient sit in a chair and the patient falls and subsequently sues Frank for negligence. The homeowners form does *not* categorize this situation as a "business" activity; thus, the form's business exclusion would *not* apply.

The third exception concerns home day care services. Occasional day care services provided for which no compensation is involved, other than the mutual exchange of such services, is not considered a "business" exposure. For instance, assume Mary has a 3-year-old child and her neighbor has a 4-year-old child. If these two women take turns babysitting each other's children with no exchange of money, this activity does *not* fall into the business category.

The fourth exception pertains to the rendering of home day care services to a relative of an insured. For example, Mary is a retired individual who cares for her mother in Mary's home. This is not considered a "business" activity, regardless of whether any payment is involved.

This definition is fairly broad-based; however, the concept of business is not always precise and clear-cut. For example, a hobby can eventually turn into a profitable and growing business. Conversely, a sideline business that is not profitable and is operated on an erratic basis may not be viewed as a business per se by the courts.

Part 2 of this series discusses court decisions and interpretations of what constitutes a "business." Part 3 of this series looks at the proper endorsements

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Member News

Robin K. Olson, CPCU, CRIS, ARM, AAM, ARP, has recently accepted a promotion to the position of director of training and education for IRMI. He will be assuming the overall responsibility for managing its online P&C continuing education programs and spring seminar series as well as developing other continuing education initiatives.

Further, The North American Precis Syndicate (NAPS) has awarded the CPCU Society its "Golden Thinker" Award for Rob's October 2005 *CPCU eJournal* article on "Identity Theft: A Personal Risk Management Approach."

We also wish to highlight **Phillip Weymouth Jr., CPCU,** for his election to the CPCU-Loman Education Foundation's Board of Trustees. The Loman Foundation has always supported the Society and its efforts in the community.

The Personal Lines Section congratulates Rob and Phil for their accomplishments and contributions to the insurance industry—they are recognized as valued members of the Personal Lines Section. ■

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and policies needed to adequately protect home-based businesses. ■

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Personal Lines Pilot: Free and Timely Information

Personal Lines Pilot, published by the International Risk Management Institute, Inc., is a free monthly e-zine and is available to insurance or risk management professionals interested in the personal lines market. The *Pilot* begins with a "letter from the editor," which covers topics such as the Katrina lawsuits arising out of Mississippi, diminution in value auto losses, the annual insurance policy checkup, and the loss damage waiver purchasing decision.

The next section gives you risk purchasing or risk control tips you can pass on to your clients. For example, it includes tips on ways consumers can reduce their homeowners or PAP premiums. Other recent tips included winterizing the home and the reasons that consumers need uninsured motorists coverage.

The *Personal Lines Pilot* also includes a "case of the month." It spotlights a key legal personal lines case, normally out of an important state appellate or supreme court. For example, recent cases have focused on the business pursuits' exclusion in the homeowners policy, a mold case out of Florida, and how an influential court interpreted the term "occupying" in a PAP case.

The *Pilot* concludes with the "Personal Lines Beat," which provides current news on various personal lines issues, such as credit scoring and insurance consumer survey results.

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Managing the Townhouse/Condominium Unit Owner Risk

by Jack Hungelmann, CPCU, CIC, ARe

■ **Jack Hungelmann, CPCU, CIC, ARe,** contributes articles on personal risk management for IRMI.com.

Author of *Insurance for Dummies* (Hungry Minds Books, 2001), Hungelmann has more than 30 years of insurance experience. His expertise is in policy knowledge, analysis, and problem solving. He has honed his risk management skills from coaching individuals and small business owners on non-insurance solutions for more than 25 years. He has provided insurance counseling for more than 1,000 clients as an insurance agent/owner.

A frequent author, Hungelmann has written several articles for *American Agent and Broker* as well as *Insurance for Dummies*. For over 20 years, he has written an insurance and personal risk management newsletter for his clients. He also taught classes for the Chartered Property Casualty Underwriter (CPCU) and Certified Insurance Counselor (CIC) designations, as well as for the North Dakota CPA Society and Hennepin Technical College.

Hungelmann received his B.A. from the University of Minnesota, and has more than 2,000 hours of insurance education, including earning the CPCU, CIC, and ARe designations. He has qualified for the CPCU Society's Continuing Professional Development every year since its inception.

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An owner today of a condominium or townhouse is much more likely to have major insurance gaps in his or her property and liability insurance coverage than the purchaser of any other personal insurance policy. There are several reasons for that. First, the basic structural coverage of the standard unit-owners policy (HO 6) is generally quite inadequate. For starters, the perils covered are the equivalent of a Homeowner's Form 2—Named Perils on Building and Contents. The structural coverage limits are usually grossly inadequate. Typically, the Coverage A Structural Coverage under the HO 6 policy is just $1,000. Most unit owners are legally responsible for insuring much more than that. Additionally, coverage for loss assessments is inadequate. This can be loss assessments that are associationwide, such as those that arise when a lawsuit for serious injuries ends up in a judgment that exceeds the association's general liability coverage limit, and the excess is assessed to the unit owner.

This also can include loss assessments made against specific unit owners when a loss is caused by the unit owner's negligence, such as a kitchen fire, and the entire Association Master Policy property insurance deductible is assessed against that unit owner. An HO 6 policy usually comes with only $1,000 of loss assessment coverage. But even if limits for loss assessment coverage are increased to, say, $25,000, in most cases, assessments for deductibles are still only covered under the increased loss assessment policy endorsement for $1,000.

Broadening the Perils Covered

The unendorsed HO 6 policy provides named perils coverage only for both Coverage A structural claims and for Coverage C personal property claims. (This is the unit owner equivalent of a Homeowners Form 2—a policy rarely sold today because of its limited coverage.) An agent for a townhouse or condo unit owner needs to change the perils covered to special perils at least for structural claims (i.e., HO 3) and probably for personal property claims as well (i.e., HO 5). This is especially important in an association because the unit owner cannot directly control the exterior maintenance. So, for example, if the older roof in need of replacing leaks all kinds of muddy water onto a unit's carpeting, hardwood floors, cabinets, furniture, piano, clothing, etc., causing major damage to these items, the unit owner won't be covered at all unless his or her agent had upgraded the perils covered. ("Water damage from roof leaks" is not one of the "named perils," nor is it an excluded peril under the "special perils" form.)

Measuring the Loss Assessment Exposure

Another shortcoming of the basic HO 6 policy is the minimal amount of coverage—usually $1,000—for assessments made against all unit owners for uninsured or underinsured property or liability claims. Three examples, assuming 100 units in the association, follow.

- The complex, insured for $5 million, is destroyed by a tornado and costs $8 million to rebuild. The $3 million shortfall would lead to each of the 100 unit owners being assessed $30,000.
- There is a drowning at the swimming pool. A lawsuit ensues, resulting in a $4 million judgment. The association

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carries $2 million of liability coverage, resulting in each unit owner being assessed $20,000.

- Heavy rains lead to a massive sewer backup in the complex. Cleanup costs and repair costs total $75,000. The association board did not purchase sewer backup coverage, leading to an assessment of each of the unit owners of $750.

Under the basic HO 6 policy, with $1,000 loss assessment and named perils coverage, our hypothetical unit owner will be personally out-of-pocket for $29,000 from the tornado assessment, $19,000 from the lawsuit assessment, and $750 from the sewer backup assessment (not a covered "named peril").

Because additional loss assessment coverage is so inexpensive, I recommend always including at least $25,000 to $50,000 additional limits with each HO 6.

A fringe benefit of broadening the perils covered is broadening coverage for loss assessment. Loss assessment coverage applies to those loss assessments arising out of perils that are covered by the particular unit owner's HO 6 policy. When the coverage is broadened to special perils, the perils covered under the loss assessment optional coverage are also broadened. Coverage for sewer and water backup should be added as well, not only because the exposure otherwise isn't covered, but also because by adding that endorsement, sewer and water backup coverage is added to the loss assessment perils covered.

Note that if the unit is in an area exposed to the risk of earthquake, and earthquake coverage is purchased, most increased loss assessment endorsements will not include earthquake automatically. The best strategy to avoid this risk is for the unit owner to strongly lobby the association board to purchase earthquake coverage on all of the structures.

Determining the Interior Structural Risk

A second reason for the difficulty in setting up an HO 6 policy with adequate coverage is the difficulty of identifying and measuring the amount of structural insurance for which the unit owner is responsible. The majority of the building structure of each of the units is insured by the homeowners' association. The unit owner is responsible for insuring just the part of the structural interior not covered by the master policy, as spelled out in association documents (typically the "Declaration" rather than the "Bylaws") and any pertinent state laws (see below). The most common language in a Declaration document is that the unit owner is responsible for everything inside the bare walls and bare floor of the unit. This means that the unit owner is responsible for insuring all of the items shown in Table 1.

The installed replacement cost of the items in this particular example is approximately $100,000. Clearly, the HO 6 basic coverage of $1,000 is grossly inadequate.

Discover All Pertinent State Laws

Some states have passed laws limiting how much of a condominium unit interior a unit owner can be held responsible to insure. Minnesota, for example, under the Minnesota Common Interest Ownership Act—Statute #515B.3–113—permits an association to hold a unit owner responsible for no more than "ceiling or wall finishing materials, floor coverings, cabinetry, finished millwork, electrical fixtures, plumbing fixtures, built-in appliances, and all improvements and betterments to the unit, regardless of when installed." In Table 1, each responsibility is within the law. But if there were other requirements, such as responsibility for interior nonload bearing walls, wiring within the walls, etc., the law would supersede the added bylaw requirements and the unit owner could ignore the value of those items when estimating his Coverage A exposure. (Caution: some older townhouse associations are exempt from the law, so make sure the association is covered by the law before relying on its requirements.)

Table 1

Unit Owner Structural Responsibility Items	Sample Replacement Cost Installed
Carpeting, hardwood floors, ceramic tile, any other flooring	$25,000
Wall coverings	$5,000
Lighting fixtures	$2,000
Plumbing fixtures (e.g., toilets, tubs, etc.)	$8,000
Built-in appliances	$3,000
Kitchen cabinets	$15,000
Unit owner installed improvements (e.g., screened-in or four-season porch)	$20,000
Any other improvements made to the unit by all previous owners (usually very difficult to determine, especially for an older unit with several previous owners)	$20,000
Total Replacement Cost Installed	**$98,000**

Source: Small Business Administration, "Home-Based Business and Government Regulation," Washington DC: Office of Advocacy, February 2004, p. ES-1.

Covering a Unit Owner's Responsibility for the Master Policy Deductible

Yet another reason why the HO 6 policy is so difficult to set up correctly is that more and more associations have changed their rules so that all uninsured or underinsured losses are no longer always assessed associationwide against all unit owners. With significantly rising insurance costs for association master policies in the last few years, more associations have gone to higher deductibles of typically $5,000 or $10,000, but in some cases even $25,000.

The problem with those higher deductibles for a specific unit owner is that if the loss is caused by the negligence of a unit owner, such as a bathtub that overflows or a kitchen grease fire, the association deductible can be the sole responsibility of the negligent unit owner. Unfortunately, in most cases, insurance companies haven't amended their policy forms to provide a way of covering that increased deductible assessment. Some companies have come out with a specific endorsement that the unit owner can purchase, which will cover the full amount of the deductible assessment. But most insurance companies have not done so. Many of those remaining companies, however, in the claims department, are covering the unit owner's responsibility for the full association deductible under Coverage A Structural Coverage, providing that that deductible responsibility is clearly spelled out in the official association documents (i.e., in the Declaration) and that the Coverage A limit is high enough to cover both the deductible and the other structural responsibilities of the unit owner.

Communicating with Claims Managers

To set up a unit owner homeowners policy correctly, if an agent represents a company that does not offer an optional endorsement to cover that deductible responsibility, the agent must contact each claims department—ideally the claims manager—and get a clear understanding of how the claims department has elected to cover this deductible responsibility until such time as the underwriting department comes up with a specifically tailored endorsement.

Most of the claims managers of the insurers I represent have determined that they will cover this deductible responsibility under Coverage A. Since the deductible involves responsibility for structural rather than personal property damage, that risk to the insurance company is fairly similar to the risk of damage to the building interior structure and, therefore, the Coverage A structural rates for covering the master policy deductible are fair to the insurance company. If an agent has a client that has a large deductible responsibility, such as $10,000 or $25,000, and that client is placed with an insurance company who flat out won't cover the insured's responsibility if assessed for that deductible, that agent needs to move that client to another company that will cover that responsibility.

11 Steps to a Well-Designed HO 6 Policy

For each HO 6 policy, agents should obtain a copy of all association documents pertaining to the unit owner's responsibility for structural damage as well as the unit owner's responsibility for the deductible. Agents must work with the unit owners to help them determine what it would cost to replace, fully installed, everything structurally that they are responsible for. Agents must change the perils coverage to special perils on building and contents, not only so that there is essentially "all risk" coverage for both, but also so that the perils coverage for loss assessment is broadened.

The following 11 steps are recommended to help agents set up the proper coverage for their clients, using the HO 6 policy for those insurance companies that have agreed to cover the specifically assessed master policy deductible under Coverage A Structural Coverage.

1. Request a copy of the association "Declaration" document. Make a list of building items not covered by the master policy (e.g., carpet, hardwood floors, tile floors, kitchen cabinets, plumbing and electrical fixtures, built-in appliances, unit owner improvements, etc.). (Be sure that the requirements are within your particular state law.)
2. Have your client estimate the replacement cost of each of the structural items that are his or her responsibility. I find it easier and more accurate to write out a list of each type of item and have the client estimate the replacement cost of each category (see the earlier table for an example of how to accomplish that). Total the values. (Don't forget the labor costs in your estimate.)
3. Find out the current master policy deductible as well as the maximum deductible authorized in the Declaration. Choose the higher (so that your client is protected when the association decides to raise the deductible to the next level).
4. Add up the totals in Steps 2 and 3. Round up to allow for errors. That total will be the coverage limit for Coverage A.
5. Add "special perils" coverage to Coverage A, changing perils covered from "named perils" to "all risk" unless excluded. This is important for three reasons: it covers more losses (e.g., water damage to walls and

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Managing the Townhouse/ Condominium Unit Owner Risk

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ceiling from roof leaks); it improves coverage for losses subject to the master policy deductible; and it changes the perils covered by loss assessment coverage from named to special.

6. Add special perils contents coverage (e.g., roof leaks, paint spills, etc.).
7. Increase the loss assessment limits to $25,000 to $50,000.
8. Add sewer backup coverage to (a) provide coverage for the direct damage to the unit or contents from sewer backup; and (b) to broaden loss assessment coverage to include assessments for sewer backup (i.e., loss assessment coverage only covers assessments for perils covered by the HO 6 policy).
9. Assess the need for flood or earthquake coverage.
10. Buy adequate and consistent liability coverage (i.e., $500,000) in limits equal to your client's other personal liability coverages, or in limits high enough to satisfy the umbrella underlying insurance requirements.
11. Buy an umbrella policy. Be sure it includes coverage for association volunteer activities including nonprofit directors and officers (D&O) liability coverage in case your client ever serves on the board. Nonprofit boards should defend and pay judgment against any unit owner insured by that umbrella policy. Caution: because an umbrella policy only covers claims arising out of bodily injury, property damage, and personal injury, this umbrella coverage clearly doesn't replace the need for that board to carry D&O coverage. ■

Brainteaser

Question:
If it were two hours later, it would be half as long until midnight as it would be if it were only one hour later. What time is it now?

Answer can be found on page 12.

Spotlight On . . .
The Personal Lines Section Committee

Name: Loren B. Gallogly III, CPCU, ARe

Year of Designation: 1991

Employer: Citizens Property Insurance Corporation

Position: Director of Underwriting

Primary work responsibilities:
I am currently responsible for the underwriting management of all four departments at Citizens–Personal Lines Multi Peril, Personal Lines Wind, Commercial Lines Wind and Commercial Lines Multi Peril.

Why did you pursue your CPCU designation?
When I first became involved with the insurance industry I noticed that those persons I was involved with who possessed the CPCU designation were very professional and oftentimes had a view of insurance that many other people simply did not have. I wanted to emulate this level of professionalism.

What prompted you to join the Personal Lines Section?
The Personal Lines Section is very unique in that we have people from a wide variety of industry disciplines involved in the section. For example, we have persons with backgrounds such as underwriting, claims, marketing, agent and broker, legal, information technology, risk management and regulatory. I enjoy working with people from the various backgrounds since we often have different perspectives on the various issues we face as a team.

What is the most unique experience you have had in your career?
After being on the company side of the business for much of my career my most unique experience was the three and one-half years I spent at a large national agency in a senior management position. This enabled me to experience the insurance industry from a totally different perspective. This experience has left an indelible imprint on how I view issues in the industry.

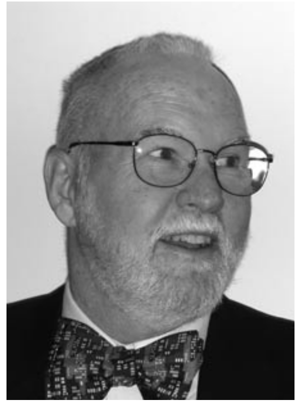
What has been your biggest challenge?
My biggest challenge has been finding creative ways to deal with the massive volumes of business we have been receiving here at Citizens. Our management team and staff has done an outstanding job of living "outside the box" in order to deal with the deterioration of the property insurance market in Florida.

Please share an interesting fact about yourself of which your fellow CPCUs may not be aware.
I am a third generation insurance person and my uncle, Bill Gallogly, was a CPCU in Dubuque, Iowa.

Insurance for Emerging Technologies Entrepreneurs: A Challenge Not To Be Ignored

by Gregory V. Serio, J.D. and Edward W.S. Neff, CPCU, ARM

■ **Gregory V. Serio, J.D.,** former superintendent of insurance for the state of New York, is managing director of Park Strategies, LLC in Albany and New York City.



■ **Edward W.S. Neff, CPCU, ARM,** is president of The Compass Company, Inc., a Capital Region-based risk management and insurance consulting firm.

Abstract
Emerging technology businesses face many challenges as they grow through the development stages into successful operations. Adequate and appropriate risk management policies and coverages are often among the significant but overlooked challenges that can contribute to their failure rate. The risk management and insurance communities, companies, and brokers alike should be working with these developing businesses in their earliest incubator stages to understand their unique risks, and develop programs and new coverage forms that will address their needs not only in their earliest days but also as they develop into mature businesses. Home-based businesses face the same challenges, as was reported last year in a little noticed Independent Insurance Agents and Brokers of New York report.

The Independent Insurance Agents and Brokers of New York released to little notice last year a report raising a critical issue for many home-based businesses: the (in)adequacy of insurance coverages for the business operations within residences. This study, which showed that many home-based businesses are exposed to potential financial peril because of inappropriate or insufficient coverages for business-related activities, should direct our attention to another unspoken and potentially critical problem: the (in)adequacy of insurance coverages for New York's emerging technologies businesses.

Just as home-based enterprises, comprising a healthy portion of the state's small business community, provide structural strength to the backbone of the state's economy, the new technologies sectors—bio, nano, and other emerging areas—represent the most positive business development trends that our region has seen in generations. The Sematech initiative that has become the cornerstone of the Capital District's nanotechnology boom, the recent announcement of AMD's decision to build a chip-fabrication facility in Saratoga County, and the seemingly unstoppable forces behind the Tech Valley movement have all contributed to the strong foundation upon which upstate New York's economy will rest for the foreseeable future.

Key to the progress of this economic expansion, of course, will be the proliferation of smaller companies either spawned to support the larger developments or to start mapping the next generation of technological breakthroughs. Small business in the Capital Region, including a new crop of home-based businesses, will take on a decidedly high-tech flair.

While the grander initiatives like Sematech and AMD most likely have adequate and tailored insurance programs, the many smaller technology and software companies that are cultivated from this tremendous economic wave may well not be sufficiently covered. Failing to adequately cover them (in types of or breadth of coverages) for the eventualities that come to confront all businesses, large and small, will have profound effects beyond the four walls of those enterprises, and will directly impact the regional economy and its ability to sustain the technology-based business boom it is now enjoying.

(Among those "eventualities" are shortcomings in the operational security and continuity of the Internet, and other information pathways that have become critical for many emerging businesses and crucial for small businesses in particular. The Business Roundtable recently released a report, "Essential Steps to Strengthen America's Cyber Terrorism Preparedness," which highlighted many

Continued on page 12

Insurance for Emerging Technologies Entrepreneurs: A Challenge Not To Be Ignored

Continued from page 11

deficiencies in the protective mechanisms that would prevent or mitigate the effects of some cyber interruption. While it did not even address the gaps in the financial safety net for high-tech and emerging market companies, i.e. insurance, the report did concentrate on the need for fixing the operational defects in our preparedness strategy.)

The new and emerging technologies businesses need protections unlike any other components of the small-business sector. And, these new entrepreneurs need to focus as much on protecting the businesses they create as on growing them. The efforts to protect and develop these fledgling businesses, however, are made difficult given that current, off-the-shelf policy offerings don't fit their needs. Economic advances in emerging technologies will be short-lived if the insurance professionals serving these new businesses do not challenge the status quo in terms of the coverages that are typically furnished to the small businesses that do and will populate the sector. As the Independent Agents' study indicated, agents and brokers need to educate insureds and prospective clients as to how available coverages fit or do not fit the operating realities of their businesses. The question is: are existing coverages suitable (or affordable, for that matter) for the businesses seeking coverage?

The forces behind the tech sector boom in the Capital Region will need to instigate this discussion. While they share, together with insurers, agents, and public policy makers, the duty to make sure that our new economic base is properly protected, it is the visionary element of the Tech Valley concept that can best articulate the needs of this marketplace. The growing economic force of the business entities that are deciding to call this area home can best persuade insurance agents and brokers (who may have their own errors and omission exposure for mismatching coverages to risks) to seek appropriate coverages more aggressively and compel insurers to provide such coverages.

Some within the insurance community will see this as a challenge they are not willing to take on. Inserting new and perhaps unknown risks into an insurance industry that has become increasingly risk averse—asbestos liabilities, for example, have mushroomed far beyond the known science at the time that the applicable liability policies were written—will of itself be a difficult task. For many insurers, it may well be more advantageous to ride the far slower path of letting legal interpretations of traditional policy language, shoehorned into these new business contexts, determine the breadth of coverage. This track may well be preferable to venturing out with new policy coverage concepts and language that have no interpretive track records.

The traditional insurance carriers may pass on the opportunity to play a role in the maturation of this branch of the economy. If so, then the emerging technology sectors and the businesses within them, from the incubated to the established, will have to take matters into their own hands. The same entrepreneurial spirit that has fueled the rejuvenation of this segment of upstate New York's economy will be necessary for the creation of a whole new insurance sector, catering to the emerging technology fields, merging the dynamism of venture capital with the security of insurance capital, and delivering for these companies coverages that work for them in terms of quality, breadth, and affordability. But this will not be your father's insurance sector, as they say, for it will be built upon contemporary notions of alternative risk financing and risk pooling, underscored by an attentiveness to risk management and loss control that does not exist in many traditional insurance relationships.

As with every other step of the way for the tech-sector entrepreneur, this won't be easy. Arcane laws will have to be revisited, and the flexibility in assembling coverages currently enjoyed by only the largest corporate entities will have to be offered to all the members of the new economy as well. Just as our technology-sector leaders could not play the role of bystander when it came time to figure a way to reinvigorate the local economy—creating the opportunities for their enterprises as well—they certainly cannot be mere observers as it relates to the changes will have to be made to allow for enhancements in insurance coverages for the market and their own insurance programs. Like their non-technology home-business colleagues in our economy, they have as much a duty to educate themselves to the insurance program they choose or have chosen for them as any agent or broker, and they need to know, in detail, how these coverages either protect *or do not protect* their enterprises.

When more than half of the home-based businesses in the Independent Agents' study are found to be without business coverage, and fully two-thirds of those studied lack adequate coverage, the challenge of properly covering the most vulnerable elements of our economy is already daunting. But when one considers that our present and future economies are similarly situated, the task does not simply become exponentially more difficult; rather, it takes on the proportion of a mission for everyone concerned or connected to this economy to make the moves necessary to marshal the resources, tear down the blockades, and do what has to be done to make these businesses more secure because, after all, they will one day make us all more secure. ■

Brainteaser Answer:

It is 9 p.m.

Sections Strategic Task Force Report Summary

by Kathleen J. Robison, CPCU, CPIW, ARM, AU

■ **Kathleen J. Robison, CPCU, CPIW, ARM, AU,** has more than 30 years of experience with leading claims organizations, and possesses a wide range of commercial and personal insurance coverage knowledge and applicability. K. Robi & Associates, LLC, which she founded in 2004, provides customized consultant services in the property and casualty insurance fields, including expert witness testimony, litigation management, claims and underwriting best practices reviews/ audits, coverage analysis, and interim claims management.

She can be reached at (423) 884-3226 or (423) 404-3538; or at info@krobiconsult.com.

At the CPCU Society's 2005 Annual Meeting and Seminars, the Board of Governors created a Sections Strategic Task Force. The task force developed a strategic vision for sections, and presented it to the board at the CPCU Society's 2006 Annual Meeting and Seminars in Nashville in September. The Board of Governors accepted the report and referred it to the Executive Committee to develop detailed recommendations for consideration by the board at the April 2007 Leadership Summit meeting. This article summarizes the report and recommendations.

David Medvidofsky, CPCU, CIC, chaired the task force. Members of the task force were Tony L. Cabot, CPCU; Matthew J. Chrupcala, CPCU; John L. Crandall, CPCU; Clint Gillespie, CPCU; Michael J. Highum, CPCU; Kelli M. Kukulka, CPCU; W. Thomas Mellor, CPCU, CLU, ChFC; Kathleen J. Robison, CPCU, CPIW; Eli E. Shupe Jr., CPCU; Nancy S. Vavra, CPCU; and Barry R. Midwood, CPCU, as CPCU Society liaison.

The task force began its assessment by focusing on issues of strategy and purpose. It developed a series of strategic questions designed to answer "who, what, and why," before addressing the question of "how?"

After task force consensus on the questions, feedback was shared with designated section liaisons. The task force also met with key stakeholders at the mid-year meeting to share findings, to test attributions, and to obtain additional input.

The task force took a qualitative approach relying on member input and interviews to develop findings. Prior survey data were reviewed.

Prior to creating the strategy, the sections' current mission and vision statement were reviewed. The task force recommended the following changes.

Special Note: *One of the recommendations is to re-brand the sections into interest groups. Therefore, the reader will note the reference to interest groups rather than sections.*

Proposed Mission

The CPCU Society aligns its members within interest groups consistent with the major disciplines of the property and casualty insurance industry. Serving the industry and other stakeholders in an ethical and professional manner, interest groups add value by increasing interest in attaining the CPCU designation and by helping make CPCU the most recognized, valued, and highly respected designation in the property and casualty industry through consistent and valuable technical content.

Proposed Vision

Interest groups offer targeted educational content that make CPCU the most widely recognized, valued, and highly respected professional designation/brand in the property and casualty industry. Instead of being focused toward a value-add for a narrow target, interest groups are at the forefront for name recognition and desirability of the CPCU designation by reaching a broad audience. Although segmented by discipline, interest groups target their consistent and high-quality technical content to anyone in the industry seeking focused information.

Interest group affiliation is provided automatically to CPCU Society members. This enables consistent and ongoing technical content to reach CPCUs affording continuing education and reminding them of the value of CPCU Society membership.

Ultimately, the reach of interest groups extends beyond just CPCU Society members. All industry professionals are, therefore, exposed to CPCU through the work of its interest groups. Exposure to the high-quality, technical content of the volunteer interest groups:

1. draws industry professionals to interest groups through exposure to their work; which
2. increases interest in CPCU and other Institute programs as a course of study; which
3. increases Institute participants and program designees; which
4. increases CPCU Society and chapter membership

Special Note: *The above is a recommended long-range vision for sections. Included in the recommendations are specific steps to position sections for the proposed mission. The task force believed strongly that attaining the mission would be a staged process.*

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Sections Strategic Task Force Report Summary

Continued from page 13

The sections' offerings must first be of consistently high value on par with other offerings before extending sections' reach beyond Society members.

Proposed Strategy

The strategy is to position sections as a provider of readily available, high-quality, technical content to stakeholders. The level of content and delivery will vary based on the audience:

- **For prospective CPCU candidates,** sections offer technical information such as symposia and expertise within the disciplines of the industry.
- **For current CPCUs** the newsletter and web site are of high value and encourage CPCUs not presently part of the CPCU Society to see the benefits of joining. Retention of current CPCU Society members increases by providing consistent, high-quality, technical content within member disciplines. CPCU Society members are connected to others within a functional discipline offering networking and resource advantages not available through other industry designations or associations.

As the technical content is consistently on par with competitor offerings, "associate memberships" are offered to non-CPCUs working in the industry and to industry providers (e.g., vendors). This provides a new revenue stream for the CPCU Society and further increases name recognition of CPCU. Candidate interest in the Institute's programs increases as well as through the exposure sections create.

Accomplishing this vision requires strategic actions that are presented as a series of strategic initiatives that align with four key perspectives:

- organizational structure
- leadership development
- membership
- value-added services

These strategic initiatives are summarized with a proposed template for reporting on results.

Organizational Structure (OS)

OS1—Re-Brand Sections as Society Interest Groups

Rationale: The term "sections" does not concisely describe their purpose. Other associations with similar structures such as PMI, ABA, etc. use "interest group" terminology. As the vision for sections evolves, re-branding them as interest groups signals something "new and improved." Further, the phrase "sections" carries connotations of silos where "interests" applies whether one works in a discipline or just has "interest" in learning more.

OS2—Create Interest Group Resource and Governance Committee

Rationale: As the interest groups are exposed to a wider audience, the demand for consistent, high-quality content will increase. CPCU Society staff provides excellent support. Interest groups can enhance CPCU Society capacity by forming a rotating four-member committee overseeing standards of content (see Recommendation VA1) and providing a resource for backup, training, and consultative advice. This committee would consist of:

- a former section chairman
- a former section web liaison
- a former section newsletter editor
- an additional member with experience in one of the above tasks

OS3—Assess Current Interest Groups and Align Them with Major Industry Functions

Rationale: The industry has evolved since the creation of sections. For example, many companies no longer have "underwriting" departments—they have moved staff functions to product teams and field functions to production positions. Project management is integrated into most positions but has no discrete focus. As membership is opened, there needs to be a clear alignment between technical interests and the content focus of interest groups.

OS4—Open Interest Group Membership to all Society Members

Rationale: Open membership will expose all CPCU Society members to the work performed by interest groups. Providing newsletter and web site access will consistently remind CPCU Society members of the value they receive by belonging to the Society. This recommendation also supports the CPCU Society's goal of visibility. Continuing education is provided while leveraging one of CPCU's key differentiators: the ability to connect its members at both the interdisciplinary level (chapters) and the intradisciplinary level (interest groups).

Leadership Development (LD)

LD1—Formalize Standard Interest Group Leader Training and Orientation for the Chairman, Newsletter Editor, and Web Liaison. This training will include an operations manual and continuously updated list of best practices.

Rationale: As membership is opened, interest group offerings will have wider exposure. Content value will become more important. Formalized training and reference materials need to be provided as tools to support the key interest group roles.

LD2—Create a Developmental Scorecard for Interest Group Volunteers and CPCU Society Members

Rationale: As budget and time demands increase, employers and employees will need to understand and demonstrate the value of their commitment. A development scorecard will show employers what their investment provides. It will also enable employees to easily articulate the value they receive. The present CPD qualifier may be promoted or modified to meet this need.

Membership (M)

M1—Create Value Statements and Other Communications Tools to Promote Interest Groups

Rationale: As the sections are re-branded and membership is opened up to all CPCU Society members, value statements and a communications strategy must be created. These efforts must crisply articulate the value of interest group membership, and describe how the value of CPCU Society membership has increased. This highlights the differentiation that interest groups provide CPCU Society members through focused technical content that CPCU Society members will continuously receive.

M2—Establish Affiliations between Interest Groups and Other Industry Organizations (e.g., PLRB, The "Big I," and RIMS)

Rationale: To promote the technical expertise of CPCU Society interest groups and to support the goal of making CPCU the most widely recognized and highly respected designation, affiliations should be formed with other associations and/or designation programs. By presenting at their conferences and contributing to their newsletters, the CPCU Society increases their reach to potential designees committed to continuous learning.

M3—Refresh the Interest Group Newsletters

Rationale: As the reach of newsletters increases (first to all CPCU Society members and longer term as a revenue-generating product) they must be refreshed. This will support the re-branding efforts. A task force should be formed to finalize recommendations—potential areas of review include electronic versus hard copy delivery (or option for both), the colors, logo, and layout, and the possibility of providing one comprehensive quarterly interest group newsletter with space for each interest group's contribution (versus publishing 14 separate newsletters).

M4—Designate Liaison(s) to Promote Interest Group Benefits to Chapters, Major Employers, and the Insurance Services Community

Rationale: The value of interest groups may be promoted by expanding the Connections concept. A discussion of the value of the interest groups must be added to the present agenda. Designating special liaisons will expand capacity to extend outreach to chapters and industry service providers.

M5—Strengthen Connection between CPCU Society and Accredited Risk Management and Insurance Degree Programs

Rationale: Students pursuing degree programs in risk management and insurance are future prospects for the Institutes' programs. Increasing awareness helps capture interested students. Recommendations to strengthen this connection include offering interest group membership to any approved university, offering a pool of guest lecturers, and providing a student forum for web site and newsletter submissions.

Value-Added Services (VA)

VA1—Develop Consistent Format and Content Standards for Core Interest Group Offerings

Rationale: As membership increases to all CPCU Society members, interest groups have an opportunity to promote their value to a wider audience. Longer term the strategy is to broaden interest group reach outside of the CPCU Society. This strategy requires content that compares favorably with alternative offerings. Specific content targets and standards assure the CPCU Society member regularly receive high-quality content. Support and governance for this recommendation is contemplated under recommendation OS3 above.

VA2—Expand Delivery Methods of Technical Content

Rationale: Time and expense dictate member participation. Present delivery methods of the newsletter and the CPCU Society's Annual Meeting and Seminars for technical content should be expanded by the interest groups to include webinars, more symposia, and chapter-ready presentations through a pool of local speakers. The possibility of on-demand or ability to purchase video of the CPCU Society's Annual Meeting and Seminars must be considered to meet the needs of our growing international presence and those who cannot attend CPCU Society's Annual Meeting and Seminars.

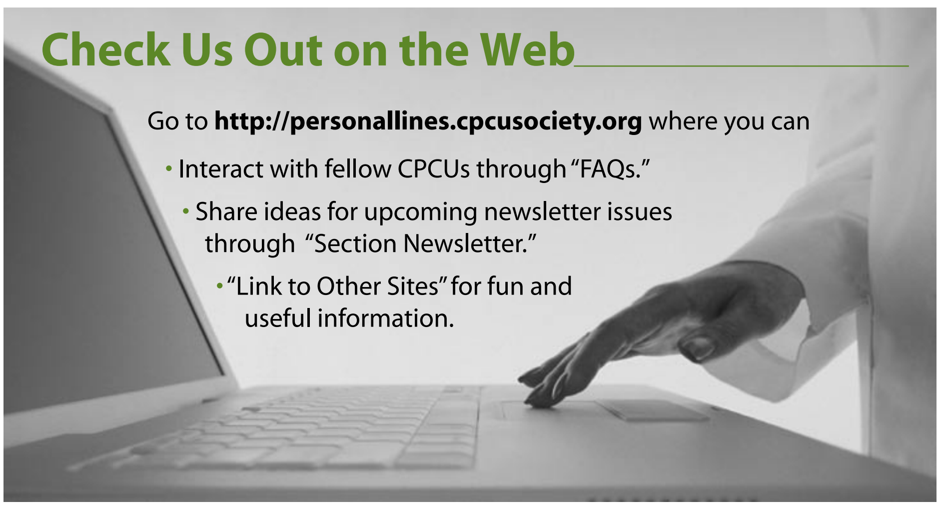
VA3—Encourage Interest Groups to Convert Highest-Rated CPCU Society Annual Meeting Technical Seminars into Symposia

Rationale: A great deal of work goes in to producing quality technical sessions that are presented at the CPCU Society's Annual Meeting and Seminars. In their efforts to re-brand themselves and increase awareness of their offerings, interest groups have an opportunity to convert these programs into tested and finalized symposia. Not only does this effort support the strategic goal of industry outreach, but it offers an additional revenue source to the CPCU Society.

VA4—Conduct SWOT Analysis for Each Interest Group; Implement Findings

Rationale: As the interest group expectations change and the prospective members increase to all CPCU Society members, each interest group needs to assure that their offerings align with member needs. Action plans should be developed based on the findings and reported back through the interest group governors. ■

What's In This Issue



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