Personal Lines Interest Group

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Personally Speaking

Message from the Chair — What Is *Your* Signature Move?

by Richard T. Lang, CPCU, AIM

Richard T. Lang, CPCU, AIM, is a casualty claim supervisor with Bear River Mutual Insurance Company, overseeing the handling of property, liability, personal injury protection and complex litigation losses. He has worked various projects, such as involving the development and implementation of imaging and claim management systems as well as the review of automobile policies and underwriting guidelines. In addition, Lang has performed peer reviews for insurance trade publications. He earned his CPCU designation in 2003. Lang has held several committee positions with the CPCU Society's Utah Chapter and currently is chair of the Personal Lines Interest Group.

I recently attended the CPCU Society Utah Chapter's business meeting, featuring a wacky and crazy, yet thought-provoking, speaker — Jason Hewlet. He has always been an entertainer by trade, weaving comedy and impressions of various artists into his routine while at the same time engaging audience members in deep thought concerning their respective life's purpose and "signature moves."

In Hewlet's case, he has the unique gift of making unusual facial expressions that create laughter and release the stress of his audience. His signature move via facial expression and voice impressionism allows him to fulfill his purpose to create joy in others.

You may be asking yourself how this relates to the CPCU Society or the insurance industry. While listening to Hewlet's presentation, I began to think about the talents and abilities of Society members I've met, as well as the purpose of our organization.

We are fortunate to be among some of the most talented and educated professionals in the insurance industry. We hold ourselves to high ethical standards and support the Society's mission to meet the development needs of our diverse group of CPCU professionals.

All of this equates to the fact that we serve others in a competent and ethical manner. In my view, the Society's signature move is to provide an opportunity to insurance professionals to enhance their own skills while also helping to develop those of others.

The Personal Lines Interest Group (PLIG) has set forth its purpose to educate professionals in all aspects of personal risk management, to create and disseminate knowledge, and to provide expertise to CPCUs and others through research and program initiatives while emphasizing high performance, functional expertise and practical experience. We are happy to serve by providing opportunities and information by way of webinars, seminars at the Annual Meeting, networking events and this newsletter.

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Message from the Chair — What Is *Your* Signature Move?

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A PLIG signature move is establishing a group of insurance professionals with an interest or specialty in personal lines — from brokers, claims adjusters and underwriters to IT, marketers and risk managers. We have created a social community via LinkedIn, and urge you to participate and share your thoughts in this online forum.

A link posted on the Personal Lines Interest Group website directs you to the LinkedIn website, where you may join our group. If you are not already a LinkedIn member, you must first establish a free member account. Log on to www.linkedin.com and follow the directions to join. Then, go to "Search," choose "Search Groups," and type in "CPCU Personal Lines Interest Group."

Each of us, as individuals and insurance professionals, brings our own talents and signature moves to the PLIG, the CPCU Society, employers, friends and family. Perhaps you are an outstanding communicator, researcher, marketer, etc. The key is allowing your talents to work for you in achieving your personal and professional goals/purposes.

I recommend writing down everything that makes you unique — your likes, dislikes, talents/skills and what you enjoy. These will become your signature moves. Second, write down your personal, professional and social goals. Then, work within your own signature moves to reach your goals, which will allow you to achieve a new level of success.

Finally, let us share in your successes by celebrating your professional accomplishments and/or promotions by providing a brief description and sending PLIG an e-mail to cpcuplig@gmail.com. You may be featured in a future newsletter and/or spotlighted on the interest group website.

Thank you for your support, and I hope you each continue to have a successful year! ■

Note from the Editor

by Daniel L. Blodgett, CPCU, AIM, AIS, PMP

Daniel L. Blodgett, CPCU, AIM, AIS, PMP, is a project manager in the Systems Department of State Farm's home office in Bloomington, Ill. He started with State Farm in 1990, holding positions such as auto underwriter and supervisor in the State Farm Payment Plan. Blodgett is on the board of directors of the CPCU Society's Central Illinois Chapter, and is past president of the Society's Southwestern Michigan Chapter and past chair of the Personal Lines Interest Group.

Hi, all! With many areas across the U.S. already experiencing very warm temperatures, I hope your summer is off to a great start. It certainly is for me (especially as we are getting into all the warm weather sports for both of my children). I sometimes wonder if I should have a chauffeur's endorsement on my driver's license.

Attention Personal Lines Aficionados At-Large

Let's talk articles! From our recent Personal Lines Interest Group (PLIG) membership survey, I understand a main draw to our website is our newsletter (yeah!!) and that a large percentage of you would like to submit an article for newsletter consideration. Well, there's no time like the present, so please don't feel shy about contacting me.

The length of an article is normally not a problem. Our newsletter format can accommodate one-page articles, multi-page articles and even a series of articles that may span a couple of PLIG issues. We have real pros in Malvern who help edit articles as well as offer suggestions from the Society's reserve of best practices.

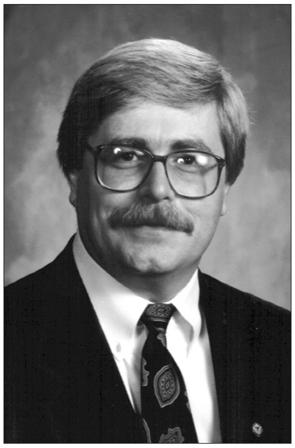
So, regardless of your authoring skill/comfort level, feel free to contact me with questions about how you can contribute to our newsletter. I will be glad to help with your submissions. Now, please enjoy the great lineup of articles that this issue of *Personally Speaking* offers:

- Our chair, **Richard T. Lang, CPCU, AIM,** leads out the issue with his column pointing out several areas of the PLIG's value.
- A great summary article by **Bill C. Wilson, CPCU, ARM, AIM, AAM,** interpreting the HO-3 homeowners policy phrase, "Where you reside."
- An article by **David A. Thompson, CPCU, AAI, API,** that ends well in regard to the value of the renter's insurance policy — as personally experienced by his daughter.
- A car-sharing franchise Zipcar article, by **Jack Hungelmann, CPCU, CIC, ARe,** the author of *Insurance for Dummies*.
- And rounding out our issue is an article on risk management at the enterprise level, written by CPCU Society Vice President **Steve McElhiney, CPCU, MBA, ARe, AIAF**.

Until next time ... ■

Unclear and Inconspicuous — How a Phrase in a Definition Referenced by an Insuring Agreement Could Cost Your Insureds Their Homes

by Bill C. Wilson, CPCU, ARM, AIM, AAM



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Editor's note: This article was condensed by the author from a white paper he wrote for the IIABA's Virtual University. Reprinted with permission. © 2009-2010 by the Independent Insurance Agents & Brokers of America. All rights reserved. The white paper, in its original form, can found at http://www.iiaba.net/VU.

Abstract

Most homeowners policies, including the "ISO standard" HO-3 examined in this article, cover damage to the dwelling on the "residence premises" shown in the policy declarations. The term "residence premises" is defined to include the dwelling "where you reside." According to some interpretations and court decisions, if the named insured and/or resident spouse do not reside in the dwelling, coverage on that structure is nonexistent. If this school of thought is correct, this gives rise to a number of circumstances that may lead to a catastrophic coverage gap for such insureds. The purpose of this article is to explore these circumstances, the rationale for/against coverage, and possible solutions to avoid potentially catastrophic coverage gaps.

Introduction

Do you ever have insureds go into nursing homes and not come out? Insureds who unexpectedly relocate? Insureds who move out in the night during a foreclosure or simply walk away from a mortgage? Insureds who rent their homes? Insureds who buy homes for their parents/children? Insureds who allow a home purchaser to move in before the closing? Insureds who renovate a newly purchased home before moving in? (Often without your knowledge?) Did you know that all of these insureds may have **no** coverage on their dwellings?

Would you feel comfortable telling an elderly insured, who unexpectedly was permanently admitted to a nursing home, that her homeowners policy won't cover her $350,000 home that was destroyed by a tornado three days after she was admitted, but it **would have covered** a total loss due to an explosion if she was operating a meth lab in her basement or building a car bomb in her attached garage?

Consumers are largely unaware that there may be a coverage gap in certain unoccupancy situations, and most insurance agents are similarly oblivious to this potentially catastrophic exposure.

Policy Language

In this article, the Insurance Services Office (ISO) HO 00 03 10 00 (the HO-3) homeowners policy is used as the model form for language review. An examination of the HO policies of all major homeowners insurers indicated that this language is identical in virtually all of them (in a few proprietary company policies, the language is, for all practical purposes, equivalent).

The "where you reside" issue rests within three HO-3 policy provisions: the Coverage A insuring agreement and two definitions excerpted below (with emphasis added).

The following is an excerpt from the Coverage A insuring agreement:

Section I — Property Coverages

A. Coverage A — Dwelling

1. We cover:
   a. The dwelling on the **"residence premises"** shown in the Declarations. ...

This is the definition of "residence premises":

"Residence premises" means:

a. The one family dwelling **where 'you' reside;**

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> b. The two, three or four family dwelling **where 'you' reside** in at least one of the family units; or
>
> c. That part of any other building **where 'you' reside;** and which is shown as the "residence premises" in the Declarations.

This is the definition of "you":

> In this policy, "you" and "your" refer to the "named insured" shown in the Declarations and the spouse if a **resident of the same household.**

One school of thought, supported by a body of case law, is that the "where 'you' reside" stipulation means that if the "you" no longer resides in the dwelling, it isn't a "residence premises," and thus there is no Coverage A, B or D since each hinges on the existence of a "residence premises." In fact, one argument says that since the Coverage C limit is a percentage of the Coverage A limit and Coverage A no longer exists, then the Coverage C limit vanishes. This viewpoint is tenuous since a specific limit is typically shown on the Declarations page and Coverage C applies on a worldwide basis without restriction to a "residence premises."

The ISO "where you reside" language first appeared in its 1976 HO forms. The 1970 ISO HO-3 form included this language [emphasis added]:

> Coverage A — Dwelling
>
> This policy covers the described dwelling building, including additions in contact therewith, occupied primarily as a **private residence.**

While it can be argued that there is an occupancy requirement in the 1970 form, occupancy by a tenant would appear to meet this requirement, so a rental exposure would not result in a lack of coverage even if it violated an "owner-occupant" eligibility rule. There was no mention in ISO's 1976 filing memorandum of this change in wording, which would imply that there was no change in coverage intent.

Exposure Scenarios

There are many ways in which nonresidency can arise, including the following situations:

- Nursing Homes.
- Relocations.
- Foreclosures.
- Rentals.
- Child Occupies Parents' Home.
- Parent Occupies Child's Home.
- Divorce or Separation.
- Illness or Infirmary of Insured.
- Death of Insured.
- Trusts.
- Homes Owned by LLCs and Corporations.
- Seller Remains After Closing.
- Seller Moves Out Before Closing.
- Buyer Moves In or Takes Possession Before Closing.
- Renovations / Homes Under Construction.
- Vacancy and/or Unoccupancy.

Important: If an insurer is aware of situations such as these but agrees to provide coverage, it is critical to get this in writing in order to estop them from asserting the language later in an attempt to deny a claim. The ISO HO "Waiver Or Change Of Policy Provisions" clause says: *"A waiver or change of a provision of this policy must be in writing by us to be valid."* Again, this may work only to the extent that the agent is aware of this or similar situations, which unfortunately is often not the case. For that reason, it is recommended that agencies poll their personal lines carriers in advance.

Due to space constraints, this article examines just three of these scenarios where four actual claims have been denied.

Nursing Homes

An elderly widow had some health problems and went to a nursing home with every intention of returning to her home when her health improved. Her home was looked after by her nonresident children, and they cut the grass, shoveled the snow, etc. Her home address was still her legal address, and her voting address was still her home address. After several months, there was a fire and the dwelling was a total loss. The insurance carrier paid the contents loss but denied the dwelling claim on the basis that her house was not her "residence premises" at the time of loss.

Rentals

The renter of a condo perished in a fire arising from his own negligence, which destroyed the condo unit. The condo owner's HO-6 carrier initially denied the claim, citing the "where you reside" language. This denial came despite the attachment of the HO 17 33 — Unit Owners Rental to Others, since it does not expressly modify the "where you reside" language. The fact that an HO-6, unlike the HO-3, does not have an owner-occupancy requirement and the fact that the premium-bearing rental endorsement was attached weighed heavily in favor of there being coverage, so the insurer ultimately paid the claim. Otherwise, the coverage under the policy that the insurer had issued would be largely illusionary.

Renovations/Homes under Construction

During Hurricane Gustav, a tree fell through the roof of a house. At the time, the home was being remodeled, and the owner visited daily during the renovation. The insurance company denied the claim based on the "where you reside" wording

— he was not residing in the house when the damage occurred.

In another case, the insured purchased a house and began renovating before moving into it. He allowed his son, who was a resident of his household at his soon-to-be-former residence, to move into the new house so it would not be vacant and unattended. During renovations, a fire broke out that caused over $100,000 in damages. The insurer denied the claim, citing the "where you reside" language, because the named insured had not yet occupied the home at the time of loss.

An interesting note about this scenario is that ISO eligibility rules permit the issuance of a homeowner's policy on a home under construction. Since residency is impossible, at least during the early phases of construction, this flies in the face of the premise that there is no coverage on the dwelling until residency.

Case Law

A cursory examination of litigation of other "nonresidency" claims indicates that there is about a 50/50 split among the courts that have reviewed this or similar policy language:

No Coverage

- *Bryan v. United States Fire Ins. Co.* (Texas, 1970).
- *Fisher v. Indiana Lumbermens Mutual Ins. Co.* (Texas, 1972).
- *Doyle v. Members Mutual Ins. Co.* (Texas, 1984).
- *Epps v. Nicholson* (Georgia, 1988).
- *Shepard v. Keystone* (Maryland 1990).
- *Nancarrow v. Aetna Casualty & Surety Co.* (Arkansas, 1991).
- *Georgia Farm Bureau Mutual Ins. Co. v. Kephart* (Georgia, 1993).
- *Heniser v. Frankenmuth Mutual Ins. Co.* (Michigan, 1995).

- *Ivanov v. Phenix Mutual Ins. Co.* (Maine, 2007).

Coverage

- *O'Neil v. Buffalo Fire Ins. Co.* (New York, 1849).
- *Joyce v. Maine Ins. Co.* (Maine, 1858).
- *German Ins. Co. v. Russell* (Kansas, 1902).
- *Reid v. Hardware Mutual Ins. Co.* (South Carolina, 1969).
- *Insurance Co. of North America v. Howard* (Oregon, 1982).
- *Farmers Ins. Co. v. Trutanick* (Oregon, 1993).
- *FBS Mortgage Corporation v. State Farm* (Illinois, 1993).
- *Hill v. Nationwide Mutual Fire Ins. Co.* (Georgia, 1994).
- *Lundquist v. Allstate Ins. Co.* (Illinois, 2000).

Reasons For Coverage

The following are reasons that support the position that a Coverage A dwelling claim should not be denied based on the "where you reside" language.

- **"Where you reside" are words of *description*, not a warranty of continuing occupancy.**
  The "where you reside" language is not intended literally to require residency at the time of loss. This viewpoint was expressed in *Joyce v.*

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Maine Ins. Co. (Maine, 1858), *Reid v. Hardware Mutual Ins. Co.* (South Carolina, 1969) and *Farmers Ins. Co. v. Trutanick* (Oregon, 1993) listed above.

- **The "where you reside" language is not clear and conspicuous.**
  While Section II of the HO-3 expressly excludes *liability* while a dwelling is being rented, Section I Coverage A has no similar clear and unambiguous exclusion while a dwelling is being rented by the owner.

  Case law is quite voluminous in that exclusionary provisions must be "conspicuous, plain and clear in such a manner as clearly to apprise the insured of its effect" and that "exceptions and limitations on coverage that the insured could reasonably expect must be called to his attention, clearly and plainly, before the exclusions will be interpreted to relieve the insurer of liability or performance," so that "exclusions are subject to invalidation where they are not conspicuous ... or hidden in a subsequent section of the policy bearing no clear relationship to the insuring clause and concealed in the print."

  The "where you reside" claim denial relies on vague, nebulous wording buried in a definition and indirectly referenced in the Coverage A insuring agreement. If the intent of the policy is to exclude coverage under these circumstances, the contract should more clearly communicate, via exclusion, that complete nonresidency suspends coverage.

- **Insureds have a *reasonable expectation* of coverage given the limited exclusions that apply to Coverage A and the implications of other policy provisions.**
  There are very few "usage" exclusions that apply to Coverage A. For example, there are limitations in Coverage C and an exclusion in Coverage B when those types of property are used for business purposes. However, there is no similar business-use exclusion for damage to the dwelling itself under Coverage A.

- **Owner-occupancy is an *eligibility* issue, not a coverage issue.**
  No one denies that the coverage and premium structures of the ISO HO program contemplate simultaneous ownership and occupancy under the HO-2, HO-3, HO-5 and HO-8 policies. So, it is not unreasonable that this should be a condition in order for one of these *HO forms* to be issued. However, eligibility should be distinguished from coverage.

  For example, under ISO's Personal Auto program, only a private passenger auto, pickup truck, van or trailer is eligible for declaration under a PAP. However, absent any other exclusion, a dump truck being driven for nonbusiness reasons is covered for liability. It is not covered for physical damage because there is clear and conspicuous exclusionary wording that precludes coverage.

- **ISO programs have precedents that supersede the ownership-occupancy/residency requirement.**
  Those in favor of using the "where you reside" language to exclude coverage for damage to dwellings that are not owner-occupied support that position using the premise that the "where you reside" wording reflects the intent of the policy to cover only owner-occupied dwellings.

  However, that viewpoint can be refuted by examining the eligibility guidelines for the HO-6 policy, which do not require that the owner occupy the dwelling unit but rather that the unit simply be used for "residential purposes." However, the HO-6 has the same "where you reside" wording as the HO-3. Therefore, it doesn't follow that this wording reflects an intent that the dwelling be owner-occupied in order for coverage to apply.

- **Any perceived increase in risk of loss is immaterial or inconsequential compared to the potential for catastrophic loss.**
  It is quite likely that the prolonged unoccupancy or vacancy of a dwelling increases the risk of loss — for some perils. That is evidenced by the exclusions for glass breakage and Vandalism and Malicious Mischief (V&MM) in the HO-3 policy for continuous vacancy in excess of 60 days. Yet even a home that has been vacant for nine months would have no greater coverage restrictions than these **unless** the vacancy arises from a permanent discontinuation of residency by the owners. In that case, the supporters of the "where you reside" language would preclude coverage for **any** cause of loss. Yet any corresponding increase in risk that would warrant such an absolute exclusion of coverage is almost as invisible as the exclusionary "where you reside" wording.

  The "increased risk" argument for imposing the "where you reside" language on an exclusionary basis doesn't hold water when you consider that it would apply to a tornado that destroys a dwelling one minute after the owners vacate the premises. Yet residency or nonresidency has nothing to do with the loss, so why exclude it in such a punitive way?

  Referencing the prior discussion about reasonable expectations, it's also hard to explain to an insured why moving out of your house three days before a closing results in its destruction by a tornado not being covered, yet if the insured's home was destroyed in a meth lab or bomb-making explosion while the insured resided there, it would be covered.

- **It is onerous, unconscionable and against public policy to exclude all losses to a dwelling on the basis that there is a minor increase in risk for *some* perils.**
  A catastrophic, bankrupting and life-changing loss is not a suitable or appropriate "punishment" for a consumer's ignorance of insurance contracts or that person's inability to identify and understand obscure exclusionary language buried in the policy, particularly given that the majority of insurance professionals in the industry are not aware of this either.

Possible Solutions

The following potential solutions to the complete and immediate loss of Coverage A due to nonresidency are proposed, beginning with a preferred solution and followed by increasingly less desirable measures.

- **Remove the "where you reside" language *and* rely on underwriting.**
  Ideally, the "where you reside" or comparable language should be removed from HO policies. Ownership-occupancy should be an eligibility not a coverage issue. It should be governed not by the policy but by the application process at the time of new business procurement and renewal. The new and renewal applications should ask the residency question, remind the insured of the residency requirement for eligibility and require a signed acknowledgement. If it is subsequently determined following a loss that the dwelling was not occupied by the owner(s) at the time of loss, the insured(s) could be assessed an additional premium commensurate with rating at the time of loss under the ISO Dwelling program or some other specified premium penalty.
- **Modify and introduce penalties for nonresidency.**
  If necessary, and in conjunction with the above, existing exclusions for extended vacancy (glass breakage and V&MM losses) may apply to any form of vacancy, unoccupancy or nonresidency. Losses that are independent of residency (e.g., tornado/windstorm) should not be excluded at all. Other claims where there is an actuarial basis for connecting the frequency or severity of loss to a lack of residency may be limited as to the amount paid. For example, ISO's commercial lines CP 00 10 — Building and Personal Property Coverage Form excludes some losses in their entirety, but the loss payments for other types of losses are simply reduced by 15 percent for vacant properties.
- **Extend coverage throughout a grace period.**
  Make this an *exclusion*, then absent the suggested changes above; similar to the ISO PAP, a grace period of at least 90 days should apply before the exclusion is applied to Coverage A. The premise that nonresidency increases the risk of loss to the extent that warrants a complete loss of coverage immediately makes no sense, given that ISO currently does not impose a vacancy penalty for glass breakage and vandalism until 60 days has passed.
- **Provide a nonresidency endorsement.**
  As an alternative to, or in conjunction with, the above possible changes, a "nonresidency" endorsement could be provided that extends coverage on a short-term basis. The ISO Dwelling program is simply not a practical short-term solution for brief periods of nonresidency, and it is possible that lenders will not accept a dwelling form. The downside to this approach is that the agent would have to be notified immediately to bind coverage under the endorsement, and often the agent has no notice until the time of the claim.
- **Educate the industry and the public about this potential coverage gap.**
  Regardless of any of the potential solutions mentioned above, there is a **huge** need for education about this potentially catastrophic coverage gap. It is probably safe to say that not one insured in 10,000 is aware of this coverage quirk. Perhaps one insurance practitioner in 100 is cognizant of the issue.
- **Consider regulatory or legislative intervention.**
  As previously noted, at least one state insurance department has issued a bulletin regarding mid-term cancellations for foreclosures or unoccupancy. Quite possibly the only reason no regulators or legislators have addressed the "where you reside" issue is because they are unaware of it. ■

Why Buy a 'Renter's Insurance' Policy?

by David A. Thompson, CPCU, AAI, API

David A. Thompson, CPCU, AAI, API, is an instructor with the Florida Association of Insurance Agents (FAIA) in Tallahassee, Fla. He travels extensively throughout the country presenting continuing education seminars.

On Oct. 4, 2009, while I was visiting my parents in Vero Beach, Fla., my cell phone rang at 4:32 a.m. and the caller ID showed it was my daughter. (It was not going to be a good call at that time of morning!) She said, "Dad, my apartment building just burned to the ground." She lost everything she owned, except for a small overnight bag she had with her.

Leslie Thompson holds bags of clothing she purchased to replace some of what she lost in her apartment fire.

Part of the remains of Leslie Thompson's eight-unit apartment building post-fire.

Fortunately, all residents (and pets) got out alive. As she hung up with me that morning, her last words were: "Thank gosh my dad is an insurance nerd!" Just 52 days earlier, she had purchased — at her dad's directive — an HO-4 policy, "paying right" at $230 a year for $30,000 of coverage on her contents.

See the photos within this article that show her apartment as well as the end result of her shopping experience to replace her belongings. Her HO-4 carrier paid a bit over $28,000 for this loss. Not a bad deal at all … pay $230 and get $28,000 back.

At times, I still can't believe that my daughter had a total loss fire. (It's always supposed to be "someone else.") Fortunately, she had the proper insurance, which allowed her to put her life back in order with very minimal disruption.

Folks, it can … and does … happen to our family members, our customers and us. It's not always "someone else." Use this experience as a selling point when you're asked, "Why do I need renter's insurance?"

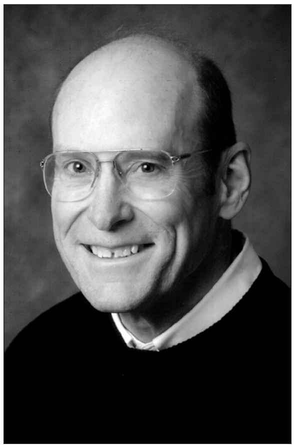
I have taken away several lessons from this event:

- It's not always "someone else" who has the fire.
- Insurance does not prevent losses like this; it makes them easier to deal with.
- Contents add up fast. When my daughter bought her policy, $30,000 of contents coverage had seemed like double what was needed. The claim paid nearly the policy limits.
- Documentation is key — she had none. This taught me a lesson about my own contents. The day after her fire, I took a digital camera and went through my house, taking more than 180 photos of my "junk." I have those photos stored at four different locations, over two computers, an online service and at the house of a family member in another state.

The $230 my daughter spent on an HO-4 is a better deal than any BBQ I have ever had … and that's a darn good deal. ■

Insuring 'Zipcars'

by Jack Hungelmann, CPCU, CIC, ARe



Jack Hungelmann, CPCU, CIC, ARe, has more than 30 years' insurance experience. His practice consists of providing both fee-based risk management and commission-based insurance services to individuals who want and are willing to pay extra for added expertise and services beyond traditional insurance agent services. Hungelmann has done hundreds of audits of personal insurance programs. He is regularly hired as a consultant by consumers around the country seeking advice or problem-solving help regarding every type of insurance related problem. A frequent author, Hungelmann has written several articles for *American Agent and Broker* and IRMI, as well as having written the best-selling book, *Insurance for Dummies* (2nd edition, 2001, 2009, Wiley Publishing).

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With increasing fuel costs, concern over the environment, and the difficulty and expense of parking in a major metropolitan area, a new type of business, referred to as "car sharing," is growing in popularity in major cities. It's a hybrid between car renting and car ownership.

I am focusing on one of those car-sharing franchises, Zipcars, because I recently researched the exposures and coverages for a Chicago client — that and I just like the name.

How It Works

The concept is fairly simple. Clients buy a membership for about $50 a year. This fee helps enable the car sharing company to purchase vehicles — generally the small, fuel-efficient variety. These cars are then "stashed" around the metropolitan area at locations known to members by looking on the Zipcar website. When members need a car, they simply go online to check availability and pickup locations, and reserve the car for the period needed. Rates are by the hour or day. When picking up the car, members just hold up their Zipcar membership card over the card reader on the dash to unlock the car. Keys are already in the car. When finished using the car, members return it to its original parking place, lock it and confirm that it's back with Zipcar via the website. (Check out www.zipcar.com if you want to know more about the process.)

Who Can Benefit?

There are several different types of people who use this service:

- Those who need a car just for a couple of hours.
- Young couples who can afford just one car but occasionally need a second.
- Someone who generally uses public transportation but finds an occasional need for a car.

One of the main advantages of Zipcar, and other franchises like it, are that it typically includes insurance for the driver's liability for injuries and property damage as well as collision and comprehensive coverage. In the case of Zipcar, the liability limit is $300,000 per accident for those 21 and older, and the collision and comprehensive coverage is subject to a $500 deductible.

Identifying the Risks

Zipcar customers face four risks arising out of their membership and use of the cars:

1. Liability for injuries and property damage to the public caused by their negligence.
2. Medical expenses and loss of income if they're injured in an accident involving the car.
3. Compensation for injuries in an automobile accident caused by uninsured or underinsured motorists.
4. Contractual liability for all damage to the Zipcar that occurs while the car is in a member's possession, regardless of cause (e.g., hail damage or theft).

Essentially, these are the same risks facing any person who rents a car.

Finding Insurance Coverage

One of the significant differences between car rentals and car sharing is that with car rentals, the renter is responsible for all four of the above risks, subject to the rental agency carrying minimum amounts of coverage to meet state law. One of the big advantages of car sharing, especially for those who don't own a car, is that the cars are insured by the group. But what if the liability limit is not enough (i.e., $300,000)? Or what if coverage is voided by actions such as letting someone else drive the car who is not a member (not permitted by Zipcar)? Or what if the member lets someone else drive, for whatever reason (e.g., such as being under the influence of alcohol or drugs or having a medical problem)? Where can the member turn?

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Insuring 'Zipcars'

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With No Personal Auto

If the Zipcar member has no auto, and, therefore, no personal auto policy, there are two options. A named nonowner policy will cover drivers on an excess basis for liability, medical, and uninsured and underinsured motorist coverage claims. This can be supplemented by the right personal umbrella policy to cover car accidents using nonowned vehicles.

The second option for liability coverage only is to choose an umbrella policy[1] that covers nonowned vehicle use without requiring underlying insurance. Coverage is subject only to the umbrella policy's self-insured retention/deductible. In this instance, be sure to get a confirmation from the umbrella-underwriting manager or claims manager — in writing — that the umbrella policy will provide primary coverage for use of the Zipcar.

Note: Even if the umbrella policy will provide the liability coverage needed, it won't provide coverage for medical bills or lost wages. Drivers will need to turn to their personal health and disability insurance for that. Unless it is required by state statute, many umbrellas also won't offer uninsured or underinsured motorist coverage — coverages definitely available with a named nonowner policy.

With a Personal Auto

For those who own or lease at least one automobile and have a personal auto policy, coverage for Zipcars should be covered under those policies because there is generally automatic drive-other-cars coverage on an excess basis included in the policy. The "furnished or available for regular use" exclusion for nonowned vehicles won't apply because the Zipcar being rented changes regularly. It also doesn't normally apply to short-term rentals.

If the Car Is Damaged while in the Renter's Possession

Although Zipcar does insure its cars for full coverage, subject to a $500 deductible, Zipcar can still deny coverage for unauthorized use, unauthorized drivers, etc. I recommend backup coverage just in case. If the member has a personal auto policy with collision and comprehensive on at least one personal vehicle, that coverage should transfer and cover damage to the Zipcar.

On the other hand, if the Zipcar member lacks a personal auto policy with at least one car having collision and comprehensive coverage, then it's a good idea to find an umbrella policy that also covers damage to rental cars for which the insured is legally or contractually liable, etc. If the umbrella has no care, custody or control exclusion for damage to nonowned vehicles, by default then, there should be coverage subject only to a self-insured retention of typically $250 to $500.

Note: Some states, like Minnesota, require that personal auto policies cover damage to a rental car under property damage (PD) liability coverage, with no deductible applying. If a member lives in such a state, then backup umbrella coverage would not be necessary.

Conclusion

The concept of car sharing in metropolitan areas is still relatively new, but because it's such an environmentally friendly concept, I expect it to be around for a while.

Endnote

1. For more information on choosing the right umbrella, see "Plugging Liability Insurance Gaps with the Personal Umbrella Policy," published on IRMI.com (http://www.irmi.com/expert/articles/2005/hungelmann02.aspx).

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Practical ERM Considerations — From an Insurance Carrier's Perspective

by Steve McElhiney, CPCU, MBA, ARe, AIAF

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Editor's note: This is the first of a three-part *Personally Speaking* series on enterprise risk management by McElhiney. The next installment will review the common elements and sources of risk as well as thoughts on "soft" risk.

The global financial crisis of 2008–2009 was a seminal event. These years will be viewed as a meridian of time — much like 1929, 1945 and 1968. In many ways, we are too close to these recent events to fully gauge the long-term impact and lasting effects.

Clearly, the way in which risk is assessed and managed has forever changed, and the "solution phase" of the crisis will greatly impact the global financial services industry — specifically the U.S. insurance industry — for decades to come.

We are only beginning to grasp the long-term effects of new regulations, processes and reviews that will be required of financial services companies. Risk, and how it is defined and calibrated, is a key focus of the changes that are emerging in a new regulatory model.

The overall failure of the recent financial crisis was a lack of an overall understanding of the systemic impact of highly correlated risks across various risk classes.

Pre-crisis, risks were (or at least it was thought) nicely partitioned into disparate risk classes and, additionally, had further secondary protections to mitigate credit risk. Under financial portfolio theory, which suggests that overall asset risks are lessened through diversification, counterparties and investors widely felt their risks were limited in addition to well defined and understood.

The financial crisis represented an extreme outlier event, a probability event that was very remote in likelihood but extremely severe in its impact. **Nassim Nicholas Taleb,** in his book *The Black Swan*, described such high severity, low likelihood outlier events by using the example of the existence of the black swan, which occurs naturally in Australia. Prior to their discovery in the 16th century, however, geneticists postulated that swans could only be white and that any other color combination was simply not genetically possible — thus the concept was dismissed. Of course, black swans do, in fact, exist and are representative of those events that reside far down the tail of a probability distribution. This example is representative of an "outlier event." The financial crisis also was such an event.

The financial crisis was a result of broad-based market and quantitative failures — the failure of complex risk models; the failure of credit risk ratings to match their predicted failure expectations; the failure of secondary risk controls (such as credit default swaps and derivatives) to lessen initial losses; and the massive degree of risk correlation that became evident from the housing crisis across regions and borrower classes.

Enterprise risk management, or "ERM," is a term of art that is widely utilized within global industry in this post-crisis environment. ERM is not, however, a bromide and does not necessarily require elaborate systems and processes to provide an adequate level of protections for an insurance company.

It is ironic that a number of the dominant global financial services companies that succumbed to the financial crisis, either through a direct failure or else requiring the support of governmental entities to prevent their eventual insolvency, had long-standing chief risk officer and ERM functions institutionalized into their ongoing operations and board-level reporting. The ERM process failed in these institutions.

The failure of these institutions arose from inadequate risk models and unanticipated correlations of risk within various portfolios (actual results differed from the expected). Further, the interconnected nature of global financial enterprises led to broad systemic failures that were completely unforeseen (the failure of one institution quickly led to the failure of others).

Risks that were (seemingly) partitioned into well-understood portfolios of exposure witnessed a wide degree of loss correlations. "Prime" mortgages, for example, failed at rates that were more anticipated in the "sub-prime" pools, and ultimately, the securitized assets supported by both created investor and counterparty failures that threatened "carried levels of equity" across the entire financial system.

It was this over-reliance on risk models that contributed to heightened appetites for financial leverage in the pre-crisis period to optimize returns on capital. This

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Personally Speaking

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Practical ERM Considerations — From an Insurance Carrier's Perspective

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over-reliance drove insolvency levels when unanticipated credit losses were eventually manifested.

As insurance professionals, we are very conversant with the concept of "return periods" with respect to catastrophic events. Insurance companies manage their books of business to certain overall return period assumptions — not necessarily to the extreme outlier events that are possible.

Thus, reinsurance is often purchased and capital is assessed by rating agencies against moderately likely return period events, such as the "1 in 100" or the "1 in 250" return periods. It would be economically inefficient to annually purchase reinsurance to protect against much higher severity events (against the higher return periods).

Two fundamental ERM risk assessment questions that we always ask clients are: "What is your probability of ruin?" and "What events or series of events could lead to the failure of your organization?". These are the fundamental questions the board of directors and the organization's management team need to be able to answer, irrespective of industry, nature or size.

These questions do not necessarily imply that all such outlier events require complete risk transfer solutions. To purchase such extreme risk transfer solutions may not be economically efficient or practical. It could dramatically impede the ability of the company to generate compelling economic returns over time to provide full protection against risks that are remote in their likelihood. Clearly, however, the *potential* drivers of failure and the correlation of risks need to be clearly understood. The solutions can involve the normal risk management concepts of mitigation or some element of risk transfer. ■

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