CHAPTER 4: MISCELLANEOUS PERSONAL LINES

Let's Begin…

Personal Umbrella Policies

Personal Umbrella Policies

A personal umbrella policy (as opposed to a business umbrella policy) offers coverage above and beyond the liability coverage the insured has on homeowners' or car insurance policies. And some personal umbrella policies also offer coverage for boats and Jet Skis—either with or without an underlying boat or specialty vehicle policy.

For many people, a personal umbrella policy is well worth the extra $200 or $300 a year—especially if the insured can save that much on homeowners' and automobile policies by reducing liability limits.

However, bear in mind that the insured still will have to have at least the minimum liability limits on the insured's auto policy that are required by law in the state. And most personal umbrella policies also require that the insured have a minimum amount of **underlying insurance** in place. The two main underlying policies that most insures require the insured to maintain are **Personal Liability** and **Auto,** however, each insurer requires different minimum amounts of liability on these underlying policies.

Since the **minimum liability coverage** available under a personal umbrella typically is $1 million, this means the insured 'd have $1.3 million worth of auto liability coverage—and $1.3 million worth of comprehensive personal liability coverage. (In effect, the liability limits on the insured's auto and homeowners' insurance policies serve as a deductible on the umbrella policy.)

Another variation is known as **split limits of coverage**. Automobile policies commonly provide split limits, under which separate limits are stated for bodily injury coverage per person, the maximum amount of bodily injury coverage per accident and property damage coverage per accident. When an umbrella provides coverage above split limits, it will begin to provide excess coverage above each of the stated underlying sub-limits.

A variation provided by some insurers is an umbrella with what is called a **smoothed limit**. Under this approach, the umbrella limit is the total amount of coverage that will be provided. Instead of providing coverage in addition to that provided by an underlying policy, the smoothed limit policy only provides total coverage up to its limit.

Example: Oliver has a $1 million umbrella policy written with a smoothed limit and $200,000 of underlying homeowners' liability. The umbrella insurance company will only provide $800,000 of excess coverage for losses covered by these policies.

Standardized Umbrella Policies: The ISO recently introduced Standardized Umbrella Policies, however, most insurers are still using their own policies. The main reason for this is because these forms are familiar to the insurers, are based on their own loss experience, and the insurers know how they will be interpreted in court.

Broader Coverage

One of the most important functions of a true umbrella is that it provides broader coverage than the underlying policies. The term **drop-down coverages** is often used to name the coverages provided by the personal umbrella that are not provided by the underlying liability policies. Some of these include:

- **Personal injury coverage**. The typical underlying homeowners' policy provides liability coverage for accidental bodily injury (meaning physical injury or death), but not for events involving libel, slander, false arrest and the like. The personal umbrella does cover the insured for liability arising out of these events.
- **Regularly furnished autos**. The standard Personal Auto Policy contains language that precludes liability coverage for the use of vehicles that the insured does not own but that are made available for the insured's regular use (such as a company car). The personal umbrella does not exclude such coverage.
- **Contractual liability**. The standard homeowners' policy severely limits coverage for liability assumed by contract. So, if the insured signs an easement agreement to build a shared access road with the insured's neighbor—and he sues the insured because the road is never completed—the umbrella will cover the insured.
- **Damage to property of others**. The standard homeowners' policy excludes coverage for damage to property of others left in the insured's care, custody or control. The personal umbrella does not exclude coverage for damage to such property.
- **Uninsured and Underinsured Motorists**. An umbrella policy will provide higher limits of coverage for uninsured and underinsured motorist coverage than the insureds underlying policy. Also, the umbrella policy would not restrict the uninsured motorist coverage to the policy territory stated in the underlying policy.

An important concept that comes into play when a personal umbrella covers a loss that is not covered by an underlying policy is termed a **self-insured retention** or SIR. (It's called a **retained limit** in some policies.) When the umbrella alone provides coverage for a loss, the insured pays what amounts to a deductible by "retaining" the first small portion of the loss (typically $250 to $1,000).

Loss payment is administered somewhat differently than with traditional deductibles. In this case, the insured write a check to the insured's insurance company for the amount of the SIR, and it pays the injured party the entire amount for which it is liable.

Defense Costs

Another major benefit of personal umbrella coverage—which we have discussed before, but not in detail—is that the policy provides for **payment of defense costs**. When the insured is accused of being liable for damages to someone else and are taken to court over it, legal costs will be incurred, even if the suit is totally groundless and ends in the insured's favor.

Fortunately, most underlying liability policies also provide coverage for defense costs, whether or not the suit is groundless. Also, these costs are paid in addition to the available limits of liability (in other words, the entire liability policy limits are available to pay damages).

Actually, the insurance company does much more than simply pay defense costs when a suit is brought against the insured.

In other words, the insurance company steps in and provides the defense and does so at its own expense. However, the insurance company's duty to defend ends when it has paid or offered to pay its maximum limit of liability.

For example, the insured have a homeowners' policy providing $100,000 of personal liability coverage, and the insured also have $1 million of personal umbrella coverage. One day the insured's pit bull bites and severely injures a visiting child, and the child's parents sue for $500,000.

If the **underlying insurer** believes a defense may be successful, it may defend the claim to conclusion, regardless of the outcome. (There may be no liability, the liability awarded may be less than the homeowners' policy limit, or the award may exceed that limit.) The **umbrella insurer** observes but does not participate in the defense. It will, however, pay its share of any award in excess of the $100,000 homeowners' limit.

However, the underlying insurer might not have to provide a defense. If it believes a successful defense is doubtful and that any settlement is going to exceed its policy limit, it might immediately **offer to pay** its $100,000 limit and **avoid defense costs** (its obligation ends when it exhausts its limit). In this case, the insured no longer have the underlying insurer defending its claim.

The personal umbrella becomes very valuable at this point for two reasons: First, the umbrella company will step in and defend the remainder of the claim; second, the umbrella's liability limit can make up the remaining $400,000 if the child's parents win their entire demand.

An umbrella policy's **duty to defend clause** is also very important when there is no underlying coverage for a particular suit. For example: Lily has a homeowners' policy, but she does not have an endorsement to provide personal injury coverage. Lily is sued by someone for slander. There is no coverage for the claim under Lily's homeowners' policy—the insurance company is not obligated to provide a defense or pay defense costs. In this case, the personal umbrella company will step in and provide a defense, pay the defense costs and provide **drop-down personal injury coverage** for damages that may be awarded in addition to the defense costs.

Even if the insured have umbrella coverage, the insured need to be careful about defense costs. Many policies do cover defense costs in addition to the limit of liability. But be aware that under the terms of some personal umbrellas, defense costs are included in the policy limit and are **not additional coverage**.

Limits of Liability

Typically, personal umbrella liability coverage comes in **increments of $1 million**, starting at $1 million and going up to $5 million—for a premium of $200 to $600 annually. (It is possible to get even higher limits. There are companies writing $10 million policies.)

The insured's **premium** will depend on the limits the insured select; the number of cars, homes, boats, etc., that the insured own; and the area in which the insured live.

To figure out how much umbrella liability insurance the insured needs, the insured will need to determine the insured's **current net worth** (assets minus liabilities). Do the insured expect this amount to increase in the near future? Because of the relatively low cost of this type of insurance, the insured might consider buying enough coverage to protect the insured's net worth for several years.

If the insured are thinking about buying a personal umbrella liability policy, it's best to place it with **the same insurance company** that writes the insured's homeowners' and auto coverage. Not only is the insured likely to get a **discount** for having multiple policies with the same company, but the insured is more likely to **avoid gaps in coverage** if one company is handling all the insured's overlapping insurance needs. Besides, most companies tailor their excess liability coverage provisions around their auto and homeowners' policies.

Personal umbrella liability policies vary from company to company. To help the insured compare different policies and to optimize the coverage that the insured receive, we've developed a chart that appears at the end of the chapter.

Personal Umbrella Liability

When would the insured need a personal umbrella policy? If the insured is being sued for libel or slander in a non-business situation, if the insured's dog bites another person or animal, or if someone gets injured at the insured's home and sues the insured for medical bills and pain and suffering.

While common personal liability policies (such as a homeowners' or Personal Auto Policy) do provide coverage for their respective liability situations, often the limits aren't high enough to pay all the damages that could be awarded in even a moderately severe case. What if the insured has a $250,000 limit for automobile bodily injury and a court enters a judgment of $500,000 against him?

If a court hands down a liability judgment that exhausts the limits of the insured's homeowners' or car insurance policy, the insured is responsible for the balance. Perhaps the insured's house will have to be sold, the insured's IRAs will need to be cashed out, or other assets will have to be liquidated in order to make payment on the judgment. If the insured's assets are exhausted and a judgment is not fully satisfied, future earnings may be attached in further settlement of the outstanding judgment. A major liability loss can wipe out assets that took a lifetime to accumulate.

Is anyone exempt from **personal liability** exposures? Except for minors, the legally incompetent and the indigent (who have no assets at risk), most of us have exposures. How can anyone who drives an automobile be absolutely positive he or she will never be involved in an at-fault accident? How can any homeowner—or renter—be certain that no visitor will ever be injured on the premises? How can anyone be sure that a personal liability claim will never arise out of something they say or something they do?

The simple answer is: **you can't.**

Another reason to consider this coverage: Obtaining an umbrella policy is a good way to lower the insured's home or car or boat insurance costs, since getting an umbrella policy typically is less expensive than getting additional liability coverage on a homeowners', boatowners or auto policy. And an umbrella policy provides coverage for all three areas, plus things those **underlying policies** will not cover.

Broader Coverage and Higher Limits

Umbrella liability policies, which were first written in this country in the 1940s, serve two major functions: They provide **high limits** of coverage to protect against catastrophic losses, and they usually provide **broader** coverage than underlying policies.

Umbrellas are written to provide insurance on an **excess** basis, above underlying insurance or a **self-insured retention** (the equivalent of a large deductible).
Most of the various personal umbrella policies on the market can be organized into two categories:

- **Following Form Excess Policies**. These provide high limits over the exact same perils, coverages and exclusions found in all of the underlying policies over which coverage is being provided (e.g., the insured's homeowners' and auto policies).
- **True Umbrella Policies**. In addition to high limits of liability coverage, these provide broader coverage than is provided by the underlying coverages.

True umbrella coverage will protect the insured's present and future income streams most effectively. It provides three essential things:

- **excess limits** over underlying policies;
- **broader coverage** than the underlying policies; and
- **defense costs** in addition to the limit of insurance.

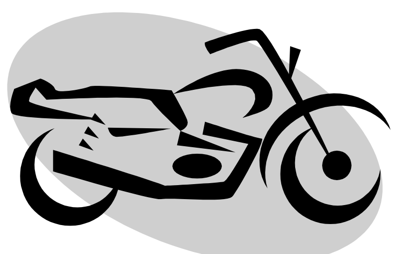
An umbrella policy will usually defend a claim even if it is groundless.

For losses that are covered by the insured's primary insurance, the umbrella coverage begins to apply only after the primary coverage has reached its **limit**. For losses that are covered by the umbrella and not by the insured's primary policies, the umbrella coverage begins to apply after a loss exceeds the **deductible**.

There are no standard umbrella policies, so it isn't easy to generalize about them. Early umbrella policies were extremely broad and contained few exclusions. However, carriers soon learned that they would need to narrow the coverage by creating more specific insuring agreements and exclusions.

The intent is to provide **affordable and comprehensive coverage** for catastrophic losses, incidental exposures and modest insurance gaps, but not to provide blanket all-risk coverage in multiple areas where there is no primary insurance. For this reason, insurance companies usually will require the insured to maintain an **adequate range of underlying coverages** before they will sell the insured umbrella liability coverage.

The exclusions and limitations of an umbrella often are much like those found in the underlying policies. However, the umbrella usually will have **fewer exclusions** than primary coverage and a broader insuring agreement.



Car and Motorcycle Excess Liability Coverage

Another option, if the insured is looking for more liability coverage, is an Automobile Excess Liability or Motorcycle Excess Liability policy. These work much like a personal umbrella liability policy, only they are tailored to take over exclusively where an auto or motorcycle policy leaves off—and, of course, they only cover liability related to the insured's car or bike.

These policies typically are written with a $1 million limit. And some of them also allow the insured to use the insured's car or bike for business—as well as personal—purposes. Although these policies are usually inexpensive, for the money, it is hard to beat a personal umbrella liability policy. The breadth of coverage offered is worth what may be only a $100 a year in additional premiums, compared with one of these narrower excess liability coverages.

Personal Watercraft

As society has become more affluent and more mobile, unprecedented numbers of American families have purchased boats and personal watercraft. Of course, the fact that people are marrying later in life also has contributed to the upsurge in sales, too—since single people tend to have more disposable income.

If the insured is one of those people who is headed for the great outdoors every chance he or she gets—along with his or her boat or personal watercraft—here's what you need to know about personal watercraft insurance.

Why a Separate Policy?

First of all, don't expect a **standard homeowners'** insurance policy to meet his or her coverage needs. Most people who rely on their homeowners' insurance to cover a boat or Jet Ski wind up with **gaps in coverage** that they don't know about until it's too late.

The kind of coverage that the insured needs is similar to personal auto insurance. At a minimum, boats and jet skis need **liability** and **comprehensive** coverage. Liability protects the insured if his or her vessel injures someone or damages his property, and comprehensive insurance protects his or her property in case of vandalism, damage or destruction caused by theft or fire. Depending on the **age and value** of his or her craft, the insured also may want to purchase **collision** insurance, which provides coverage for damage the insured cause to his or her own property.

Homeowners' Policy Limitations

If the insured has a homeowners' policy, it will provide very **limited watercraft coverage**. For instance, coverage for physical damage to watercraft, trailers, furnishings, accessories, equipment and motors is limited to just $1,000 per occurrence. Not only is this a relatively low dollar amount, but this coverage applies only to the named perils in the homeowners' policy. So, even if the insured get the broadest homeowners' coverage available, it still won't protect his or her boat for "perils of the seas" (including wave action, stranding, sinking or capsizing).

Theft coverage for watercraft also is **restricted** under a homeowners' policy. It applies only to theft that occurs at the insured's home. If his or her boat and/or trailer were stolen from a lakeside vacation spot, a parking lot in a national park or any place else other than his or her home, there would be no coverage.

Liability coverage under a homeowners' policy is limited, too. A homeowners' policy offers coverage only to a very few types of vessels. For the kinds of vessels that are covered, it includes coverage for ownership, maintenance, use, entrustment of the watercraft by an insured to anyone else and vicarious parental liability for the actions of a child or minor using the watercraft. Excluded watercraft, obviously, are not covered.
The following chart illustrates some of the restrictions that affect the coverage of certain types of boats.

Power and Length Restrictions for Covered Watercraft

	Owned by the insured	**Rented to the insured**	**Borrowed by the insured**
Outboard	Total 25 hp or less	No limit	No limit
Inboard and inboard-outdrive	Total 50 hp or less	Total 50 hp or less	No limit
Sailboats	26 feet or less	26 feet or less	No limit

However, the insured may be able to take up some of the slack in terms of liability coverage via an endorsement to his or her homeowners' policy. The **watercraft endorsement** provides the range of normally excluded liability coverage (related to ownership, maintenance, use, entrustment and vicarious liability) for boats that exceed the power and length limitations outlined above.

A caveat: The insured still wouldn't be covered if the insured were in an official race or practicing for a race (unless his or her craft is a sailboat). In addition, sailboats and inboard and inboard-outdrive-powered boats wouldn't be covered for bodily injury to any employee if that employee's main duties pertain to the maintenance or use of the watercraft—and there is no coverage while the watercraft is used to carry people for a fee or while it is rented to others.

The watercraft endorsement may solve some of his or her problems with homeowners' insurance coverage. However, it doesn't help alleviate the **physical damage** exposures the insured face.

Pleasure Boats

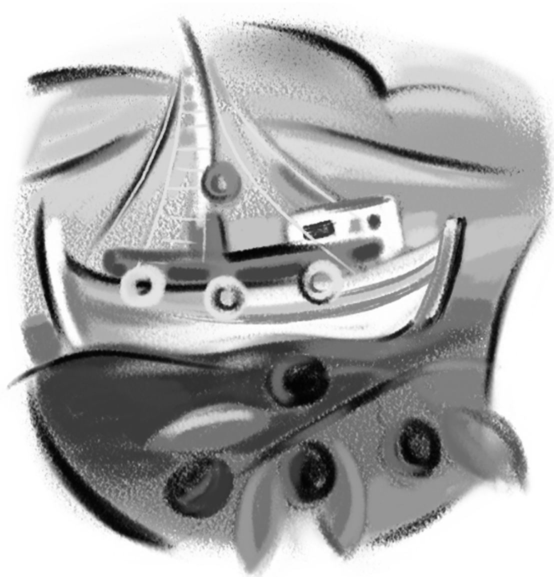
In some respects, owning a boat is a lot like owning a car. For one thing, the insured will face the same sorts of exposures to loss. These include:

•**Bodily injury** and **property damage** to others, such as injury to passengers, skiers, swimmers, occupants of other craft and damage to other craft.

•**Physical damage** to the craft itself because of collision with other boats or objects, fire, and theft (as well as many of the other comprehensive-type losses to which cars are exposed); and losses due to "perils of the seas," including wave action, stranding, sinking, or capsizing).

•Injury to the boat operator and other guests onboard the craft because of the actions of another boater who is **uninsured**.

•Liability imposed because of the responsibility for removing a **wrecked craft** from the waterway.



The insured can insure most boats as part of his or her homeowners' policy or with a separate boatowners' package policy or an ocean marine policy. Yachts have their own type of coverage, since there are a few additional concerns.

Regardless of the type of coverage the insured buy, certain **conditions and exclusions** are almost always part of a pleasure boat insurance contract. Policies stipulate that the craft must be used "solely for private pleasure purposes," and that coverage **will not apply** if the boat is hired out, chartered, or used to transport people or property for a fee. Another common exclusion removes coverage while the watercraft is being used in an official **race or speed contest** (unofficial events are not excluded).

Boatowners Policies

Instead of trying to adapt a homeowners' policy to meet only some of the watercraft needs, the insured will probably be better off getting a **boatowners policy**, which is designed to provide all of the coverages necessary to meet a boatowner's needs. Some of these policies are designed to cover small to mid-sized boats, while others are designed specifically to cover larger craft, including high-value **houseboats** and even **luxury yachts**.

It's important to point out that insurance companies use different terms from the rest of us when they describe these policies. While most people use the phrase *personal watercraft* as the generic name for Jet Ski or Wave Runner-type crafts, insurers call boat policies **personal watercraft policies**. We'll call them *boatowners policies*, to be clear. To make things even more confusing, insurance companies also offer policies specifically for Jet Ski-style personal watercraft.

Obviously, when the insured get quotes for a boatowners policy, the insured will need to be sure the insured and his or her agent are on the same wavelength.

So, what do the insured get on a boatowners policy? Again, boatowners policies are a lot like car insurance policies. A typical policy will include:

- **physical damage** coverage for the boat and its equipment (on either a replacement cost or actual cash value basis);
- **liability** coverage includes bodily injury or property damage to others; operator's liability; passenger liability; flotilla liability (extended liability for a boat owner who operates the vessel of another)
- **medical payments** coverage for occupants of the boat; and
- **uninsured boater** coverage to cover injuries that may be caused by an uninsured or hit-and-run boater.

Policies designed for larger vessels often also include coverage for personal property on board the craft, and special coverage for injuries to crew members.

Yacht Policies

The policies typically purchased by **yacht owners** differ in structure from the boat policies we've discussed so far, but they provide many of the same types of coverage. True yacht policies are structured more like the **traditional ocean marine policies** that are available to cover commercial ships.

Yacht policies also use some different terminology. Here are some of the key coverage concepts and terminology the insured can expect to find in a yacht policy:

- **Hull coverage**. This is physical damage coverage for the vessel itself, and the equipment and machinery necessary to the operation of the vessel. A few unique coverage clauses (sue and labor, lay-up returns and running down) differentiate this coverage from that found in other boatowners policies.
- **Trailer coverage**. This covers the boat trailer pulling the watercraft.

•**Sue and labor clause**. The insured must take all reasonable steps to protect damaged property from further damage. Payment will be made for expenses incurred in doing so.

•**Running down clause**. This provides property damage liability coverage in the event his or her vessel strikes another vessel. It covers damage to the other vessel (both hull and cargo), but not bodily injury liability (which is available under protection and indemnity coverage). It is attached to and only written with hull coverage (it is like collision coverage written to protect others).

•**Valued policy**. Coverage for higher-value craft may be written on a valued-policy basis. The hull coverage of most yacht policies is written in this manner, making them more like ocean marine policies than personal watercraft policies, which cover smaller vessels.

•**Protection and indemnity** (P&I). This coverage provides the bulk of the liability coverage for accidents and other events that arise out of the ownership, maintenance or use of the yacht. It includes coverage for:

a) **Bodily injury to others** (including those on-board his or her vessel, such as passengers or crew members, and people who are not onboard his or her boat);

b) **Damage to the property of others** (this supplements the running down clause, and covers all other types of property damage liability, such as damage to fixed objects and non-collision damage to other vessels); and

c) Property damage liability arising out of **raising and/or removing** (or failure to do so) the wreck of the yacht.

A major difference between the yacht policies (P&I) and the boatowner's liability coverage is that the boatowner's liability coverage does not provide workers compensation coverages.

Yacht policies also include coverage for obligations due to the federal Longshoremen's and Harbor Workers Act, which requires compensation benefits for injuries to various maritime workers other than crew members.

These policies also include **medical payments** coverage, like that described for smaller boats.

"Best of all, it's 100 percent earthquake-proof."

Earthquake Insurance

Earthquake insurance is quite different from flood insurance. For one thing, it was—and still is, in some cases—underwritten by insurance companies, rather than a federal agency. This means the rates and policies differ from company to company.

The Personal Auto Policy (PAP) provides coverage for damage to the insured's vehicle resulting from an earthquake under the "Other than Collision" (aka Comprehensive) coverage. Many Inland Marine policies also cover losses caused by earthquake. Earthquake /earth movement is specifically excluded by homeowner's and dwelling policies.

Since the beginning of 1997, however, Californians also have been able to purchase coverage through a state program, called the California Earthquake Authority (CEA). CEA policies are like flood insurance policies—they are sold by insurance companies, but claims are paid by the CEA.

The CEA was created because of the **1994 Northridge earthquake**, which caused some $12.5 billion in damages—more than the insurance industry expected to pay.
Because California law requires insurance companies to offer earthquake coverage with every homeowners' policy, the vast majority of insurance companies either stopped selling new homeowners' insurance policies in the Golden State or they scaled back their efforts considerably—restricting new policies to areas unlikely to be affected by an earthquake.

Meanwhile, the state legislature was looking for ways to make earthquake coverage accessible and affordable—and to encourage insurance companies to write homeowners' insurance in the state. After much debate, in September 1996, an act creating the CEA was signed into law.

The CEA is funded in large part by insurance companies—which must pay to join, if they want to sell CEA policies along with their own homeowners' insurance. The rest of the up to $10.5 billion in funding comes from investors and California consumers, via their premium dollars.

To qualify for CEA coverage, a house must have been built in 1960 or later. Or, if a house was built before 1960, it must be anchored to the foundation, it must have structurally sound weight-bearing walls braced with plywood or its equivalent, and its hot water heater must be secured to the building frame.

CEA policies are **bare-bones**—they're certainly more restrictive than the policies insurance companies had been offering prior to the Northridge quake. And CEA policies aren't cheap, either. The good news is that the CEA policy does at least offer replacement cost coverage.

Many insurance companies modified their existing earthquake policies when they came up for renewal—restricting the coverage and raising the deductible. Now that the CEA is in operation, most insurance companies have simply converted their policies to CEA policies on renewal.

The CEA Base Policy

Limit of Insurance

Earthquake insurance—from the CEA or from a private insurance company—is written in addition to a homeowners' or dwelling policy. This is important to note, because the **amount of coverage** on a home under an earthquake policy is **limited to the amount of coverage under the homeowners' or dwelling policy**.

Coverage for **personal property** also is quite limited. The CEA policy will only pay up to $5,000 for personal belongings—and there are restrictions.

The CEA policy will pay up to $1,500 for living expenses, if a home becomes uninhabitable due to a quake. It will also pay up to 5% of the insured value of the home for **emergency repairs**.

If an earthquake caused soil erosion under a home, the CEA policy will pay up to **$10,000 to stabilize the soil**. It will also pay up to $10,000 to bring a home up to **present building code requirements** while making insured repairs.

CEA policies also have the following sub-limits:

- $5,000 for chimney repair or replacement
- $1,000 for computer equipment repair or replacement
- $250 for money
- $300 for business property

Deductible

The CEA policy includes a **15 percent deductible**. So, for a $100,000 homeowners' policy, the policyholder pays the first $15,000 worth of damage to the dwelling and its contents after an earthquake. Renters only have a $750 deductible on earthquake personal property coverage, since they don't have dwelling insurance. Renters may want an earthquake policy, because their landlord's coverage extends only to the building; it does not protect their belongings.

Supplemental Coverages

The CEA also offers some supplemental coverages. Including:

- Lowering the deductible to 10%
- Increasing personal property coverage up to $200,000
- Increasing emergency living expenses up to $100,000

Exclusions
CEA earthquake policies do not cover damage to:

- •detached garages;
- •pools;
- •driveways;
- •masonry walls or chimneys;
- •fences; or
- •landscaping.

It also does not cover certain types of content such as satellite dishes, art, stained glass, chandeliers, computer files, and glassware and china.

Premiums
Rates for coverage depend on where a home is, when it was built and whether it is of frame (wood or stucco-covered wood) or masonry (brick, stone, adobe or concrete block) construction. (Masonry rates are usually significantly higher than frame rates.) Earthquake retrofitting (bringing an older home up to current building code specifications) also will reduce rates.

To determine the risks in various areas—and, therefore, the rates that should be charged—EQE looked at every single California earthquake policy in force and ran it through a computer model. The firm considered soil types (which range from bedrock—the safest—to the kind of soft, silty soil you would find at the bottom of a river bed, which is the most prone to damage).

It also looked at the age of the homes in a given area—because earthquake codes have changed over the years, as folks have learned what types of construction do and do not withstand quakes. And, finally, the company looked at the kind of foundation various homes had—and how those homes were attached to the foundation.

EQE then developed rates based on **ZIP codes**—broken down within each ZIP code for different types of construction, age, and kind of dwelling (including houses, apartments, condos and mobile homes). This resulted in 5,000 different rates.

The rates for these **19 different territories** range from about $1 to $5.25 per $1,000 of insurance per year. For more information see www.earthquakeauthority.com

Advantages and Disadvantages of using the Earthquake Endorsement:

Advantages include:
1. Lower deductibles
2. Extended Replacement Cost, Ordinance & Law Endorsements, and Personal Property Replacement Cost endorsements would all apply to earthquake claims.
3. Earthquake is an extra covered peril for type of coverage.

Disadvantages include:
1. Higher coverage costs than a separate policy
2. The deductible applies to each limit of coverage separately. (Usually 15% of the limit)

Advantages and Disadvantages of multiple limit vs. single limit coverage and reduced coverage policies: The declarations page of a homeowners' policy contains a list of the multiple limits of insurance. For example, a home may have $200,000 Dwelling coverage, $50,000 Contents coverage and $10,000 Separate Structure coverage…etc. By having a separate earthquake policy with a *single limit* of coverage, $200,000 for the peril of *earthquake* could be written and only one deductible would apply. Conversely, a policy with *multiple limits*, there would be multiple deductibles for each coverage limit (Dwelling coverage, Contents coverage, Separate Structure coverage…etc.)

Some companies allow you to purchase a *reduced coverage* earthquake policy. This policy allows you to choose the limits of coverage and does not require the Dwelling coverage to match the Homeowners' limit of insurance. While the advantage of a lower cost is there, it may actually be a disadvantage, because most people choose their coverage based on price instead of their needs.

Flood Insurance

While your standard homeowners' policy will cover water damage caused by heavy rains, most home—and business—owners could not get actual flood insurance until 1968, when Congress voted to create the **National Flood Insurance Program (NFIP)**. Prior to that time, the federal government had focused its efforts on flood control techniques, such as building dams, levees and seawalls—and on disaster relief for flood victims.

The National Flood Insurance Act of 1968 took a new tack. It created a federal program to provide flood insurance to communities in flood zones—as long as the communities reduced future flood risks to new construction.

Participation in the program is required on a community basis—rather than an individual basis—because local zoning laws and building codes seriously affect the amount of damage an area will suffer due to flooding. The federal government realized that the whole community would have to get behind efforts to reduce damage—and federal relief costs—in order to make the NFIP work.

To be eligible for flood insurance, a community must require permits for all construction in high-risk areas, and ensure that the materials and techniques used in the new construction will minimize flood damage. Almost any building which is walled, roofed, principally above ground and is fixed to a permanent site is eligible for coverage by a flood policy.

But obtaining flood insurance isn't the only reason communities participate in the NFIP. If an area did not participate and the president were to declare that area a disaster due to flooding, the community would not be eligible to collect federal aid for the repair or reconstruction of insurable buildings in **Special Flood Hazard Areas**. People in those communities still could receive other forms of disaster assistance, such as food and emergency shelter, but they wouldn't get the government's help in rebuilding their homes and businesses.

Needless to say, this is a profound incentive for community participation—and almost all of the communities with serious flood potential have joined the NFIP, which is administered by the Federal Insurance Administration, or FIA, a component of the Federal Emergency Management Agency (FEMA). If you buy a home in a flood zone, the mortgage lender probably will require that you purchase flood coverage.

Limits to the coverage provided by the NFIP are usually dictated by the communities; participation in safety measures and zoning. The **Emergency Program** is used when a community first adopts the requirements of the NFIP regarding land use, building permits, and safety measures. This is done because the land has not yet been surveyed and mapped, and flood zones have not been established. During this time the NFIP allows a lower limit of coverage than in the regular program and rates may be higher. Once a community has complied with flood control and land use requirements it qualifies for the **Regular Program** which offers property owners higher limits.

Binding Authority- An agent has no binding authority under the NFIP. Flood insurance is effective 30 days after the agent completes the application and receives payment for the policy, if the application is receive by the processing center within 10 days after the application is signed.

Eligibility

Today, you can insure almost any enclosed building and its contents against flood loss—if your community is participating in the program. If you live in an area that is **prone to flooding**, you probably know that yours is one of the more than 18,000 communities that participate.

NFIP insurance can be written on **any building** that:

- has two or more exterior rigid walls;
- has a roof;
- is fully anchored to prevent flotation, collapse or lateral movement; and
- is principally above ground.

Mobile homes that are anchored to permanent foundations, condos, condominium associations and homes that are under construction also can be covered by the NFIP.
Buildings that are located over water or that are principally below ground cannot be insured under this program—and neither can travel trailers and converted buses or vans.

Limits of Insurance

The amount of flood insurance you can purchase depends on the value of your home. However, the maximum limit for flood insurance is **$185,000 for a house**, and another **$60,000** for its contents. For many people, this may not begin to cover their losses.

The types of items that usually receive limited coverage in a standard homeowners' policy (art, jewelry, furs, gold, silver, etc.) receive even less coverage under a flood policy. The maximum coverage for all of these items is just $250. Coverage for business equipment in a home also is limited—to $2,500. But you can purchase additional insurance to protect all of these things.

Building Coverage	**Regular Program**		**Emergency Program**
	Basic Limits	**Additional Limits**	
Single Family Dwelling	$50,000	$200,000	$35,000
2-4 Family Dwelling	$50,000	$200,000	$35,000
Other Residential	$150,000	$200,000	$100,000
Non-residential or small business	$150,000	$350,000	$100,000
Contents Coverage (per unit)			
Single Family	$20,000	$20,000	$10,000
Other Residential	$20,000	$20,000	$10,000
Non-residential or small business	$130,000	$130,000	$100,000

In addition to coverage for the house and its contents, the dwelling form of the standard flood insurance policy also includes coverage—up to **10 percent of the policy amount**—for **garages and carports**. You also can schedule coverage for up to 10 additional buildings on your property (if you have a workshop or a guest house, for instance).

Exclusions

Many flood insurance policy provisions are similar to those found in a fire insurance policy. Flood policies do not cover:

- accounts, bills, currency, deeds, evidences of debt, money, securities, bullion and manuscripts;
- lawns, trees, shrubs, plants, growing crops, pets and livestock;
- aircraft, self-propelled vehicles and motor vehicles;
- fences, retaining walls, outdoor swimming pools, bulkheads, wharves, piers, bridges, docks, and other open structures on or over water;
- underground structures and equipment, such as wells and septic tanks;
- roads, machinery or equipment in the open;
- newly constructed buildings that are in, on or over water; and
- structures that are primarily containers, such as gas or liquid storage tanks (but silos and grain storage buildings, including contents, may be covered).

NFIP **coverage includes protection for foundation elements** (including posts, pilings, piers or other support systems for elevated buildings), utility connections and mechanical equipment necessary for the habitability of the building (such as furnaces, hot water heaters, clothes washers and dryers, food freezers, air conditioners, heat pumps, electrical junctions and circuit breaker boxes).

Buying Flood Insurance

While the NFIP is a federal program, flood insurance is **sold locally**—through insurance companies. More than 200 insurance companies currently sell and service flood insurance under their own names.   Any licensed broker-agent may place business with the program.

Rates will depend on a home’s age, where it is located and how it was built. How much a community has done to reduce the risk of flooding also will impact rates. If a house is on high ground and was built according to current standards, rates may be as low as a few hundred dollars a year. On the other hand in a high-risk area, premiums could be 10 times that amount or more.

Deductibles for flood insurance typically are quite reasonable (especially when compared with the deductibles for earthquake insurance)—in the $500 to $750 range.

To determine the relative risk of flooding for a particular site—which obviously profoundly affects insurance rates—check a Flood Insurance Rate Map (FIRM). Each community's FIRM is issued by FEMA, usually after a Flood Insurance Study has been performed to analyze risk zones and elevations.

Whether a home was built before or after FEMA came in and created the local flood map also impacts rates. That's because pre-existing structures in flood zones receive subsidized rates—and structures that are shown by a flood map to be outside of serious flood zones benefit from even lower rates. Newer homes outside of serious flood zones get the best rates of all.

Floods and flash floods occur in all 50 states. Historically, about one-third of all claims paid by the NFIP are for flood damage in areas identified as having only "moderate" or "minimal" risk of flooding. Flooding in these areas typically is a result of inadequate drainage.

If a community doesn't participate in the NFIP, residents may still be able to buy some level of flood coverage. Check with the NFIP for further details at www.fema.org/nfip.

FAIR Plans

Finding homeowners' coverage in **urban centers** is a particular problem. Part of the reason stems from the outbreak of rioting in city centers during the mid- and late 1960s. Until the mid-'60s, riot coverage for homeowners' property losses had been widely available as part of standard homeowners' insurance packages. That soon changed. Insurance companies began to exclude riot damage from standard policies—and some stopped writing homeowners' insurance at all in urban centers.

In addition to concern about the riot risk, insurance companies were increasingly unwilling to insure property in neighborhoods characterized by congestion and deterioration. Inner-city homeowners' and business owners soon found that property coverage was becoming unavailable or unaffordable.

By law, any insurance company that wishes to buy riot reinsurance must participate in a HUD-approved FAIR plan. The term FAIR stands for **Fair Access to Insurance Requirements**. Many states created these plans to make essential property insurance available to consumers in areas where coverage had become unavailable—or at least extremely difficult to obtain—due to conditions that are beyond the control of property owners.

In some states, these programs are referred to as the FAIR Plan. In others, they are known as **Joint Underwriting Associations** (JUAs). Some people also call them **assigned risk programs**. Whatever the name, the premise is the same.
Although they are administered by the states, FAIR plans are operated by **participating insurance companies**. Insurers that do business in a state usually have to participate in that state's FAIR plan **in proportion** to the amount of insurance they write in the voluntary market (that is, everything that they are not being forced to write in that state).

For example, if ABC Company writes 10 percent of the standard homeowners' insurance in a given state, it will be required to write 10 percent of the high-risk policies in the state's FAIR plan.

Consumers who qualify can buy FAIR plan insurance just as they would buy insurance from a company—directly or through licensed agents representing the participating companies. FAIR plans make coverage available only in **designated areas**, which may include entire cities or counties, or may be defined by ZIP code or other geographical boundaries. In some cases, the designated area includes the entire state.

Because **each state sets up its own FAIR plan** and can regulate the plan as it chooses, there are slight variations in how each plan is run. However, it is possible to provide an overview of how these plans work—and why some of them may cause trouble for homeowners.

The California FAIR Plan

Because of California's large geographical area and the size of designated brush hazard areas, California FAIR Plan business represents a substantial proportion of all FAIR plan business written in the country.

Approximately 45 percent of all FAIR plan business written nationwide consists of risks located in California.

The California FAIR Plan Association is an industry-wide association consisting of all insurers who have Certificates of Authority to write fire insurance in the state. Information about applications, inspections, procedures, available limits or other operational details can be obtained by contacting the FAIR plan directly.

The California FAIR Plan—like most such plans—is intended to be an insurer of last resort. Property owners are usually required to make an effort to obtain coverage in the voluntary market before submitting an application to the FAIR plan.

Any person having an insurable interest in real or tangible personal property in an officially designated area who has been unable to obtain basic property insurance through normal channels from an admitted insurer or a licensed surplus line broker, is entitled to make an application for coverage to the FAIR plan. "Basic Property Insurance" as defined by the California Insurance Code includes fire, extended coverage, vandalism, and malicious mischief. (CIC 10091[c])

Coverage may not be refused because of environmental conditions (such as a deteriorated neighborhood or local brush fire hazard) which are beyond the control of the applicant. However, the property must be insurable—it must satisfy the FAIR plan's basic underwriting criteria.
A FAIR plan can change the designated areas in which it will write coverage. Changes in designated areas may only be made by the Insurance Commissioner and Department of Insurance.

Example: Following the Northridge earthquake in January 1994, insurers became reluctant to write dwelling and homeowners' coverage in California—due to a state law that earthquake coverage must be offered in connection with residential property insurance. Coverage rapidly became unavailable for many consumers. To remedy this problem, the Insurance Department expanded the FAIR Plan areas to include **all areas** statewide.

Producers do not have binding authority. However, if the premiums are returned to the FAIR Plan within 15 days of the quote, coverage is effective as of the date of the quote. If the premium is received after 15days , then the coverage is effective as of the date the premium was received. Additionally, no broker fees can be applied to any government sponsored program directly or in directly. (CIC 10093(a)

The California FAIR Plan issues policies to cover dwelling risks, commercial property risks and businessowner property risks. Different policy forms are used for each of these risks—and different maximum amounts of insurance are available for each. Here are a few of the policies:

- **Dwelling Policies**. The maximum available limit for all coverages under a dwelling policy is $1.5 million per location. This is a combined maximum amount of insurance. Separate policy limits for dwelling coverage, other structures, personal property and any endorsements that provide additional coverages cannot exceed $1.5 million in total.
- **Commercial Property Policies**. Under general underwriting guidelines, the maximum available limit for commercial buildings is $3 million per building. Separate limits apply to commercial contents and various limits ($1.5 million to $10 million) are available.
- **Businessowner Policies**. The maximum available limit for property coverages under a businessowner policy is $2 million for the building and $1 million for business personal property. These are separate limits. Businessowner policies also include liability coverages and offer optional burglary and robbery coverages.

Dwelling and commercial property policies issued by the FAIR plan are written with a standard deductible of $250 per occurrence. Higher optional deductibles (such as $500, $1,000 or $2,500) are available. The deductible applies to most of the property coverages. However, if earthquake coverage is written, a separate 10 percent deductible applies to earthquake losses.

Tips for FAIR Plan Applicants

As is usually the case, a licensed agent can help you determine the appropriate amounts of insurance and assist you in obtaining supplementary coverages which may not be available through the FAIR plan (such as theft and liability coverages).
Applications submitted to most Plans must be on a brokerage basis—which means the agent or broker is a legal representative of the applicant and not the FAIR plan.

Policy Limits

The California FAIR plan offers relatively high limits. In the Golden State, the maximum available limit for all coverages—dwelling, other structures, personal property and any endorsements—is $1.5 million per location. These policies are written with a standard deductible of $250 per occurrence. Higher optional deductibles—such as $500, $1,000 or $2,500—are available.

In California, the insured can choose from three types of coverage:

•**Actual Cash Value Coverage**. If there is a covered loss to the insured's home, the plan will pay either the depreciated value of the damaged dwelling at the time of loss or the cost of repairing or replacing the property with like construction, but only up to the policy's limit of liability. If ACV coverage applies, coverage for building code upgrades is not available.

•**Replacement Cost Coverage.** If the insured choose this option and there is a covered loss to the insured's home, the plan will pay to repair or replace the property with like construction, but only up to the policy's limit of liability. To be eligible for replacement cost coverage, the dwelling must be insured for 100 percent of its replacement cost at the time of loss. Replacement cost coverage does not apply to personal property.

•**Building Code Upgrade Coverage.** This option is available only if the replacement cost coverage option has been selected. Building code upgrade coverage—also known as ordinance or law coverage—provides up to $10,000 of coverage for the additional costs required to bring a damaged dwelling up to current building code requirements. Without this coverage, a policy would pay only the amount needed to repair or replace the damaged dwelling to restore it to the condition it was in prior to the loss, and would not cover any additional costs due to changes required by current building codes.

Under most FAIR plans, the coverage provided is the equivalent of the basic homeowners' policy. **The insured cannot purchase all-risk coverage.** The risks covered under the plan are:

- fire;
- lightning;
- internal explosion
- windstorm or hail;
- explosion;
- riot or civil commotion;
- aircraft;
- vehicles;
- smoke;
- volcanic eruption; and
- vandalism or malicious mischief.

Fire Mitigation

Wildfires in California cost insurers millions of dollars every year, therefore fire mitigation of vital importance. A wildfire is any uncontrolled fire in combustible vegetation that occurs in a wilderness area. A wildfire differs from other fires by its extensive size and speed in which it moves, often changing directions and leaping roads and fire brakes.

Wildland-urban interfaces– These are the areas of transition between unoccupied wildlands and human developments. Communities that are within ½ mile of the zone may also be included. These communities and lands are at risk from wildfires.

Topography and Fuel types – The spread of wildfires is greatly influenced by the materials present and the topography of the land, the more vertical the land the greater the fire risk. Flammable materials such as brush, small trees, grass, debris, shrubs are just but a few of fuel types that are in great abundance in the hilly areas of California.

Location and weather – Heat waves, droughts, cyclical climate changes and regional weather patterns, such as high pressure ridges increase the risk of wildfires.

Construction – Building Codes in fire-prone areas typically require that structures be built of flame-resistant material and a defensible space be maintained by clearing flammable materials within a prescribed distance from the structure.

Defensible Space – The natural and landscaped area around a structure that has been designed and maintained to reduce fire danger.   This is also known as "firescaping" This area provides access for firefighters and often reduces the risk of the fire spreading. Additionally, firefighters sometimes do not attempt to protect a structure with insufficient defensible space for their own personal safety.

Land use and planning – Communities must take all of the factors (wildland-urban interfaces, topography, fuel types, location, weather, construction/building codes and defensible space) in to account when planning and deciding on what is best for their area and the safety of the residents as population growth continues to expand to fire prone areas.