



## So You Know Property

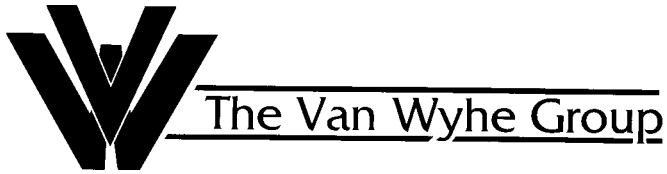
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**The Van Wyhe Group**

1-800-326-4741

PO Box 4130

Waukesha, WI 53187



## **So, You Know Property**

Written by  
**Phyllis Van Wyhe CPCU, CIC, CSP**

Illustrations by **Bob Cook**

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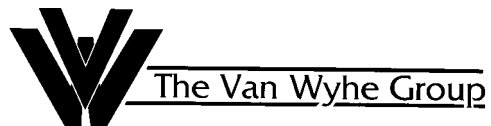
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## A Property Quiz



1. The Homeowners policy:
  - a. Does not have a vacancy clause
  - b. Has a vacancy clause, but it is never enforced
  - c. Has a vacancy clause that is activated after the building has been unoccupied for more than 60 days.
  
2. With Commercial Property policies:
  - a. There is no definition of vacancy
  - b. Coverage does not change when a building is vacant for less than six months.
  - c. ISO contracts now have a definition of vacancy
  
3. All of the following are reasons an insured might schedule computers except:
  - a. To get broader perils covered
  - b. To cover a valuation gap on a leased computer
  - c. To get mechanical breakdown coverage without a deductible
  
4. The coinsurance clause found in our commercial property policies is only activated with a partial loss.
  - a. True
  - b. False
  
5. The standard Homeowners policy:
  - a. Includes a coinsurance clause
  - b. Has an 80% requirement, but the clause is not coinsurance
  - c. Coinsurance is never a factor with this policy

## THE ANSWERS

### 1. The Homeowners policy: a. Does not have a vacancy clause

The insured moves to Topeka and his home is empty with a “For Sale” sign out front. Great Grandma agrees to go into the nursing home until she recovers, but insists she will return to her home by Christmas. The insured buys a house but will do extensive renovation before moving in. There are a variety of reasons why a home might be vacant or unoccupied. When there is no one living in the house but it is covered under a Homeowners policy, the issues are both eligibility and coverage.

Regarding the coverage issue, the Homeowners policy does not have a vacancy clause. However, that does not mean there are not problems when the house is unoccupied. The policy only applies if the building is a “residence where you reside.” When that is no longer the case, coverage ceases even though a policy appears to be in force.

Often, the agent does not even know when the dwelling is vacant or unoccupied; however, if the insured calls and asks how vacancy with impact coverage, an agent must be certain to give a correct answer. In this work, we will look at the wording in the Homeowner contract that impacts coverage when the dwelling is vacant or unoccupied.

### 2. With Commercial Property policies: c. ISO contracts now have a definition of vacancy

“Just leave some contents in it and it will not be vacant it will be unoccupied.” Have you ever extended this advice to a client? Beware! In the early 1990’s ISO added a definition of vacancy to the commercial policies. In the middle of the decade, they revised that definition. Today, an agent should never discuss the issue of vacancy with a commercial client without first checking the contract language.

This work includes a section that examines how the commercial contract responds when a building is vacant or unoccupied and discusses how an agent should address the issue.

**3. All of the following are reasons an insured might schedule computers except:**

**c. To get mechanical breakdown coverage without a deductible**

Computers are automatically covered under the personal property coverage found on both the commercial property policies and the Homeowners policy. However, there are several reasons why the insured may choose to schedule them. One reason is that additional perils that will be covered under open perils coverage of the inland marine form. This contract will cover such perils as power surge, change in temperature and mechanical breakdown. However, the coverage provided for mechanical breakdown usually has a deductible of \$1000; it is never covered without a deductible.

To find the other reasons one might want to schedule a computer, review the section of this work that addresses that issue.

**4. The coinsurance clause is only activated with a partial loss.**

**a. True**

The coinsurance clause does not come into play in the case of a total loss; it is only activated with a partial loss. The insured will have a different problem if the insured has a total loss and is only insured for 70% of the replacement cost. In this case, the insured will have to decide which 70% of the building to replace because he will run out of limits.

Coinsurance is one of the most misunderstood concepts in insurance. Because this clause should always be taken into consideration when setting limits, every agent should know the workings of the provision. In this work we look at coinsurance from two important angles. The section on facts and myths addresses misunderstandings. The following section presents a good explanation of the concept that can be used with any of your clients.

**5. The standard Homeowners policy:**

**b. Has an 80% requirement, but the clause is not coinsurance**

The standard Homeowners policy does have an 80% requirement in the valuation clause. Technically, it is not a coinsurance clause; it is an insurance-to-value

Clause but operates similar to the coinsurance clause found in our commercial contracts. Most agents writing Homeowners are not familiar with the clause because the industry has not enforced it for many years. It is sort of like an appendix someplace in your abdomen; you still have one, but you don't know what use it is.

Today, it is important to know the difference between coinsurance and insurance-to-value because ISO has added an insurance-to-value clause in the latest revision of the Businessowners Policy (BOP). Many companies have adopted this form and an agent needs to be prepared to explain it.

### **THIS WORK**

While it may be a good idea to read a property policy from beginning to end periodically, most agents simply do not have the time or the inclination. This work is designed for the agent who will never do that, but does want to review key property issues that are used on a regular basis.

## **Chapter 1: VACANCY UNDER THE HOMEOWNERS POLICY**



Unlike the commercial property forms, the ISO Homeowners policy does not contain a vacancy clause. However, when there is no one occupying or living in the home, there are three considerations.

### **Freezing Pipes**

Under the Homeowners policy, there is no coverage for damage caused by

*“Freezing of plumbing, heating, air conditioning or automatic fire protective sprinkler system or a household appliance”*

The policy goes on to state that this provision only applies

*“while the dwelling is vacant, unoccupied, or being constructed, unless you have used reasonable care to*

- 1. Maintain heat in the building; or*
- 2. Shut off the water supply and drain the system and appliances of water.”*

This condition applies to both building and personal property. It is listed as an exclusion in the open perils coverage provided for building under the Homeowner policy. With the named perils coverage on personal property, the condition is a restriction included in the named peril of Freezing.

**When You Move Out**

Another issue arises when the insured moves out of the dwelling and no longer resides there. In the coverage grant for dwelling, one finds that the policy covers only the dwelling listed in the Declarations on the “Residence Premise.” When one reads the definition of residence premises one finds it is the dwelling “where you reside.”

When the insured ceases to reside in the dwelling, the policy no longer provides any coverage for the home. This provision has been tested and upheld in the courts. It becomes a problem when Grandma has been in the nursing home so long that her house is no longer considered a residence where she resides. That threshold is definitely subject to interpretation.

**The Theft Limitations**

Under some circumstances, there is a limitation on theft of personal property when the insured is not at the premises. While not a vacancy consideration, it is a type of unoccupied exposure. The restriction is found in the description of the theft peril and excludes loss to:

*“property while at any other residence owned by, rented to, or occupied by an ‘insured,’ except while an ‘insured’ is temporarily living there.”*

Let us look at an example:

*Bob and Betty Boop have a Homeowners policy on their primary dwelling in the metropolitan Detroit area, but do not have a Unit Owners policy on their condo in St. Petersburg. They have the personal liability exposure for the condo covered by endorsement to their Homeowners policy and know that policy will cover their contents at another residence for 10% of their personal property limit. However, if their contents are stolen from their condo, they must be in St. Petersburg at the time if they expect the coverage extension from their primary policy to apply.*

## Vacancy Under The Homeowners

The theft peril also carries a limitation on the property of a student away from home.

*“Property of a student who is an ‘insured’ is covered while at a residence away from home if the student has been there at any time during the 45 days immediately before the loss.”*

The student, who goes home for the summer, leaving his computer and stereo in his dorm room, had better go back to campus and visit his possessions sometime in July if she hopes to have theft coverage.

### **The Bottom Line**

Every agent should be careful in the advice given to the client who will be away from their covered residence for an extended period of time. The couple should have someone checking on their home when they go to Europe for three months over the winter. The college student should be careful about the contents left in the fraternity house over the summer. And, when Grandma goes into the nursing home the agent should discuss the situation with the underwriter and then document that discussion.

## **Chapter 2: VACANCY: A MOVING TARGET**

*Dudley DoRight, CIC has insured Bill Bailey's Bugles for over fifteen years with few losses. Bill recently moved his operation to a new building on the south side of town. He has put the old building on the market, but there has been little interest. Dudley is concerned about the vacancy provision in the property policy, so he tells Bill, "Be certain to leave some stuff in it. Then, it's not vacant; it's unoccupied."*



Unfortunately, Dudley was not the only agent giving this advice to clients. As a result, the industry is making changes to the vacancy provisions found in the commercial forms, both the Commercial Property Policy (CPP) and the Businessowners Policy (BOP). Today, every agent writing commercial coverage should hesitate to discuss vacancy without first checking the form. In this section we review the vacancy provisions of the commercial contract and then focus on what is changing.

### **The Timing Issue**

It is all a matter of timing with the vacancy issue. If the building is vacant for thirty days, there are no real problems. The standard contract states:

*“If the building where loss or damage occurs has been vacant for more than 60 consecutive days before the loss or damage occurs...”*

If the building has been vacant for less than 60 days, coverage remains unaltered.

**Coverage When The Building Is “Vacant”**

When the building has been vacant for 60 days or more, there are two primary implications:

- There is no coverage for six possible causes of loss. It becomes easy to remember these six when one realizes they fall into two categories:

**Water-related damage:** Specifically, sprinkler leakage, unless you have taken steps to prevent freezing, and water damage.

**Bad People Perils** (The things bad people do to vacant buildings): Specifically, vandalism, theft, attempted theft, and glass breakage.

- There is coverage for any other covered causes of loss; however, any payment that would otherwise have been made is reduced by 15%. If the insured has a fire, for example, when the building had been vacant for over sixty days, the insurer will determine the amount of the covered damages and then pay 85% of that amount.

**What Is Meant By “Vacant”**

As you can see, there are some serious implications to vacancy with our commercial forms. But, when does a building become “vacant.” Our contracts have never had a definition; but that is changing.

With the 1990 revision of the commercial property forms, ISO, for the first time, added a vacancy definition:

*“A building will be considered vacant when it does not contain enough business personal property to conduct customary operations. Buildings under construction are not considered vacant.”*

## Vacancy: A Moving Target

No one is quite certain what the new definition of vacancy actually means; however, we all know it means more than “just keep some stuff in it.” Because this definition is subject to interpretation, ISO revised it when they redid the property forms in 1995. With that revision, there are two parts to the definition of vacant:

When the insured is a tenant:

*“Building means the unit or suite rented or leased to the tenant. Such building is vacant when it does not contain enough business personal property to conduct customary operations.”*

When the insured is the building owner:

*“Building means the entire building. Such building is vacant when 70% or more of its square footage is not rented or is not used to conduct customary operations.”*

As with the previous forms, a building under construction is not considered vacant.

These new provisions are indicative of the fact that ISO is trying to pin down a definition of vacancy and create one that is less subject to interpretation.

### Testing The Policy Definition

Which of the following would be considered “vacant” under ISO’s new definitions of that term?

*The insured tenant is a retail operation that has moved her store to a new mall down the street. She will be using the old location for storage until the lease runs out but she has not notified their insurance carrier of the change in occupancy.*

Is this building vacant?

Is it used to conduct customary operations?

I do not have an answer, but I am concerned.

## Vacancy: A Moving Target

*The ground floor of a four-story building has been rented out as a religious bookstore and the top three floors are leased to a large, prestigious law firm. In April, the bookstore moved to another location and the landlord rented the store to an adult toy store. The law firm, slightly upset, moved their offices to a new location in June, even though their lease runs until the end of the year. The three upper floors will set empty until the end of the year unless the law firm can sublet them.*

Is that building vacant on July 1?

I don't think so. As long as the attorneys are still paying rent, vacancy is not an issue. Look again at the wording of the definition of vacancy.

If the lease runs out on January 1 of the following year and the building is still setting empty, is the building vacant?

It probably is, if the policy is written using the 1995 forms; after 60 days that would become a problem.

Does the insured consider it vacant?

Does the agent consider it vacant?

### **The Vacancy Permit**

With the ISO forms, the vacancy restrictions just discussed can be removed for an additional premium by adding the Vacancy Permit Endorsement (CP 04 50).

Ordinarily, underwriters are hesitant to use this endorsement and will carefully underwrite the circumstances surrounding the vacancy with particular emphasis on the protection of the property during the time it sets empty.

### **The Bottom Line**

The courts have not yet interpreted this new language in our property forms; until they do, we will not really know what "vacancy" is. Another difficulty for agents comes from the fact that two property policies can differ significantly in how they handle the issue:

- The 1995 ISO form is different from the 1990 form.

## Vacancy: A Moving Target

- Some independently developed property policies do not provide any protection after 60 days of vacancy.
- The AAIS Building and Personal Property Policy has limitations that apply when the building is “vacant or unoccupied” for more than 60 consecutive days.

Today, a prudent agent would not discuss the issue of vacancy without first reviewing the particular contract in force on the risk.

## Chapter 3: SCHEDULING COMPUTERS

There is automatically coverage for computer equipment under all of our standard property policies, both personal and commercial. The definition of covered personal property under these policies is broad enough to encompass all types of electronic apparatus. Some of the direct writers (State Farm, for example) state they have \$5000 coverage on computers, but that is a limitation, not a coverage grant. The standard industry contracts do not have such a limitation.



The ISO Homeowners policy has two limitations on adaptable electronic apparatus, for example, a laptop, but does not limit the coverage for desktop computers.

If coverage for computer equipment is provided automatically, why would anyone want to schedule it? There are a number of possible reasons, including the following:

- **Perils Insured Against**

When computers are scheduled, the perils insured against are usually be broader. The Homeowners policy usually provides contents coverage on a broad form cause of loss basis; the commercial forms usually provide special cause of loss. If you schedule computer equipment on a policy that provides the open perils of inland marine you may pick up coverage for such things as mechanical breakdown, power surge, and change in temperature. These perils would not be covered under the personal property coverage provided by either the broad form perils or special cause of loss found on our standard contracts.

## Scheduling Computers

When reviewing the additional perils covered under the inland marine form be aware that mechanical breakdown is sometimes offered as an option rather than an automatic inclusion; and, when it is included the deductible is usually \$1000.

- **The Valuation Clause**

How much are you going to get for the computer at the time of a total loss? Most of our property policies are written on a replacement cost basis. For electronic equipment, this is usually less than the original purchase price because of rapid technological advances. This can cause a problem if the insured has leased the equipment or purchased it on an installment basis. Those agreements often hold the lessee responsible for a set dollar figure with the figure gradually going down on a straight line basis. In that case, the lessee may owe more than the current replacement cost of the equipment at the time of loss. Whenever valuation is a problem under our standard contracts, think inland marine.

- **Data**

Is the coverage under our standard contracts broad enough to cover the possible loss of data if the equipment is destroyed or stolen. The Homeowners policy sets a limit of \$1500 on personal records but provides no coverage for business data. There is also a limitation on lost data on the commercial property forms. If this is a significant exposure, scheduling the equipment and purchasing coverage for data may be called for. And, while you are checking the coverage for direct damage to lost data, also consider the indirect loss. Will the business be shut down if their data is destroyed? Is there coverage for that under the standard contract? Is the coverage broad enough?

- **The Premises Issue**

Our commercial policies are premises policies; personal property is covered only while it is on the premises. If the computer equipment of the insured ever leaves the premises, scheduling the equipment is the solution.

## Scheduling Computers

- **The Deductible**

Perhaps the commercial property policy has a \$1000 deductible. Maybe the Homeowners policy has a \$500 deductible. If the insured does not want the computer to have that deductible, inland marine is the answer.

### **The Bottom Line**

Should computer equipment be scheduled? The first step is to evaluate the coverage automatically provided under your property policy. Is it broad enough to properly insure the client's exposure? When the answer is "no," one must determine if the exposures can be covered by scheduling the equipment. Usually the answer is "yes."

## Chapter 4: COINSURANCE, AN EXPLANATION



Do your clients understand coinsurance?

Have you developed an explanation that makes it easier for them?

Have you ever started explaining the concept and ending up confusing the issue more than clarifying it? Relax; you are not alone.

Coinsurance is one of the most misunderstood concepts in modern insurance. Even those insurance professionals who understand the coinsurance clause and how it works, may do a mediocre job of explaining it to the insured. Often, our explanations attempt to give the insured too much information. Frequently, we fail to focus only on those aspects of coinsurance that are important to the policyholder.

There is a great deal you know about coinsurance that the client does not need to know; it will only confuse them. The key to explaining coinsurance to a client or prospect is to keep it simple and only give them what they absolutely need.

### **A Simplified Explanation**

Try this explanation:

*“In exchange for lower rates, you agree to be insured for at least \_\_\_ of the \_\_\_ at the time of loss. If you are not, you become a coinsurer and share in any partial loss. There is a formula in the policy that tells you your share. We in the industry call that formula ‘Did over Should’.”*

## Coinsurance: An Explanation

When explaining any aspect of insurance to the insured, it is a good idea to lead with the benefit. The primary way the insured will benefit from coinsurance is lower rates. Coverage can probably be obtained without a coinsurance clause; but, the rate will be significantly higher.

You have, no doubt, heard the theoretical justification for coinsurance. It tells us how unfair the rates would be for some people if we did not have coinsurance and the policyholder were free to select any insurance amount. Believe me, your insured does not care about rate equity. Lead with a benefit and make it a benefit they can appreciate. And, you may want to dwell on the benefit a bit. Later when they complain about some of the implications of coinsurance, you may need to come back to it.

### The Promise

*“you agree to be insured for at least \_\_\_ of the \_\_\_\_\_, at the time of loss”*

By accepting a coinsurance contract, the insured is making a promise that will be tested at the time of loss. The exact parameters of that promise vary, depending on the specific contract. In the first blank in the explanation, fill in the coinsurance percentage from the insured’s contract (usually 80%, 90% or 100%). The second blank should show the valuation clause of the contract (usually either ACV or Replacement Cost).

Be certain to stress the fact that this promise will be tested at the time of claim. Oftentimes, it is a good idea to add a cushion in case the value estimates used in setting limits were incorrect. In addition, the value of the property could increase during the policy period, creating insufficient limits at the time of claim.

### Breaking The Promise

*“If you are not, you become a coinsurer and share in any partial loss. There is a formula in the policy that tells you your share. We in the industry call that formula ‘Did over Should’.”*

## Coinsurance: An Explanation

What happens if the insured's limit is not adequate to meet the coinsurance requirements at the time of claim? Simple. The insured will become a coinsurer; that is where the name Coinsurance came from.

Every insurance professional is familiar with the "did-over-should" provision in the coinsurance clause. Often, when you ask an agent to explain coinsurance, he or she simply says "did over should," and then picks up a pencil and begins doing the math. I would suggest you forget the math with most of your clients and keep your explanation simple.

*"There is a formula in the policy that tells us your share. We in the industry call that formula 'did over should'. It simply means that if, at the time of loss, you are only carrying half the amount of insurance you should be carrying, and you have a \$10,000 loss, we are only going to pay you one half of your loss."*

If the insured becomes upset with these ramifications of coinsurance, remind them of the benefit of the provision – lower rates.

### **The Rest Of The Story**

The insured, who has followed this explanation, will probably now say "Then, I should be insuring for 80%." Unfortunately, many agents will agree. At this point, I would say:

*"Is there a possibility you could have a total loss? If you have a total loss and you are only insured for 80% of the value, you will have to decide which 80% of the building you are going to replace."*

Many agents overlook the possibility that there can be a total loss. Always give the insured the opportunity to insure to value; if they choose not to, document your file with a signature.

### **The Bottom Line:**

Today, many agents are looking for ways to add value to the insurance transaction. One of the best opportunities to do that is by clarifying, and sometimes justifying, the insurance product and how it works. To accomplish that, an agent needs a strong, working knowledge of the subject.

## Chapter 5: COINSURANCE: FACTS OR MYTHS



*Fact or Myth #1: The coinsurance clause does not come into play on a total loss.*

*Fact or Myth #2: The coinsurance clause has no impact when the insurance carried is the amount required.*

*Fact or Myth #3: The Homeowners policy contains a coinsurance clause.*

*Fact or Myth #4: The Businessowners Policy (BOP) contains a coinsurance clause.*

Coinsurance is one of the most misunderstood insurance concepts and is shrouded in myths. Let's look at each of the four items listed above and see if it is fact or fiction.

### **#1: The coinsurance clause does not come into play on a total loss.**

This one is fact. Coinsurance is never a concern on a total loss. The problems that often surfaces with a total loss is inadequate limits, not a coinsurance penalty. Let's look at an example.

RC of Building	\$100,000
Policy Limit	\$ 40,000
80% Coinsurance basis	
Total Loss	\$100,000

Did/Should x Amount of loss = Recovery

$$\$40,000/80,000 \times \$100,000 = \$50,000$$

## Coinsurance: Facts or Myths

According to the Did-over-Should formula, the insured should be eligible to collect \$50,000 on this claim. However, we will never pay more than the policy limit; so, the insured collects no more than \$40,000. There has not been a coinsurance penalty, but the insured still comes up short.

**Rule of Thumb:** If you have an 80% coinsurance clause on your policy, the clause has no effect when the loss equals or exceeds 80% of the actual value of the policy.

If you have a 90% clause, coinsurance has no impact when the loss exceeds 90% of the value. In each of these cases, the insurance pays the entire loss, up to the policy limit. When you reach 80% of the loss (on an 80% policy) coinsurance is no longer a consideration; there will not be a coinsurance penalty. However, the limit may not be enough to pay the entire damage to the damaged property.

**#2: The coinsurance clause has no impact when the insurance carried is the amount required.**

This one is fact. It is only when (on an 80% coinsurance contract) both the insurance limit and the loss fall below 80% of the value. In that case, the insured becomes a coinsurer.

RC of Building	\$100,000
Policy Limit	\$ 90,000
80% Coinsurance basis	
Total Loss	\$100,000

Did/Should x Amount of loss = Recovery

$$\$90,000/80,000 \times \$100,000 = \$112,500$$

In this case, both the insurance limit and the loss fall above 80% of the value. The coinsurance clause has no impact; the insured will collect the policy limit of

## Coinsurance: Facts or Myths

\$90,000. The problem here is not coinsurance; it is inadequate limit. The insured will recover less than the loss sustained simply because he/she ran out of limits.

In the first example we saw a situation where the insurance limit was less than 80%, but the loss was more than 80%. And, we said coinsurance did not have an impact. Now we have seen that if both the limit and the loss are over 80%, coinsurance has not impact.

Let us finally look at a situation where both the insurance limit and the loss fall below 80%.

RC of Building	\$100,000
Policy Limit	\$ 40,000
80% Coinsurance basis	
Total Loss	\$ 40,000

Did/Should x Amount of loss = Recovery

$$\$40,000/80,000 \times \$40,000 = \$20,000$$

In this case, the limit of insurance would be enough to cover the damages but the insured has not kept the coinsurance promise and becomes a coinsurer. The insured cannot access all of the limit he has purchased because of the coinsurance clause.

**Rule of Thumb:** The coinsurance clause only comes into play when both the insurance limit and the loss fall below 80% (assuming an 80% contract).

### **#3: The Homeowners policy contains a coinsurance clause.**

This statement is not accurate. The Homeowners policy, strictly speaking, does not contain a coinsurance clause; but it does have an Insurance To Value (ITV) clause, which is very similar. With both provisions, the insured is required to insure for 80% of the replacement cost in order to

collect the full replacement cost amount of a partial loss. (For more details on the difference, see the next section *Coinsurance versus Insurance To Value.*)

Although the HO policy contains the ITV clause, from a practical standpoint, it has little impact because most carriers do not enforce it. The industry decided years ago that penalizing a homeowner at the time of a partial loss would be disastrous public relations.

One should remember that the ITV clause in the HO policy applies to building but not to personal property. There is no incentive to insure the contents of the home to value and no penalty if one does not.

#### **#4: The Businessowners Policy (BOP) contains a coinsurance clause.**

The answer to this one is yes and no. Traditionally, the BOP has not had a Coinsurance or Insurance To Value (ITV) clause. There have been no penalties if the insured is not insured to value at the time of the loss.

The standard BOP contract was changed with the 1997 revision of the ISO form. The most significant change, with that revision, was the addition of an Insurance to Value clause that applies to both building and personal property.

Many agents do not appear to be concerned about the addition of this clause to the BOP. They contend that it is the same clause that has been on the Homeowners policy for decades and it does not appear to be a problem on that policy. That complacency may be dangerous. Although the industry has does not uniformly enforce the clause on the Homeowners policy, do not think they will hesitate, for a minute, to activate it on a commercial policy.

With the marketplace as competitive as it has been over the past decade, many companies that are adopting the 1997 revision of the BOP are currently waiving the Insurance to Value Clause. If the market hardens, you can expect that to change.

## **Chapter 6: COINSURANCE Versus INSURANCE TO VALUE (ITV)**



Many of our property policies include an incentive to insure to value. With the policies covering direct loss we find either a Coinsurance clause or an Insurance-to-Value provision. Business Income coverage includes a

Coinsurance provision and in the Extra Expense form there is a monthly limitation. All these provisions are included to encourage the insured to insure the exposure to value.

Insuring to value is important because the rates are based on it. The actuary, in promulgating the rates, has statistics on property values in the area as well as industry-wide loss costs for filed claims. He/she then makes an assumption about insurance to value and sets the rate. If the insurance amount carried is close to the value of the property, the rate per \$100 is less. You know this is true because the rate for a 90% coinsurance contract is less than the same contract written on an 80% basis.

This article will contrast the two incentives to insure to value used with direct property coverages, the Coinsurance clause and the Insurance-to-Value provision.

### **How Coinsurance Works At The Time Of Loss**

When accepting a policy containing a coinsurance clause, the insured is promising he will be insured for a specified percentage of value, at the time of loss. For example, he may be promising to be insured for 80 of the replacement cost, or 90% of the ACV, at the time of loss. When such a provision is included in the

## Coinsurance vs. ITV

property contract, one of the first tasks of the claims adjuster, at the time of loss, is to determine if the insured has kept that promise.

The coinsurance clause only comes into play on a partial loss; so, if the property has been totaled, or nearly totaled, the coinsurance provision will not impact the claims settlement. When the insured's property has sustained a partial loss and the values are not adequate to cover the coinsurance promise, the insured will share in the loss. In this situation, when the coverage has been written on a replacement cost basis, the policy gives the insured two options:

- **Collect on a Replacement Cost basis and have the amount of the loss settlement reduced by a coinsurance penalty.** The did-over-should formula in the policy will determine how much the settlement will be reduced.
- **Collect on an Actual Cash Value (ACV) basis and have the amount of the loss settlement reduced by a coinsurance penalty.** The insured has the right to accept payment on an ACV basis, but a potential coinsurance penalty still looms. The did over should formula is applied to the ACV. However, there are times when an ACV settlement with a penalty will be greater than a Replacement Cost settlement with a penalty.

### How The Insurance-To-Value Provisions Works

The Homeowners policy does not contain a Coinsurance clause; it has an Insurance-to-Value provision. The two are similar but differ in the options that are available to the insured at the time of partial loss when the property is underinsured.

We have seen the two options available to the insured with the Coinsurance clause. With the Insurance-to-Value provision, the insured can

- **Collect on a Replacement Cost basis and have the amount of the loss settlement reduced by a coinsurance penalty.** The did-over-

should formula in the policy will determine how much the settlement will be reduced.

- **Collect on an Actual Cash Value (ACV) basis.** With this provision, when the insured elects an ACV settlement, there is no possibility of a penalty. The insured will collect the full ACV of the property.

The Insurance-to-Value provision definitely has an advantage over the Coinsurance clause. The advantage accrues at the time of claim, if the limits of the policy are not what they should be. From a practical standpoint, the Insurance to Value provision is seldom activated on a Homeowners policy at the time of claim, probably because of the disastrous public relations potential it carries.

### **The Bottom Line**

While the distinction between these two provisions may be fascinating to the student of insurance, the average agent will seldom need the knowledge. One certainly would not want to burden clients with this tortured explanation; they do not care.

Some agents totally ignore the Insurance to Value clause on the Homeowners policy. Since the industry seldom enforces the provision, this approach has some justification.

Many agents treat the Homeowners policy as if the Insurance-to-Value clause were actually a Coinsurance provision. That is not far from the truth. If something looks like a duck, walks like a duck, and quacks like a duck, you have my permission to refer to it as a duck.

## Chapter 7: THE BOTTOM LINE

Any agent concerned about E&O exposures must be concerned from two perspectives:

- **Proactive Exposures**

Proactive exposures are created when the agent takes the initiative in providing service to a client. Perhaps the agent does a periodic review of the insured's coverage, discussing issues and making recommendations. When the agent takes a proactive position, the information shared with the client must be complete and accurate.

- **Reactive Exposures**

Reactive exposures exist automatically when the client or prospect asks a question or requests an explanation of coverage. Often the agent feels compelled to provide an answer on the spot; the more prudent agent will verify the coverage before responding.

In the area of property coverage, as in most other areas, an agent faces both proactive and reactive exposures. Those exposures are becoming more complex as property coverages are revised. Every agent should periodically review those issues that are used most often when dealing with property clients.

## EXAMINATION: So You Know Property

1. When a commercial building is “vacant”
  - a. There is no coverage.
  - b. Any loss payment will be reduced by 15%.
  - c. There is no coverage for water damage, sprinkler leakage, and vandalism.
  - d. There is no coverage for fire and wind damage.
  
2. All of the following are reasons an insured might schedule computers except:
  - a. To get broader perils covered.
  - b. To cover a valuation gap on a leased computer.
  - c. To get broader coverage for data.
  - d. To get mechanical breakdown coverage without a deductible.
  
3. A Homeowners policy:
  - a. Contains an Insurance To Value clause, but it is rarely enforced.
  - b. Does not contain any type of coinsurance or Insurance To Value clause.
  - c. Contains a coinsurance clause, and it is enforced on most partial losses.
  - d. Contains a coinsurance clause, but it is rarely enforced.
  
4. A Vacancy Permit on a commercial building:
  - a. Can usually be obtained at no charge.
  - b. Is carefully underwritten.
  - c. Is automatic if the building has been insured by the same company for five years.
  - d. Has been withdrawn by ISO and is no longer used by the industry.
  
5. Under the Personal Property coverage on the Homeowners policy:
  - a. There is no coverage for Personal Property off the premises.
  - b. Theft from a dorm room is covered only if the student was in the room at the time of the theft.
  - c. There is no coverage for theft from a dorm room.
  - d. Theft from a dorm room is covered only if the student has been there within the last 45 days.
  
6. All of the following are true about coinsurance except:
  - a. The coinsurance clause does not come into play with a total loss.
  - b. The Homeowners policy contains a coinsurance clause.
  - c. The Homeowners policy contains an Insurance to Value clause.
  - d. Historically, the BOP has not contained a coinsurance clause.

## **EXAMINATION ANSWERS**

1. c

2. d

3. a

4. b

5. d

6. b