Credit Guard Mania and Loss Control

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Whether the forgeries should have been caught before they went through is not the issue.

Nothing short of closing my checking account could have prevented this outrage, unless you consider I should have locked up my cancelled checks in the first place. I hadn't thought about that.

I shall spare you the agonizing details of what I went through to clear my credit and my good name. It was infuriating that I had to get "me" back from the imposter(s) and the thieves who procured my checking account information.

As an attorney, I am comfortable advocating for myself and navigating the various agencies including the Police Department, State Department of Motor Vehicles, Social Security Administration, and others, which must cooperate to facilitate the resolution of identity theft. I was unintimidated by bureaucratic red tape and I prevailed. It took three months to get a new driver's license and write checks at establishments that subscribe to Tele-Check. Three fraudulent checks with my identifying information were passed, but no fraudulent credit card charges, loans, or crimes were effected in my name. I consider myself lucky.

Like most identity fraud victims, I am not certain how my personal information was stolen, but I have a theory. The thieves did not get my driver's license or credit cards or blank checks. They got my personal identifying information from my cancelled checks and printed their own with my identifying information. I was immediately aware that something was awry, but I didn't go far enough to prevent it.

Remember the Independence Day burglary? The burglars either got into my filing cabinet or they stole the mail out of my USPS approved mailbox and lifted my personal identifying information from my checking account statement. Neither the filing cabinet nor the mailbox was locked.

The filing cabinet held paid medical bills and general correspondence. I thought locking up blank checks was sufficient. Who would want my paid medical bills and cancelled checks, anyway? Identity thieves want your personal identifying information too. It can happen to you.

Little did I know that there had been a rash of identity theft on the Garden Highway. I should have closed my checking account. Had I known then what I know now, I absolutely would have closed the account.

Credit monitoring and insurance are critical components of personal finance risk management. However, prudence and prompt action reduces the risk and minimizes the consequences of identity theft. Preventing the harm in the first place is the least expensive way to treat the risk of identity theft. Insurance purchasing decisions should be made in consideration of a well-thought-out loss prevention plan and a commitment to implement and monitor. ■

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Personally Speaking

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Volume 6 Number 4 December 2004

Chairman's Corner: We're On a Roll

by Dale M. Halon, CPCU, CIC

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

Circle of Excellence Recognition Program

It must have been the Los Angeles weather that was so inspirational for the Personal Lines Section Committee at the Annual Meeting and Seminars. Together, we not only pulled off two informative and well-attended seminars (see the related article inside), but had the most productive section planning meeting of which I've ever been a part. I'm continuously energized by my friends and colleagues.

Let me give you the highlights of what Personal Lines Section members can expect in the months to come as a result of the meeting:

- We're hoping to present three seminars at next year's Annual Meeting. Topics under consideration include senior driving, information privacy, and the use of information for underwriting to deter fraud. If anyone has any ideas or would like to help put one of these on in Atlanta, please let me know.
- We've initiated a section member benefit called, "Ask the Expert." This initiative will make personal lines experts available to all section members when wanting to know the answer to an insurance-related question. Look for a separate e-mail regarding this feature.
- Seminars on the Road—Better than the circus. We are going to offer the seminar content from this past Annual Meeting to CPCU Society local chapters. If anyone is interested in making this opportunity available to your chapter (yes, you can make chapter money on this and win precious Circle of Excellence points for your chapter), please let me know.
- Our section was awarded the Gold level in the Section Circle of Excellence Recognition Program. This is in recognition of the hard work, not only of the leadership committee, but by ***all*** section members . . . ***this means you!*** To keep us on a roll, please be sure to advise Robin K. Olson, CPCU, of any education you advance or other promotion of the CPCU message to the community at large. In a future edition of *Personally Speaking*, we'll publish the structure of the Circle of Excellence Recognition Program and list some examples. Please help ensure that we strike gold again in 2005!
- We need a few good CPCUs—My term as chairman expires at the 2005 Annual Meeting and Seminars. That means you won't have to read my silly little articles any more. We're extremely lucky to have good successors and many other possible leaders in the leadership committee. However, even though we have been blessed with new and excited individuals to replace people who either change jobs or further themselves in other CPCU Society leadership roles, we'd always welcome any other section member who would like to sign up for national service. Trust me, you will find it a rewarding experience.

I hope you can feel my excitement for the upcoming year. We look to continue to find ways to make the membership to the Personal Lines Section of value. As always, please feel free to contact me directly at (614) 895-8806 or dale.halon@choicepoint.com with feedback, ideas, suggestions, or good actuarial jokes. ■

Personal Lines Section Presents Two Seminars at the Annual Meeting in Los Angeles

By Daniel L. Blodgett, CPCU, AIM

Daniel L. Blodgett, CPCU, ARM, is an auto business analyst in the Systems Department of State Farm's Home Office in Bloomington, IL, where his specialty is personal lines auto insurance and related systems technology. He is originally from Michigan, where he was a personal lines auto underwriter and a supervisor in the State Farm Payment Plan. Blodgett is currently an active member of the CPCU Society's Central Illinois Chapter and is currently on its Board of Directors. Previously, he was a member and former president and vice president of the CPCU Society's Southwest Michigan Chapter. Blodgett received his CPCU designation in 1995.

Editor's Note: The following is a summary of two panel presentations entitled, "Insurance to Value—Perspective After the Loss" and "Insurance to Value—Getting It Right Before the Loss" at the CPCU Society's 2004 Annual Meeting and Seminars in Los Angeles, CA, October 26, 2004. Both seminars were developed by the Personal Lines Section.

Insurance to value—is there a more sensitive topic in our industry lately? It's a crisis in states such as California with recent wildfires and in Florida with hurricanes, and remains a nationwide concern. Our Personal Lines Section committee chairman **Dale M. Halon, CPCU, CIC,** moderated the seminars, which were both well-attended by insurance professionals during the Annual Meeting in Los Angeles. Let's set the stage and look at an example of what happens if your home is not adequately covered:

> Your home is insured for $300,000 under coverage "A" (dwelling), which was derived using a square footage valuation tool. In other words, your 2,000 square foot home was valued at $150 per square foot. Now let's introduce the loss—a catastrophic loss such as a hurricane, for instance. The price of lumber goes up, the availability of contractors goes down, and you are forced to deal with rebuilding costs that are up to $250 per square foot. Not only that, but you finished your basement or added a room so your house is actually **2,350** square feet now. At $250 per square foot, it will cost you **$528,750** to rebuild your home. Your coverage "A" cap is limited to 125 percent of your coverage, so you will receive a policy payment of $375,000. This leaves you with a coverage shortfall of **$153,750** ($528,750 – $375,000) and how many of us have that kind of money in our rainy day fund?

To make our summary personal to you, take the following survey. This same survey was given to participants in the first seminar in Los Angeles and their voluntary results were reviewed in the second workshop:

Insurance to Value Survey

1. How often do you speak with your agent/company about your coverage?

   Semiannually:
   Yes ____ No ____

   Annually:
   Yes ____ No ____

   Never:
   Yes ____ No ____

2. Have you enhanced the value of your home over the past 12 months (i.e. added deck, kitchen, bath)?

   Yes ____ No ____

3. Do you have guaranteed replacement cost (dwelling)?

   Yes ____ No ____

   Is it capped?
   Yes ____ No ____

4. Who is responsible for maintaining proper coverage on your home?

   Agent:
   Yes ____ No ____

   Insured:
   Yes ____ No ____

   Both:
   Yes ____ No ____

5. In the event of a total loss, would you have adequate coverage to rebuild your home?

   Yes ____ No ____

6. Would you mail in a dwelling questionnaire if your company requested?

   Yes ____ No ____

7. Are you insured by a company ranked in the top 15 based on premium volume?

   Yes ____ No ____

Here are the highlights of our voluntary responses:

- How often do you speak with your agent/company about your coverage? 50 percent said never
- Have you enhanced the value of your home over the past 12 months? 37 percent said yes
- Do you have guaranteed replacement cost? Is it capped? 21 percent said no to both
- Who is responsible for maintaining proper coverage on your home? 32 percent answered the insured is responsible
- In the event of a total loss, would you have adequate coverage to rebuild your home? 87 percent said yes
- Would you mail in a dwelling questionnaire? 21 percent said no
- Are you insured by a company ranked in the top 15? 68 percent said yes

So why are we in this crisis? During the seminar, "Insurance to Value—Perspective After the Loss," panelist and fellow Personal Lines Section Committee member Kent W. Schaum, CPCU, COO, of Mass-Tel Communications, Inc., explained several aspects from the claims adjuster's perspective. In the past, catastrophe frequency and the subsequent financial impact were lower. Recently, he has seen an increase of home construction in high-risk areas as well as the cyclical increase in catastrophic weather patterns. Also, we have done such a good job fighting small fires that Mother Nature has not been allowed to "cleanse" forests of highly combustible undergrowth. Therefore when a wild fire does occur, there is more fuel available to spur the devastating impact.

There have been coverage changes since the Williamsburg replication—meaning to replicate your property to pre-loss values no matter what the cost. Replacement cost coverage was introduced as well as a percentage-based deductible based on your coverage "A" limit.

So who determined the coverage limit? The carrier? The producer?

"Insurance to Value—Perspective After the Loss" panelists: Dave Diehl, Stephen J. Erigero, J.D., and Kent W. Schaum, CPCU

Per Schaum, there are other cost factors to consider after a catastrophic loss:

- Local contractors cannot meet the needs of the community for rebuilding.
- Additional living expenses (ALE) are higher as you may need to relocate to a hotel two hours away from where you used to live.

This weighs into family obligations such as getting your children to school, going to work, etc.

Negotiating the adjustment process is tricky. Contractors use different estimating systems than claim representatives, not to mention the original valuation tools used to set the value of the home when coverage was written. Another issue to consider—if the insured decides to purchase a replacement home, rather than rebuild, is he or she entitled to the replacement price allotment?

Panelist Stephen J. Erigero, J.D., a partner with the Los Angeles-based law firm RMKB (Ropers, Majeski, Kohn, Bentley, LLP), provided the audience with a fresh legal view. The southern California wildfires occurred approximately a year ago. Complaints against insurers must be filed within one year of a loss, so guess who had a really busy week leading up to our Personal Lines Section-sponsored seminar? Erigero had several copies in hand of the hundreds of newly filed complaints. He briefly read from them to give us the flavor of their tone. Obviously, he protected the personal information on the statements from the participants. In summary, complaints filed accused insurers and producers of breaching their contracts and not providing adequate coverage.

Agents and insurers have duties. We should all be familiar with negligence standards and fiduciary responsibilities. Many complaints say their policy or agent promised ". . . replacement cost coverage . . ." or to ". . . provide to replace all business and personal property . . ." yet coverage caps prevent this. The key is that agents and brokers can inadvertently hold themselves out as experts in a field of coverage by advertising replacement cost. Brokers may yet be held to a higher standard of duty since they typically advertise to place business with the best coverage available. To defend themselves, a broker would have to show that he or she did this at the time the coverage was written. Insurance companies with exclusive agents have a greater liability stemming from their agents' negligence.

What part does the policyholder play? Erigero says policyholders purchase products based on cost. When premiums are increased they tend to shop around for

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Personal Lines Section Presents Two Seminars at the Annual Meeting in Los Angeles

Continued from page 3

a better deal. In his opinion, policyholders view their property value based on their insurance limit rather than vice/versa.

Panelist Dave Diehl, deputy commissioner for California's Rate Regulation Branch, is a member of Commissioner Garamendi's Executive Staff. He rounded off the first workshop by emphatically stating it is not an "us versus them" situation, in which "us" are consumers and "them" are insurers. Diehl says consumers should know the replacement cost of their property but this is not realistic. It's important to keep communication lines open with the agent, insurer, and consumer. They should not be adversaries in this situation.

The California Insurance Department sees consumer confusion in terminology such as "guaranteed replacement cost," "extended replacement cost," and "limited replacement cost." Another concern for the CA DOI is that additional living expenses (ALE) run out after 12 months and homes are not being rebuilt in this timeframe. It takes up to six months alone to get the building permit in some situations.

He says that if the insurance industry does not apply the time and resources to resolve this issue, then the elected representatives will be forced to enact legislation to do so. Regulators understand the supply/demand curve and that labor and construction costs soar when a catastrophe occurs; however regulatory bodies say the industry must provide options for consumers.

Diehl says that when bad things happen, we try to look for others to blame. When you underinsure coverage "A," the rest of the property is underinsured too. He implores the industry to be proactive versus reactive. How about a basic cost calculator on the insurer's web site? A policyholder could enter values of their home and property to see if they are adequately covered. If not, call your agent.

The second program was called "Insurance to Value—Getting It Right Before the Loss." So why are we in this mess in the first place? Halon posed the question and kicked things off by discussing several issues: the challenges in establishing property values, replacement cost capping, and retention of business at renewal time. Prior to a loss, what causes underinsurance? Is it the fact that consumers want cheaper premiums or to coinsure? How about ineffective or incomplete valuation tools? Agents and brokers have tremendous competitive pressure to write business. Lastly, is there a lack of sound underwriting by carriers?

Panelist Larry Wellstein of Marshall & Swift/Boeckh (MS/B), which is a supplier of property valuation tools, explained that a sample of more than 6,000,000 homes showed that in 2004, 61 percent were underinsured by an average of 25 percent. He discussed two methods of determining property value: model and component. The model method estimates replacement cost based on static, assumptive costs while the component method estimates replacement cost based on individual home characteristics.

The model method uses the same factors regardless of local building codes, climate conditions, local styles and customs, and overall square footage. The component method adjusts for geographic building conditions, dwelling age, local climate conditions, styles and customs, overall square footage, and the user can further refine components based on the exterior and interior.

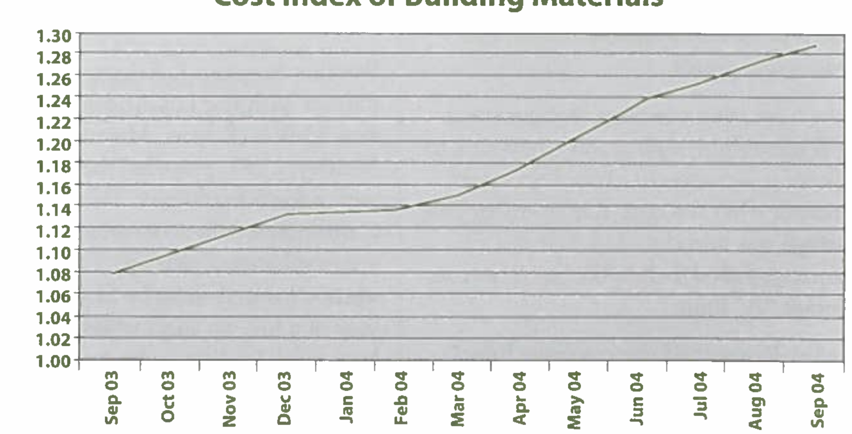
Wellstein also discussed why new construction cost is lower than rebuilding. First there is more skilled labor available, it's more efficient to build new with "top-down" construction, the builder has better access to the worksite, and you don't have demolition, debris removal, and other fees.

Cost of construction material has gone up per his statistics. (See Figure 1.)

Panelist Pamela Radsch, vice president and manager of the Los Angeles office of PLI Brokerage, Inc., gave the audience an agent's perspective. She sees her role to be an advisor, a personal shopper, and an advocate/intermediary for the customer. Securing the sale while insuring to value can be done by applying what she calls the five A's:

- **Appropriate** fact finding
- **Application** of the proper valuation techniques supported by knowledge of the industry and region-specific issues
- **Advice** that is right on point
- **Advocacy** between all
- **Avoidance** of errors and omissions

Figure 1
Cost Index of Building Materials



As advisors, agents have the duty to uncover all the facts of the property being insured while discussing replacement cost and personal risk management. Knowing your markets and carriers is a key element as a producer. The transfer of risk, use of caps, and getting the right product for the property builds the right kind of relationship with clients. Where the "rubber meets the road," in Radsch's view, is being the advocate for the client. Education of replacement value, annual review of risk, and when to contact her is given priority during counseling clients.

How complicated is the southern California home valuation? Just look at the value per square foot she provided from actual policies through her brokerage. (See Table 1.)

Ranges from $97 to $181 make it difficult to be accurate while writing business.

Final panelist Manuel Rios, vice president of underwriting and marketing for Homesite Insurance Group, reviewed the results of the insurance to value survey given during the first ITV program. From the underwriting perspective, he says it is a primary responsibility of the underwriter to develop proper valuation for the insured.

Insuring homes to value is difficult from an underwriting view as technology is excellent but not exact. Auto insurance seems to be the primary focus of many insurers due to competitive pressures so homeowner insurance products are lacking. Also, homes are upgraded and remodeled over time while an auto depreciates normally. Add to this the fact that underwriting may have inaccurate

■ *"Insurance to Value—Getting It Right Before the Loss" panelists: Manuel Rios, Pamela Radsch, Larry Wellstein, and Dale M. Halon, CPCU, CIC*

dwelling information at policy inception and you have the critical ITV situation you see today.

Rios discussed replacement cost capping in that it has been used to reduce overall exposure to catastrophic losses. Also, guaranteed replacement cost had several flaws including the fact that homes are upgraded over time and valuation methods can be manipulated. Underwriting has renewal valuation processes, but they are not a complete solution as surveys show 5 percent of homes will receive upgrades each year while consumers are not encouraged, nor motivated, to report additions or enhancements to their property.

Conclusion

Catastrophic claim frequency and severity are on the rise while consumers continue to build homes in high-risk areas. Mother Nature continues her threat to property, which keeps insurance to value such a sensitive topic. Just ask any of the thousands of families who find themselves in this predicament. Some underinsured clients are filing complaints or even suing producers and carriers alike with no end in sight. No one is 100 percent to blame—not customers, carriers, producers, nor regulators. Customers must be educated at point of sale of the critical importance of proper dwelling coverage. Rigorous focus is needed by carriers on obtaining dwelling updates while companies dealing in valuation tools must upgrade and deploy new technology.

Home rebuilding is subject to economics of the supply and demand curve for labor and construction costs. However, as an industry we should take the lead in developing a resolution. This most likely means applying time and resources to the problem and finding better ways to estimate value of the insured property at policy inception and subsequent renewals. We need to develop programs that properly insure our clients' homes to value; if not, our elected officials may enact new legislation dealing with the state of affairs. But let's not fix this problem to avoid legislation; let's fix this for the betterment of society. Our policyholders, family, friends, neighbors, and even you and I personally, may be involved and a future home-loss situation. Let's not be underinsured. ■

Table 1

Coverage A	Cost	Location
440,000	$150 per square foot	Southern California
908,000	$181 per square foot	Southern California
694,000	$139 per square foot	Southern California
644,000	$169 per square foot	Southern California
243,000	$97 per square foot	Southern California

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

by Greg Nelson, CPCU, AIM

Editor's Notes: In this issue we continue with Part II of excerpts of the Orange Empire Chapter research regarding "Are You Underinsured?" Part II examines selecting the proper amount of insurance. Part I appeared in Personally Speaking, Volume 6 Number 3. This article was researched and written by Greg Nelson, CPCU, AIM. A past president of the CPCU Society's Orange Empire Chapter, he has been on the Board of Directors of the chapter since 1988, and has served as the Research Committee chairman for the last eight years. In that period, he has written four research papers that have been recognized by the CPCU Society for Excellence in Research. He is presently the senior vice president for Safeco Financial Institutions Solutions, a specialty division of Safeco Insurance Company, which provides insurance products and services to financial institutions.

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

The Proper Amount of Insurance

Selecting the proper amount of insurance on your home isn't as simple as it may sound. Just what is the proper amount of coverage to maintain? As a homeowner, you may want to protect the investment in your home, although some only purchase the amount of insurance necessary to pay off the loan on the home. Several parties may have an interest in the amount of insurance purchased by the insured to protect the home. The homeowner obviously has an interest in the property. Most homeowners would like the home rebuilt or replaced should their home suffer a total loss. Hence, most homeowners will secure insurance in the amount of the replacement cost of the home. Homeowners usually purchase policies with replacement cost provisions. Mortgage lenders also have an interest in the insurance purchased to protect a home. Lenders are usually required to verify that their borrowers maintain a minimum amount of coverage in order to satisfy their primary investors such as Fannie Mae and Freddie Mac. In general, Fannie and Freddie require lenders to maintain coverage on loans in the amount equal to the loan balance or the replacement cost of the structure. Federal regulations do not directly require mortgage companies or homeowners to buy "hazard" insurance (usually a DP3 or an HO-3 policy). They are required to buy insurance in order for the lenders to be able to continue to secure funds from Fannie, Freddie, and other GSEs. But if a home is located in an area that has been identified as a "flood" zone, the Federal Emergency Management Association, (FEMA) requires that the insured property be insured for flood for at least 80 percent of the replacement value of the property.

Comparing the different requirements, it appears that the homeowner can secure the proper amount of coverage by insuring the home for the full replacement cost of the property. This would meet the requirements set by Fannie and Freddie and other investors as well as protecting their own financial interest in the property. In a similar manner, if the borrower secures enough insurance to replace the property under a flood policy, that will meet the requirements of FEMA as well.

Insuring for the full amount to replace the property appears to meet the contractual needs of the mortgage contract and protects the homeowner investment. But just how do you make sure that you are insuring the property for the proper amount of coverage? Recent losses have shown insuring for the "replacement" value sometimes can be difficult because of many factors that must be considered prior to the loss. Recent history has shown that selecting the right replacement cost for a home can be very challenging, even when the insured makes a serious effort to do so.

Hurricane Andrew

In August 1992, Florida was struck by one of the most powerful hurricanes in United States history. Making landfall near Homestead, Florida, Hurricane Andrew had sustained winds of 145 miles per hour with gusts up to 177 miles per hour. In the matter of a few hours, Andrew destroyed thousands of homes and caused more than $15.5 billion in insured losses. It remains one of the top five catastrophes in recorded history.[1]

Many homeowners located in the Homestead area thought they had purchased enough coverage to replace their homes. However, thousands of homeowners discovered in settlement of their claims that the coverage they had purchased was not sufficient to rebuild their homes because of the increased cost of rebuilding due to updated building codes and ordinances. The average home rebuilding costs increased by $20,000 after the hurricane due to these factors.[2] Also, building materials and labor costs both skyrocketed after the hurricane. Plywood doubled in cost after the catastrophe due to the scarcity of lumber.[3] Since homes that were being rebuilt had to meet revised building code requirements, the cost to build increased considerably. After the hurricane, it became evident that some of the homes that were destroyed were built below standard building codes that existed at the time of the loss. In other words, contractors built the homes below the existing building codes when the homes were constructed years before. So in rebuilding the homes, costs included expenses associated with several levels of improved building codes. All of this contributed to rebuilding costs increasing significantly after the hurricane.

Oakland Hills Fires

One of the most unexpected catastrophes of recent years was the Oakland Hills fire of 1991. With fierce winds pushing a stubborn brush fire, it expanded into a massive residential fire in the hills just east of Oakland, California in October 1991. In the period of one day, more than 3,000 homes were destroyed. Twenty-five people died as they were trapped in burning homes or killed as they tried to flee the fire.[4] Although the fire itself was a tragedy, the scope of the tragedy expanded as many homeowners not only lost their homes and all of their possessions, but also discovered that they did not have enough fire insurance to rebuild their homes. Many of the homeowners had replacement cost coverage but the policy limits they had purchased fell far short of the cost to rebuild their homes. This coverage pays for the replacement or rebuilding cost of the structure in the event of a total loss, but will not pay more for the loss than the policy limit. Many of the homeowners had not increased the limits on their policies to keep pace with inflation or to adjust for the increased costs to rebuild due to improved building codes and ordinances. Homes that were insured for $100 to $125 per square foot could not be rebuilt for less than $165 to $225 per square foot.[5] Some policies have limitations on what will be covered if some of the increased costs of the loss relate to rebuilding the structure to meet new building code requirements. Some policies will not pay for these costs at all. Others will pay for them if the insured has paid for an additional endorsement that provides coverage for losses due to updated building codes. After the fire, many homeowners, agents, and insurance companies disputed the coverages under the policies and the definition of replacement cost. Disputes also arose over the increased costs due to changes in building codes. Some of the disputes revolved around the issue of who was responsible for identifying the proper amount of coverage—the homeowner, the agent, or the company. In the end, it took many years to settle these disputes.

A unique situation that arose during the Oakland Hills fire situation is that some of the homeowners had a special endorsement on their policies called "Guaranteed Replacement Cost Coverage." This coverage insured the home for full replacement cost of the home in the case of a total loss, regardless of the policy limit. Unfortunately, many of the policyholders were not aware that the "guarantee" endorsement had limitations. Some of the company endorsements had exclusions to extra costs to rebuild due to changes in building codes. Additional costs to rebuild the home due to changes in building ordinances or codes would have to be borne by the homeowner; the insurance carriers would not pick up those costs. This created such a negative situation for insurance carriers after the Oakland fire, that most carriers eliminated the "guaranteed replacement cost" endorsement in California.[6] This catastrophe and the surrounding disputes regarding the "guaranteed replacement cost" coverage, essentially led to the coverage being removed from policies by most companies.

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

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Now some insurance carriers are offering a variation of the guaranteed replacement cost endorsement calling it "Extended Replacement Cost Coverage." This endorsement will provide for additional coverage above the policy limit to repair or replace the structure. Typically it is 25 percent, but it varies by carrier. However, there may still be limitations due to changes in building codes and ordinances, so homeowners need to review their policies and endorsements closely to make sure their policies do not exclude these costs.

More Recent Replacement Cost Issues

Insuring for the proper replacement cost continues to be a problem both in individual and catastrophic losses. David Shaffer, a San Francisco agent, has documented several losses in recent years that illustrate the problem of insuring for the proper amount to replace a home with changes in building codes. In one case, a home in Atherton, California insured for $406,000 cost $822,000 to rebuild with $200,000 of the cost due to building code upgrades. A home in Stinson Beach, California cost $1.2 million to rebuild due to more than $300,000 in code-related expenses. In a very exaggerated case, a home in San Francisco cost more than $1 million to rebuild, with more than $700,000 of the cost being due to code upgrades.[7]

In 2002, residents of Fallbrook, California suffered total losses from a wildfire named the "Gavilan" fire. Several couples discovered that their homes were underinsured by several hundred thousands of dollars. Although they insured their homes for $150 per square foot, they were quoted rebuild costs of $170 per square foot. After the fire, Rich and Cheryl Stanton were told their home would cost $805,000 to rebuild, but were only offered $723,000 by their insurance company. The Ragsdale family was offered $100,000 less than the cost to rebuild their home. Another couple, the Hoeglunds, were offered their policy limit of $300,000, but that fell $80,000 short of the full replacement cost of their home.[8]

Southern California Wildfires

In October 2003, Southern Californians watched in horror as Santa Ana winds drove several fires to consume more than 750,000 acres of brush and forestland. More than 4,000 structures were destroyed, including 3,600 homes. Although most homeowners insured for values that they thought were appropriate for the replacement of their homes, initial indications are that many of these homeowners may find themselves underinsured, primarily due to increased construction costs. Due to the large number of homes and businesses destroyed by the fires, material and labor resources are expected to be limited resulting in increased costs to rebuild in the fire-ravaged areas. Prior to the fires, Bill and Lorinda Ross thought that $107,000 would rebuild their lakeside home. Even if that did not, they had an extended replacement cost endorsement on their policy that added an additional 25 percent coverage. Unfortunately, they have been told that the cost to rebuild their home will be $170,000 and they will be $38,000 short after their insurance settlement.[9] In San Bernardino County, which was severely impacted by the fires, many homeowners, like Mark and Lynette Adelson, are finding that their homeowners policy will not pay to replace their fire-destroyed home because the policy does not include the cost to pay for building code upgrades.[10] Many homeowners purchased coverage with the belief that using standard replacement cost projections to calculate the amount of insurance needed to rebuild their homes would be sufficient. But they are now finding that they may not have enough coverage to pay for the complete rebuilding of their homes.

Underinsurance—A Pervasive Problem

In reality, not insuring for the proper replacement cost may be more of a problem than most people realize. Changes in building codes explain part of the reason why many homeowners may not have their homes insured for the proper amount. The lack of building resources after a catastrophe also contributes to increased building costs. Since many people calculate the replacement cost of their homes without considering these extra cost factors, many of them end up with insurance coverage much less than needed to reconstruct their homes. Inflation also has a big impact on the gap between insured amounts and the replacement cost of dwellings. Construction costs have risen 3 percent a year since 1987.[11] Although most homeowners policies have automatic inflation increases each year, they often do not factor in the extra costs associated with building code changes or the strain on resources as a result of catastrophic losses. These factors all contribute to create a situation where many homeowners do not have enough insurance coverage to rebuild their homes in the case of a total loss. And as home values increase, the possibility for underinsuring your home increases. Estimates are that there are more than one million homes in California with replacement values of more than $500,000. In view of the large number of high-value homes, and these other factors, some estimates put the average underinsured value in California at 25 to 50 percent.[12] California is not the only area of the country to have this problem. Marshall & Swift/Boeckh, a provider of local building cost information, estimates that as many as 64 percent of homes in the United States are underinsured. Their study found that the average home is underinsured by $27,000. And although that is a significant improvement from its previous study, it still indicates that more than half of the homes in the country are underinsured.[13] Underinsurance is a critical problem for most homeowners in the United States.

> ***The homeowner is ultimately responsible for identifying and purchasing the proper amount of insurance.***

Just who is responsible for identifying the proper amount of insurance to rebuild their homes? Agents typically assist the homeowner in identifying the proper amount of coverage for their homes. There are various methods for calculating the value of the home and what it would cost to rebuild the home in the event of a total loss. Insurance companies also use different techniques to evaluate the replacement costs of the homes. However, the homeowner is ultimately responsible for identifying and purchasing the proper amount of insurance. After the Oakland fires, there were many lawsuits regarding this issue. In some cases, homeowners filed suit against their agents and companies or filed complaints with the Department of Insurance. In some cases they were able to secure settlements higher than their policy limits. However, these cases were rare as the courts found that the consumer bears the final responsibility for selecting and purchasing the proper amount of coverage. This was established in California law in the case of *Gibson v Government Employees Insurance Company* (1984) 162 Cal.App.3d 441. Although the case dealt with a liability policy, it held that because the insured knew what assets needed to be protected and what the value of the assets were, that the duty to properly insure oneself rests with the insured.[14] This ruling has been applied to property insurance situations as well. It is critical for homeowners to take a sincere interest in the coverage they buy for their homes and the amount of insurance that they purchase. If there is a loss and their insurance is not adequate to pay for the loss, they will not be able to blame their agent or their company as the courts have determined that homeowners must take responsibility for buying the right amount of insurance.

Our next issue of *Personally Speaking* will conclude with Part III in the series and will address the methods of calculating replacement cost. ■

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Steps To Take in Presenting and Preparing a Property Insurance Claim

by Walter G. York, CPCU, AIC, CCLA

Walter G. York, CPCU, AIC, CCLA, is an account executive with RCM&D and is responsible for a wide range of accounts including non-profits, public entities, healthcare, and manufacturing.

York began his insurance career as a claims adjuster for The Hartford. He also worked as a claims supervisor for Reliance Insurance Company, and as an insurance analyst for the Baltimore Gas and Electric Company (BGE) before joining RCM&D. He obtained additional risk management experience at the Insurance Buyer's Council and at the Mass Transit Administration.

York holds a bachelor of science degree in business administration from the University of Maryland and a master of administrative science degree from the Johns Hopkins University. He holds the Chartered Property Casualty Underwriter (CPCU), Associate in Claims (AIC), and Casualty Claims Law Associate (CCLA) designations.

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Up until the time a major claim occurs, relationships among insureds, brokers, and carriers are very friendly and cordial. However, once a major claim or disaster occurs, the relationship among the parties can change, particularly if there are different interpretations of the contract.

My personal lessons learned from being involved on large property claims as a claims supervisor, risk manager, consultant, and broker are as follows:

1. Protect the property from any additional damage. Notify the police if a law may have been broken.
2. Designate one individual to serve as the claims coordinator, and one as a designated backup.
3. Contact mitigation companies from a pre-approved list of water, smoke, and restoration companies. Contact your carrier in advance of a loss for its recommendations. Keep the emergency contact numbers available for your staff. Consider using a contractor from the carrier's preferred vendor list. This will alleviate any questions on the standard fees charged for the clean up, and ensure that the company is reputable, bonded, insured, and has adequate staff and approved equipment.
4. Report the loss to your broker and insurance company as soon as possible. Maintain a record of toll-free claim reporting numbers of your carriers. Losses occur at any time and it is important to have claim reporting procedures in place as well as direct access to your carriers.
5. Document the loss by taking photographs and videos.
6. Do not discard anything until the insurance adjuster evaluates the damage. Do not destroy any evidence until the cause and the origin of the loss have been determined. The adjuster will want to identify subrogation possibilities.
7. Prepare a written inventory of all damaged property.
8. Review all coverages with your broker or agent. Refer to sublimits concerning extra expense, business interruption, expediting expense, debris removal, etc. Make sure that your organization complies with all the terms and conditions of the policy. Ask the company adjuster to explain all available coverage for this loss, including limitations and exclusions.

   Any questionable or unclear coverage issues should be discussed with the agent or broker.
9. Work closely with the insurance adjuster to establish the scope of the damages and the repair cost. Keep adequate records of any extra costs necessary to keep the business operating.
10. Make sure your accounting system is in place and establish a charge or job number so that all repairs and labor costs can be tracked. Advise all of your personnel of the accounting procedures that have been implemented.
11. Develop a spreadsheet to keep track of repair costs.
12. Request an advance payment on large claims. This can improve your organization's cash flow after a catastrophic loss. Prepare documentation necessary to support the requested advance.
13. Obtain invoices for all repair costs. Remember, it is up to the insured to prove the loss. Make sure the invoices supply enough information to detail what is being repaired and why. If invoices are not readily available, written estimates may be sufficient for work not yet completed. This will avoid a potential dispute on scope and cost of restoration.
14. Your broker or agent is an important resource to help you through the process and should be kept apprised of the claim's progress. If coverage questions arise, your broker or agent can be of assistance to you in addressing the issue with the adjuster.
15. Consider the use of a public adjuster if the loss involves major inventory damages or extensive repairs. From a time management/cost-benefit standpoint, this practice could considerably reduce your in-house personnel man-hours needed to substantiate the loss as well as reduce your organization's administrative burden.
16. Consider the use of a Certified Public Accountant if there is a substantial business interruption or extra expense claim. As in item #15 above, in-house personnel man-hours and administrative burdens could be reduced with the use of an outside expert. When considering a CPA, I would use ***only*** a firm or an individual with experience and knowledge of the insurance contracts. There are too many otherwise qualified CPAs who have no idea how to work within the bounds of the insurance contract especially in the area of business interruption.
17. If there is extensive structural damage issues, consider the use of a professional engineer to provide an expert report on the scope of the damages.
18. Keep your insurance carrier adjuster advised in writing as to the progress of the claim and the associated repairs. Insurance adjusters do not like surprises.
19. Prepare a claim submission that details all repairs, has detailed back-up material, and is easy to understand. Make sure that you respond in a timely manner to any requests that the carrier would make for filing a proof of loss. If the claim is submitted with all the necessary information, the adjustment will be settled faster and more amicably.
20. Once a claim is submitted, be prepared to negotiate and compromise on certain issues concerning coverages and damages. The insurance contract is subject to individual interpretation, and it is important to keep that in mind while negotiations are being held. Your broker or agent can act as your advocate in presenting a fair and reasonable claim to the carrier.
21. If a coverage question arises, you may want to consult with legal counsel. The earlier that counsel is retained on a significant coverage issue, the more likely that there will be a prompt resolution. Use ***only*** counsel experienced with commercial property policies. Do not use a general corporate counsel; use only a specialist in this area.
22. If there is a disagreement with regard to the amount of loss, refer to the appraisal section of the policy. The appraisal process is also a requirement prior to suit and should only be used if settlement negotiations cannot be reached.

In summary, when a major loss occurs, your risk management and insurance program must respond. Therefore, the various departments of your organization must work together to solve problems that will arise. Teamwork, clear and accurate record-keeping practices, and communication are the key factors involved in an insurance adjustment that is fair, reasonable, and timely. ■

Outsourcing Technology Overseas on Behalf of the United States Property Casualty Insurance Industry

by Andrew J. Barile, CPCU

Andrew J. Barile, CPCU, has been in the insurance industry for more than 40 years in the United States. His experience covers all types of insurance coverages, and all forms of insurance entities. Barile has developed all varieties of insurance programs, from development to implementation and execution stages. His articles have been published in all insurance trade journals and he is a frequent lecturer at seminars throughout the United States.

Editor's Note: The following is an article on a very timely issue facing the insurance industry—outsourcing. What are your views? Let us hear from you. E-mail the editor at dbak8@allstate.com.

Introduction

The United States insurance industry has continued to look for new ways to increase profitability, whether it be in designing new ways to produce revenue, or introduce project management to the equation to reduce expenses. Outsourcing reduces expenses.

Many of the advantages of outsourcing technology have begun to occur in the last 10 years, especially as the insurance industry needs to increase its return on investment as it focuses on raising additional capital from the capital markets.

Expense reduction and focusing on the core competencies are the words of today. The benefits of outsourcing business processes are very well-known to all insurance industry top management. Execution of this concept is a key to success.

Important Need for Technology Outsourcing

After reading hundreds of insurance company annual reports, we notice in the letter to the shareholders the CEO's comment "We need to reduce the ratio of expenses to premiums through the use of technology and strategic deployment of our capital." How many times in 40 years of experience have I heard that comment? My first question is how are they going to "execute"?

Major focus has been on the growth of the insurance claims administration outsourcing market.

Capital Management Investors Looking Closely at Technology Improvements through Outsourcing

As a consultant to capital management companies, I hear concerns that insurance company management may not be doing enough in the technological area to reduce expenses and improve earnings. Many capital management companies have major positions in insurance company stocks and may be driving insurance companies to outsource and increase their spending on outsourcing. Whether insurers are developing insurance products faster or reducing costs, capital management firms are looking for the end result.

Capital management firms want insurers to seek new ways to conduct business, and increase profit margins. They have recognized that insurance companies who have gone from outsourcing to offshore destinations, such as India, have reported savings of 10 to 33 percent, depending upon the project size.

Increasing Litigation Against Technology Companies for Failure to Perform

Many technology companies provide policy and claims administration to the property and casualty insurance industry, and offer comprehensive outsourcing services, software, and software services. Many have also overstated their ability to perform and there has been many growing claims under the performance bonds purchased by technology companies. Technology companies that misrepresent the ability of their products must understand they will have to pay the consequences: "the client terminated its outsourcing contract with the technology company and demanded payment under the performance bond due to the technology company's default under the contract."

Business Development/ Budget for Acquiring Clients

Technology companies, especially those operating from overseas, not only need insurance industry expertise (domain) but business acumen. They are looking to access this market without a dollar expenditure. Most will fail without a business development budget. Most underestimate the costs of developing clients in the technological area of the business.

Success will come from those technology companies that have done their research, and have a definitive focus . . . is it the wholesale insurance agency, the managing general agency, the property and casualty insurance company that use all of the distribution systems (1) direct, (2) retailers, (3) wholesalers, (4) MGAs. You need to understand the complexity of the insurance business before you can develop the software to improve its efficiency.

Do not underestimate the need for the business development budget for acquiring your new clients.

The Due Diligence Process

Determine what is right, reasonable, fitting, and necessary in the due diligence process in selecting an outsourcing company for your technology needs.

This is the most important aspect of the outsourcing event since too often technology companies make the "sweeping statement" that they provide technology solutions for the insurance industry.

The insurance industry is defined as:

1. life
2. property and casualty
3. insurance brokers

And outsource business processes in:

1. sales and distribution
2. underwriting
3. policy administration
4. accounting
5. claims processing
6. back office

One word of caution, this is the entire insurance industry, and due diligence must be done on the details.

Insurance Companies with Favorable Outlook for Earnings, Cash Flow, and Growth

Insurance companies, through outsourcing technology overseas, will continue to adjust their business model to adapt to changing market dynamics and push forward to increase their profitability.

Technology-driven competitive pressures also are influencing the insurance industry, embracing outsourcing to increase their profitability.

Congratulations to the Personal Lines Section

for being recognized with the
Gold Level Circle of Excellence Recognition Award!

Dale M. Halon, CPCU, CIC, (center) accepts the Circle of Excellence Gold Award at the Annual Meeting and Seminars in Los Angeles on behalf of the Personal Lines Section.

E GOLD
CIRCLE OF EXCELLENCE
RECOGNITION PROGRAM

Credit Guard Mania and Loss Control

by Ellen Yamshon, Esq., CPCU

Ellen Yamshon, Esq., CPCU, is an advocate for risk reduction through conflict prevention and dispute resolution. She is an attorney and a mediator for the Western Center for Alternative Dispute Resolution; chair emeritus of the Board of Directors of the Sacramento Mediation Center; and a recipient of the California Mediation Week Peacemaker of the Year Award for her pioneering work in negotiation and mediation.

Yamshon is on the National Panel of Arbitrators for the American Arbitration Association. She has negotiated mortgage loans on behalf of major banks and savings associations for subsequent sale to government programs. She is a former claims supervisor; has held insurance agent and broker licenses; and has been licensed by the National Association of Securities Dealers.

A recognized expert in program development, Yamshon has evaluated conflict resolution operations of government agencies and community-based organizations at home and abroad. She has lectured on conflict management and negotiation in the College of Business Administration, California State University, Sacramento; and is a contributing author on alternative dispute resolution and ethics topics in *Understanding the Law,* a popular textbook. She sits on the National Advisory Board of the Consortium for Alternative Dispute Resolution in Special Education, a National Center for Dispute Resolution funded by the United States Department of Education.

Chances are you already know a fair amount about identity theft. You don't need to be an insurance professional to recognize that identity theft is a big problem. As a consumer, you've heard the horror stories and you get the solicitations for "fraud alerts." If you log onto the Internet, pay credit card bills, listen to the radio, attend sports events, or watch television you can't miss it. I call it "credit guard" mania. It's ubiquitous.

Non-insurance entities are competing for a segment of the identity theft insurance market. Credit reporting agencies, consumer credit counseling services, banks, and credit card companies have fashioned protection plans touted as your "insurance against identity theft." Competition is intense. In addition, new businesses have emerged and grown as a result of society's fear of identity theft. They include documentation destruction companies, credit restoration counselors, and advocates.

Credit monitoring services are reportedly generating $500 million in annual revenues. Fees vary significantly as do the package of services offered. For $69.95, Equifax, one of the big three credit reporting agencies, will monitor and send e-alerts within 24 hours of any change in your credit. If you incur any expenses in clearing an unauthorized charge, Equifax will reimburse you up to $2,500. In contrast, Experian, another big three company, will monitor and report back to you for $79.95, but that doesn't include reimbursement for the out-of-pocket expenses to clear your credit or time lost at work.

The relentless play on our collective anxiety over identity theft makes rational evaluation of the various insurance products difficult, if not impossible. Recognizing that the menace of identity theft can be controlled, if not completely prevented, will help frame the analysis. Loss prevention does not eliminate the need for insurance. However, insurance dollars should be spent on the unforeseeable and catastrophic, not on risks that are preventable.

Identity theft is perpetrated invisibly, completed in no time, and is generally detectable only after the fact. Identity theft is not a violent crime in the strictest sense because your bodily integrity is not threatened or breached, at least at the outset. They stick it to you painlessly but the financial consequences and reputational harm can be devastating. It can be quite sickening, literally.

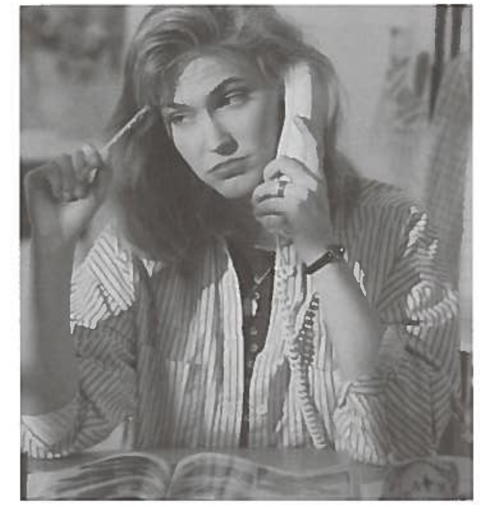
Like AIDS, you can get this financial virus without knowing it and unless you are vigilant about discovering it, it can develop into an illness that is difficult to treat. Confirmation of identity theft can be traumatic in and of itself and the recovery process can be lengthy and stressful. If prolonged, it can result in the sort of emotional distress that manifests physically and may need medical attention.

As far as your good name and your credit rating are concerned, though, you could be dead on arrival. The good news is you can resurrect your credit rating and repair your reputation. The bad news is that in the process, you may lose your job, be forced to declare bankruptcy, or accused of committing a crime perpetrated by a larcenist using your identity.

In a recent nationwide survey, Fireman's Fund discovered that almost every homeowner knew about identity fraud (97 percent) and nearly all were concerned, to some degree (90 percent). Furthermore, 80 percent of the homeowners surveyed claim they know what they need to reduce the chances of identity theft, but only 70 percent report that they have taken action. Assuming that action is actually doing something beyond putting together a to-do list, which leaves 30 percent who are especially vulnerable.

I will venture a guess that you too have given some thought to this matter and have taken steps. You're required to shred sensitive documents at the office and you probably do the same at home. Do you use a crosscut paper shredder?

I bet at some point you realized that carrying multiple credit cards was a bad idea if only because it makes your wallet heavy. So now you only carry a few, right? You never give out your social security number or credit card number to a stranger over the telephone. If you shop the web, you use discretion in placing your account information, right? Speaking of credit cards, you check your statements for unauthorized charges promptly, every time, right?



Think about your mailbox—not your e-mail—your physical mailbox, where you get deliveries from the United States Postal Service. Is it secure? Does it lock?

Let me ask you this: Do you know the exact dates that your bank statements are mailed? Do you have your computer programmed to remind you when to expect your bank statement? Do you call the bank right away if you don't get your statement? Do you reconcile the check register and the statement promptly?

Do you periodically scan your supply of blank checks, in the middle of your checkbook and in storage? Are both blank and cancelled checks under lock and key?

If you are taking these precautions, you are in good shape. You may think that if you are vigilant about following them, it can't happen to you, right? Don't make that mistake. Even if you are doing all the right things, you are not immune. However, vigilance will dramatically reduce the likelihood and severity of any breach of your financial security.

Let me tell you about my brush with financial disaster. I can't claim to have been doing all the right things, but I was conscientious to the extent that I was aware of ways to prevent identity theft. This went a long way to reduce the consequences of the breach. But it still happened. Vigilant is what I need to be now that I have joined the ranks of the one in four people who experience identity theft every year.

I tracked the due dates of my credit card and bank statements. I programmed my PDA to remind me when a statement was due and synchronized it with my personal computer, so that wherever I was I would not forget to track my accounts. I learned in law school that if you put your trash on the curb, it becomes public domain. Ever since, all documents with personal identifying information get shredded.

My house was burglarized over the July 4 holiday weekend last year. My family and I were on vacation. We returned to find the contents of our house upside-down. The burglars rammed in the side door entrance to get in the house, taking out the doorframe. We live on a winding levee road in the unincorporated section of Sacramento County, about 10 miles from the police station. The burglar alarm limited but did not prevent the burglary.

I believed I modeled good risk management behavior in preparing for our vacation. Before we left, my family and I planned how we would secure our valuables. I left my laptop at the office, my son hid his behind the vacuum cleaner in the broom closet, and my husband left his in his closet behind some clothes. The few very special pieces of jewelry I own were in the bank vault along with my credit cards, blank checks, and my social security card.

We did not lose much as a result of the burglary, or so I thought: kids' backpacks, CDs, videos, sports jerseys and shoes, some camera equipment. My husband's laptop was taken, but one of three is better than all. I was grateful for my homeowners' coverage and frankly I was pleased that we had thought about spreading the risk of losing all three laptops.

My bank statements are mailed from the bank on the fifteenth of every month. I expect them by the twentieth at the very latest, so when I got that annoying ding from my PDA on July 17, I was mildly concerned. When I didn't receive a statement by the twentieth, I called the bank since I hadn't gotten my checking account statement.

Honestly, I wasn't too concerned and I did not close my account. I was satisfied that the bank was on notice that my statement hadn't arrived and that if there were any wrongful activity, the bank would catch it.

Also, lost mail is not all that unusual where I live. On occasion, my neighbors and I exchange misdelivered mail. I assumed my neighbor had gotten my bank statement in error. I got a duplicate statement from the bank when I found out that it was not misdelivered.

Three weeks later, my banker informed me that three checks cleared my account including one with my account information, but with a man's name and identifying information. The two with my name and personal identifying information, including my California driver's license number were signed with signatures that were obvious forgeries.

The bank was on notice that my bank statement was lost or missing and three checks totaling $3,000+ cleared before we all figured out what had happened.

Continued on page 16