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UNDERSTANDING PERSONAL PROPERTY INSURANCE

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CHAPTER 1: INLAND MARINE FLOATERS

The basic homeowner's policy usually contains various limitations and exclusions on coverage. Therefore persons who are owners of valuable personal property often need broader and more comprehensive coverage than is provided by the basic homeowner's policy. This broader and more comprehensive coverage may be obtained through the appropriate Inland Marine Insurance Policy.

The very first form of personal property insurance coverage was an Ocean Marine policy. The policy was written to provide financial protection for owners of ships in case their property or cargo was lost at sea.

Ocean marine policies insured the cargo from port to port. Later on a clause was added to also insure cargo while it was being transported on land. As an end result policy coverage extended from the original point of departure until their final destination point to include both ocean and inland transportation of those goods.

Eventually a separate policy was developed that dealt only with the insuring of the goods while being transported on land and the policy became known as an inland marine policy verses an ocean marine policy.

Inland Marine policies eventually began to provide a broad coverage for other property of a "floating" or moveable nature. Since these policies did not come under any state jurisdiction, they could be tailor made to the need of the insured.

Inland marine policies were offered on an "all risk basis" rather than a "named peril" basis as offered in most casualty policies.

DEFINITION OF INLAND MARINE INSURANCE

In 1933 the NAIC drafted a definition used in limiting the insuring power of marine underwriters that specified the risks and coverage, which could be written as marine insurance. The definition was revised in 1933 and in 1976. In the 1976 version, due to legal concerns, the definition now simply defines and describes the risks and coverage that are subject to marine insurance. This definition has been adopted by many states as a form of identifying a marine policy.

Property that is transported from one place to another, goods in transit (the exception being over oceans), bridges, television broadcasting towers, tunnels, and other instrumentalities of transportation and communication would be covered under Inland Marine Insurance.

Various floater policies can also be used to cover personal effects and property. The floater policy will provide coverage to items that "float" or move along with the covered property while it is changing locations.

Inland Marine Coverage was developed from ocean marine insurance in the 1920s. In the early years the marine insurers covered transportation loss exposure. Fire and casualty insurers had difficulty in competing because the fire and casualty lines had to be written separately and the rates they could charge were subject to state regulation.

The marine insurers however were able to write property and casualty lines under an "all-risks" contract and they were not bound by state regulation.

INLAND MARINE FLOATERS CHARACTERISTICS

An Inland Marine floater has four characteristics.

- Tailored Coverage
- Selection of Policy Limits
- Extensive Coverage to Perils Covered
- Worldwide Coverage

TAILORED COVERAGE

A personal articles floater provides coverage for nine optional classes of personal property including:

- Jewelry
- Coin Collections
- Cameras

This permits the insured to select coverage for the class or classes of property needed. It is also possible to write the coverage separately such as:

- ✓ Jewelry Floater
- ✓ Fur Floater
- ✓ Coin Collection Floater
- ✓ Stamp Floater
- ✓ Camera Floater

SELECTION OF POLICY LIMITS

As you know the basic homeowner's policy has limitations on coverage of certain types of valuable property. The insured must look to a floater policy in order to get higher limits of coverage. Also, as a rule, when a basic homeowner's policy combines the value of certain types of personal property with the value of unscheduled personal property it is possible that the combined total may exceed the homeowner's policy limits on personal property. Here again, the floater policy can provide higher limits.

EXTENSIVE COVERAGE TO PERILS COVERED

When a floater is written it usually provides coverage on a "risks of direct physical loss" basis. The floater covers risk of direct physical loss to the property that is described except certain losses that are commonly excluded. The commonly excluded losses will be discussed shortly.

WORLDWIDE COVERAGE

The property described in most floaters will be covered any where in the world with the exception of FINE ARTS, which are usually covered only in the United States and Canada.

POLICY PROVISIONS OF FLOATERS

The following policy provisions appear in most Inland Marine Floater policies.

- ✓ Loss Settlement
- ✓ Loss to a Pair, Set, or Parts
- ✓ Loss Clause
- ✓ Claim Against Others
- ✓ Insurance Not to Benefit Others
- ✓ Other Insurance

LOSS SETTLEMENT

Except for fine arts, the amount that will be paid for a covered loss will be the LOWEST of the following four amounts:

- The actual cash value at the time of loss or damage
- The amount for which the insured could reasonably be expected to have the property repaired to its condition prior to the loss
- The amount for which the insured could possibly be expected to replace the property with property substantially identical to the article lost or damaged
- The amount of insurance stated in the policy

The third exception from above is going to require the following brief explanation.

The insurance company, at a discounted price, can purchase much of the property insured in a floater. Therefore the insurance company may want to replace the lost or damaged item rather than make cash reimbursement. Should the insured reject the replacement offer the insurance company's cash reimbursement will then be limited to the amount for which the insured could reasonably be expected to replace the item.

This amount is the insurance company's discounted price since the insured can be reasonably expected to replace the item at that price.

LOSS TO A PAIR, SET OR PARTS

In the event that there is loss or damage to a covered property in a pair or set, such as the loss of one earring, the amount to be paid is not based on a total loss. The insurance company may either repair or replace any part to restore the pair or set to its value before the loss or pay the difference between the actual cash value of the property before and after the loss.

LOST CLAUSE

Under this policy provision the amount of insurance provided will not be reduced except for the total loss of the scheduled article. If the insurance is reduced because of a total loss of a scheduled article, the insurance company will either refund the unearned premium or apply the unearned premium to the current premium due if the scheduled article is replaced.

CLAIM AGAINST OTHERS

This policy provision is very similar in nature to the subrogation clause. If a loss occurs and the insurance company believes they can recover the payment for that loss from the person or parties responsible, then the loss payment to the insured will be considered a loan that must be repaid out of any funds recovered from others. The insurance company will expect the insured to cooperate with any attempt the insurance company makes to recover from others responsible for that loss. Should the recovery attempt be unsuccessful the insured will not be required to pay the "loan" on the loss settlement.

INSURANCE NOT TO BENEFIT OTHERS

No organization or other person that may have custody of the property and whom is paid for services can benefit from the insurance on the property. The purpose of this provision is to prevent a third party who caused the loss from denying liability

for payment because the property is insured; thus, the insurance company's right of subrogation against the neglect party is retained.

OTHER INSURANCE

In the event that there is other insurance at the time of loss that applies to the property, that insurance is considered excess insurance over the other insurance.

INSURING AGREEMENT

As a rule Marine floaters provide coverage to property on an "all-risks" basis. Physical loss to covered property is provided except for the following exclusions:

- Wear and Tear
 - Deterioration
 - Inherent Vice
 - Insects or Vermin
 - Mechanical Breakdown or Failure
 - Electrical Breakdown or Failure
 - Repairing the Property
 - Adjusting the Property
 - Servicing the Property
 - Maintaining the Property
-

GENERAL EXCLUSIONS

General exclusions that appear in all floater policies are war, nuclear reaction, and radiation.

PERSONAL ARTICLES FLOATER

Often referred to as PAF the Personal Articles Floater provides coverage on nine optional classes of personal property. As mentioned coverage is worldwide except for fine arts.

The nine classes of personal property that can be insured are:

- Jewelry
- Furs
- Cameras
- Musical Instruments
- Silverware
- Golfer's Equipment
- Fine Arts
- Postage Stamps
- Rare Coins/Current Coins

Certain newly acquired property such as jewelry, furs, cameras, and musical instruments will be automatically covered for 30 days providing that insurance was already written on that class of property.

The amount of insurance, on newly acquired property, is limited to the lower of 25 percent of the amount of insurance for that class of property or \$10,000.00. The property must be reported to the company within 30 days of purchase in order for the coverage to continue. You will be charged an additional premium for coverage from the date of acquisition.

JEWELRY

Coverage on personal jewels applies anywhere in the world. Each item of jewelry must be scheduled with a specific amount of insurance shown for it. This includes watches, necklaces, and rings. Because of the moral hazard, jewelry will be very carefully underwritten. As a rule, the insurance company will require either the original bill of sale or a signed appraisal before the jewelry is insured. The insured must also have satisfactory resources and the insurance company will want to know that the insured is not in the habit of losing or misplacing articles.

FURS

The PAF can be used to insure:

- Personal Furs
- Items consisting principally of Fur
- Garments Trimmed in Fur
- Fur Rugs
- Imitation Fur

Again, each item must be separately listed with a specific amount of insurance shown for it. As with jewelry, because of the moral hazard furs are very carefully underwritten.

CAMERAS

A Personal Articles Floater can also be used to insure the following items. Each of these items must be individually described and valued.

- Photographic Equipment
- Cameras
- Projection Machines
- Portable Sound Equipment
- Recording Equipment
- Motion Picture Cameras
- Motion Picture Projectors
- Films
- Binoculars and Telescopes

Exceptions to the rule regarding scheduling items would be:

- ✓ Miscellaneous Smaller Items
- ✓ Carrying Cases
- ✓ Filters

.... providing the total value of the blanketed items is not more than 10% of the total amount of insurance on cameras.

MUSICAL INSTRUMENTS

The following items can be covered under a PAF:

- Musical Instruments
- Instrument Cases
- Sound Equipment
- Amplifier Equipment

Should a musical instrument be used and played for pay during the policy period it will not be covered unless an endorsement is added reflecting this use and a much higher premium paid.

SILVERWARE

Silverware and gold-ware may also be covered under a PAF. Pens, pencils, smoking implements and jewelry may not be insured as silverware. These kinds of property can be insured as jewelry.

GOLFER'S EQUIPMENT

Golf equipment such as golf clubs golf clothes will be covered. Other golf equipment may be insured under a PAF.

Clothing contained in a locker is also covered while the insured is playing golf. Golf balls are covered only by fire and burglary providing there are physical marks of forcible entry into the building, room or locker.

FINE ARTS

- Fine arts can include the following:
- Paintings
- Antique Furniture
- Rare Books
- Rare Glass
- Bric-a-brac
- Manuscripts

Fine arts are insured on a valued basis and must therefore be on a schedule with the amount that was paid for that item clearly stated. Damages paid on an actual cash value basis up to the stated value. Newly acquired fine arts will be automatically insured for ninety days. The insured is required to notify the insurance carrier within ninety days of acquisition and the additional premium due will accrue from date of acquisition. The limit on fine arts property is subjected to 25% of the total insurance.

Fine arts are subjected to three major exclusions:

- ✓ Damage caused by repairing, or retouching
- ✓ Breakage of art glass windows, glassware, statuary, marble, bric-a-brac, porcelains, and similar fragile articles
However, the exclusion does not apply if fire, lightning, explosion, aircraft, collision, windstorm, earthquake, flood, malicious damage or theft, and derailment or overturn of a conveyance causes the breakage
- ✓ Loss to property on exhibition at fairgrounds or at national or international expositions is excluded unless the premises are covered by the policy

STAMP AND COIN COLLECTIONS

These collections are insured for loss anywhere in the world. The stamps and coins may be insured in one of two ways, scheduled basis or blanket basis.

The scheduled basis is suggested if the items are extremely valuable. In this way each item is specifically listed and insured.

Under the blanket basis the insurance applies to the entire collection since each item is not separately described. In the event of a loss to a scheduled item, the amount to be paid is the LOWEST of the following:

Actual Cash Value

- The amount for which the property would reasonably be expected to be repaired
- The amount for which the property would reasonably be expected to be replaced
- The amount of insurance

In the event of a loss to an item covered on a blanket basis, the amount paid will be the cash market value at the time of loss. There is a \$1,000.00 maximum on any unscheduled coin collection. There is a \$250.00 maximum limit on any of the following:

- ✓ Single Stamp or Single Coin
- ✓ Individual Article
- ✓ Single Pair
- ✓ Single Block or Single Series
- ✓ Single Sheet or Single Cover
- ✓ Single Frame or Single Card

The following limit is also applied to stamps or coins insured on a blanket basis. This limit has the effect of a 100% co-insurance clause.

It states that the company is not liable for a greater proportion of any loss than the amount of insurance on blanket property bears to the cash market value at the time of loss. In other words, say the insured has an un-scheduled coin collection on a blanket basis valued at \$500.00. One coin worth \$50.00 is stolen. At the time of theft, the entire collection had a current market value of a \$1,000.00. The insured's maximum recovery is \$25.00. Had the insured purchased \$1,000.00 worth of insurance, the \$50.00 loss would have been paid in full.

STAMP AND COIN COLLECTION EXCLUSIONS

The following is a list of important exclusions that apply to stamp and coin collections:

Damage from:

- ✓ Fading
- ✓ Creasing
- ✓ Denting
- ✓ Scratching
- ✓ Tearing
- ✓ Thinning
- ✓ Transfer of Colors
- ✓ Inherent Defects
- ✓ Dampness
- ✓ Extremes of Temperature
- ✓ Depreciation
- ✓ Damaged from being Handled
- ✓ Damage from being Worked on
- ✓ Mysterious Disappearance
- ✓
 - **NOTE** except if the item is scheduled or specifically insured, or is mounted in a volume and the page to which it is attached is also lost.
- ✓ Property lost in the custody of transportation companies
- ✓ Shipments by mail other than registered mail
- ✓ Theft from any unattended motor vehicle
- ✓ Losses to property not part of a stamp or coin collection

PERSONAL PROPERTY FLOATER

This floater provides extensive coverage on personal property owned or used by the insured that is kept at the insured's residence. This rider will also provide worldwide coverage when this property is temporarily away from the residence. The property is issued on a special all-risk basis. This means all direct losses are covered except specifically excluded.

SCHEDULED PERSONAL PROPERTY FLOATER

This floater is used to provide coverage for personal articles and valuable items that do not fall within the nine categories previously listed. Examples of such items are:

- Dentures
- Typewriters
- Camping Equipment
- Wheelchairs
- Stereo Equipment
- Grandfather Clocks

This is not a complete list but it can be said that almost any kind of personal property may be insured under a scheduled personal property floater. Since coverage is provided on un-filed forms said coverage could be adapted to meet the needs of the individual insured.

SCHEDULED PERSONAL PROPERTY

A question is often asked about when personal property should be scheduled. As a rule people who own valuable personal property should have it scheduled and specifically insured under a floater policy. Diamond rings, fur coats and other jewelry of high value should be specifically scheduled. The following types of personal property should also be considered for scheduled coverage. They are:

- ✓ Unique Objects
- ✓ Works of Art
- ✓ Rare Antiques
- ✓ Paintings
- ✓ Stamp Collection
- ✓ Rare Coin Collection
- ✓ Portable Property
- ✓ Cameras
- ✓ Camera Equipment
- ✓ Musical Instruments
- ✓ Sports Equipment
- ✓ Fragile Articles
- ✓ Glassware
- ✓ Statuary
- ✓ Scientific Instruments
- ✓ Typewriters
- ✓ Home Computers
- ✓ Business or Professional Equipment

Since the basic homeowner provides coverage for personal or business property only to a maximum of \$2,500.00 on the resident premises and \$250.00 away from the resident premises it is suggested that the property be more adequately insured by scheduling the property with a stated amount of insurance shown for it.

UN-SCHEDULED PERSONAL PROPERTY

A personal property floater may be used to insure the following thirteen classes of un-scheduled property:

- Silverware, gold ware, pewter ware
 - Clothing
 - Rugs and Draperies
 - Musical Instruments and Electronic Equipment
 - Paintings and other Art Objects
 - China and Glassware
 - Major Appliances
 - Guns and Other Sports Equipment
 - Cameras and Photographic Equipment
 - Building Additions and Alterations
 - Bedding and Linens
 - Furniture
-

- All other Personal Property and Professional Books while on the residence

The total amount of insurance in each of the above categories is the maximum limit for recovery in any single loss in that category. The total amount of the thirteen categories is the total policy limit.

NEWLY ACQUIRED PROPERTY

Any newly acquired property will automatically be covered up to the LOWER of 10% of the total amount of insurance or \$2,500.00.

Insurance on newly acquired property may be applied to any of the numbered classes. Newly acquired property at the principal residence of the insured will be covered for thirty days from the time the property is moved there. The coverage on the newly acquired property is subject to the amount of the insurance for each numbered class.

PROPERTY NOT COVERED

Personal property floater will not cover the following personal property:

- Animals, Fish, Birds
- Boats, Aircraft
- Trailers, Campers
- Motorcycles, Motorized Bicycles
- Motor Vehicles Equipment, Motor Vehicles Furnishings
- Property pertaining to a business, property pertaining to a professional
- Property pertaining to an occupation
- Property usually kept somewhere other than the insured's residence throughout the year

Additionally the personal property floater places specific limits on certain property.

For example:

- A \$100.00 limit on money
- A \$100.00 limit on numismatic property
- A \$500.00 limit on: Securities, Notes, Stamps, Passports, Tickets, Jewelry, Watches, and Furs

EXCLUSIONS

The personal property floater also excludes certain losses such as:

- ✓ Animals owned or kept by the insured
- ✓ Mechanical or structural breakdown
- ✓ Water damage exclusion clause
- ✓ Any work on covered property except jewelry, watches, or furs
- ✓ Dampness/Extreme changes of temperature except if caused by: snow, rain, hail, or sleet
- ✓ Bursting of pipes
- ✓ Bursting of apparatus
- ✓ Acts or decisions of any person, group, organization or government body
- ✓ Wear and Tear
- ✓ Deterioration
- ✓ Inherent Vice
- ✓ Insects or Vermin
- ✓ Marring or scratching of property
- ✓ Breakage of eyeglasses
- ✓ Glassware
- ✓ Fragile article
- ✓ Lightning
- ✓ Theft
- ✓ Vandalism
- ✓ Malicious mischief

Should personal property that is separately described and specifically insured by any other insurance have a loss, it will be excluded under a standard homeowner policy. Therefore the amount of insurance under a floater policy should be sufficient to pay for losses in full to cover the property.

As a rule unscheduled personal property under a homeowner's policy is insured on a replacement cost basis.

Consequently the advantages and risks of direct loss coverage under the PPF must be carefully weighed against the possibility of being underinsured.

PERSONAL EFFECTS FLOATER

The PEF is designed for travelers who want coverage on their personal effects while traveling. The PEF will provide coverage on the personal property of tourists and travelers anywhere in the world. However this will only be in effect while the covered property is away from the residence premises. This coverage will apply to: the insured, his or her spouse, and any unmarried children who permanently reside with the insured.

PERSONAL EFFECTS COVERAGE

Property normally worn or carried by an individual comes under the heading of personal effects. Coverage for personal effects will include; personal effects, luggage, clothes, cameras, and sports equipment while the insured is traveling or on vacation.

PROPERTY EXCLUDED

The following property is excluded under PEF coverage:

- ✓ Automobiles, Motorcycles, Bicycles or Boats
- ✓ Accounts, Bills, Currency, Deeds, Evidence of Debts, or Letters of Credit
- ✓ Passports, Documents, Money, Notes, Securities or Tickets
- ✓ Transportation
- ✓ Household Furniture
- ✓ Household Animals
- ✓ Automobile Equipment
- ✓ Salesperson Samples or Merchandise for Sale or Exposition
- ✓ Physicians/Surgeons' Equipment
- ✓ Artificial Teeth
- ✓ Artificial Limbs
- ✓ Theatrical Property

ALL-RISKS COVERAGE

Personal effects will not be covered on an all-risks basis. Risks of direct physical loss to a property are covered except as follows:

Damage to personal effects from:

- ✓ Wear and tear
- ✓ Gradual deterioration
- ✓ Inherent vices
- ✓ Vermin
- ✓ Insects
- ✓ Damage while property is being worked on

Breakage of articles of a brittle nature unless caused by:

- ✓ Fire
- ✓ Theft
- ✓ Accidents to a conveyance

OTHER EXCLUSIONS

In addition to the exclusions previously mentioned the following exclusions also are present:

- ✓ Personal effects are not covered while on the named insured's residence premises
- ✓ Property in storage is not covered
- ✓ Personal effects in the custody of students while in school are not covered except for loss by fire

LIMITATIONS ON CERTAIN PERSONAL EFFECTS

Jewelry, watches and furs are subject to a single article limit of 10% of the total amount of the insurance, with a maximum of \$100.00.

Focus Points

- Homeowner's policies usually contain limitations and exclusions on coverage.
- Inland Marine Insurance covers property more comprehensively than standard homeowners policies.
- Inland Marine policies provide coverage for property of a "floating" or movable nature.
- Personal Floater policies can also be used to cover personal effects and property.

- o Floater policies provide coverage to property while it is changing locations.
- o Inland Marine Coverage was developed from ocean marine insurance in the 1920s.
- o Originally the marine insurers covered transportation loss exposure.
- o Marine insurers were able to write policy lines under an "all-risks" contract and were not under state regulation.
- o Personal article floaters provide coverage for nine optional classes of personal property.
- o Floater policies can provide coverage higher limits basic homeowners insurance.
- o Floater policies provide coverage on a "risks of direct physical loss" basis.
- o Property described in most floaters is covered worldwide with some exceptions.
- o The insurance company can purchase much of the property insured in a floater.
- o Payment for loss or damage to a covered pair or set is not based on a total loss.
- o Under the lost clause, the amount of insurance will not be reduced except for the total loss of the scheduled article.
- o Physical loss coverage to a property is provided with exceptions.
- o War, nuclear reaction, and radiation are general exclusions that appear in all floater policies.
- o Personal Articles Floaters provide coverage on nine classes of personal property.
- o Personal Articles Floaters carry coverage that is worldwide except for fine arts.
- o Newly acquired property is automatically covered for 30.
- o Coverage on personal jewels applies anywhere in the world.
- o Each item of jewelry must be scheduled with a specific amount of insurance.
- o Because of the moral hazard, jewelry is very carefully underwritten.
- o Insurance companies require either the bill of sale or a signed appraisal before the jewelry is insured.
- o Fur item must be separately listed with a specific amount of insurance shown for each.
- o Personal Articles Floaters can be used to insure cameras and photographic equipment.
- o Personal Articles Floaters can be used to insure musical instruments and equipment.
- o Silverware and gold-ware may also be covered under a PAF.
- o Golf equipment will be covered under a Personal Articles Floaters
- o Fine arts are insured on a valued basis.
- o Newly acquired fine arts will be automatically insured for ninety days.
- o Coverage for fine art is subject to three major exclusions.
- o Stamp and coin collections are insured for loss anywhere in the world.
- o The stamps and coins may be insured on a scheduled basis or blanket basis.
- o The scheduled basis is for items of extreme value where each item is specifically listed and insured.

- o Blanket basis applies to an entire collection.
- o Personal Property Floater provides coverage on property owned or used by the insured and kept at the insured's residence.
- o Personal Property Floaters provide worldwide coverage when the property is temporarily away from the residence.
- o Property Floaters are issued on a special all-risk basis.
- o Scheduled Personal Property Floaters provide coverage for personal articles not within the nine main categories.
- o Personal property floater may be used to insure the thirteen classes of un-scheduled property.
- o The Personal Effects Floater is designed for coverage on personal effects while traveling.
- o Coverage under a Personal Effects Floater is worldwide.

CHAPTER 2: INSURANCE ON WATERCRAFT

Watercraft can range in size as follows:

- Rowboats
- Canoes
- Outboard motorboats
- Inboard motorboats
- Dinghies
- Sailboats
- Speedboats
- Houseboats
- Yachts

HULL AND TRAILER LOSS EXPOSURES

Watercraft as well as their equipment, trailers and furnishings may be exposed to a wide variety of theft and physical damage loss. Examples of a few are:

- ✓ Two speedboats collide.
- ✓ A sailboat is overturned in heavy winds.
- ✓ A boat sinks in a severe storm.
- ✓ A sandbar strands a houseboat.
- ✓ An outboard motor falls into a lake.
- ✓ A boat trailer is stolen.
- ✓ An explosion seriously damages a boat.

HOMEOWNER'S POLICY PHYSICAL DAMAGE COVERAGE

Watercraft and trailers are covered under Section One of a homeowner's policy for physical damage and theft. However this coverage is very limited. The major limitations on coverage are as follows:

Direct loss to:

- ✓ Watercraft
- ✓ Trailers
- ✓ Furnishings
- ✓ Equipment
- ✓ Outboard motors from windstorm or hail are covered ONLY if the property is inside a fully enclosed building.

Theft of:

- ✓ Watercraft
- ✓ Trailers
- ✓ Furnishings
- ✓ Equipment
- ✓ Outboard motors away from the resident premises are specifically excluded
- ✓ Watercraft and other boating property are covered only for a limited number of named perils

Coverage on:

- ✓ Watercraft

- ✓ Trailers
- ✓ Furnishings
- ✓ Equipment
- ✓ Furnishings

... Is limited to a maximum of \$1,000.00.

PERSONAL AUTO POLICY PERSONAL DAMAGE COVERAGE

An automobile policy is not designed nor does it cover any physical damage to boats. The boat trailer however can be insured for physical damage loss under a personal auto policy. The trailer must be described fully in the declarations of the auto policy.

LIABILITY LOSS EXPOSURES

When you own or operate a watercraft you can be exposed to a wide variety of liability losses exposures such as:

- ✓ A water-skier is injured because of excessive speed
- ✓ Speedboat swamps another boat causing it to turn
- ✓ A boat runs into swimmers and seriously injures them
- ✓ A boat collides with a dock causing property damage
- ✓ Two boats collide injuring the occupants
- ✓ A child falls overboard and drowns and was not provided with a life preserver by the boat operator

HOMEOWNER'S POLICY LIABILITY COVERAGE

Section II of a homeowner's policy provides personal liability insurance and it covers certain watercraft loss exposures providing the boat is under a specified size and length. Personal liability provides the insured with protection against bodily injury or property liability that arises out of the use or operation of certain owned watercraft. The liability protection can also apply on an excess basis for certain covered non-owned watercraft.

There are however several important categories of watercraft liability that the homeowner's policy excludes from coverage. They are:

- Owned watercraft regardless of size with inboard or inboard/outboard motor power.
- Rented watercraft with an inboard or inboard/outboard motor power with more than 50 horsepower.
- An owned or rented sailing vessel that is more than 26 feet in length.
- Watercraft powered by one or more outboard motors with more than 25 horsepower if the motors were owned by the insured at the inception of the policy and not declared or reported. However watercraft powered by outboard motors with more than 25 horsepower are covered if the motors were acquired prior to the policy period and providing the insured declared them at the time of policy inception or declared them within forty-five days of acquisition.

The above exclusions do not apply when the craft is in storage.

Focus Points

- Watercraft and trailers are covered under Section One of a homeowner's policy for physical damage and theft.
- Automobile policies do not cover physical damage to boats.
- Boat trailer can be insured for physical damage loss under a personal auto policy.
- Section II of a homeowner's policy provides personal liability insurance and covers certain watercraft loss exposures.
- There are several categories of watercraft liability that the homeowner's policy excludes from coverage.

CHAPTER 3: OUTBOARD MOTOR AND BOAT INSURANCE

This type of insurance is designed for those who own motorboats and for those who have adequate personal liability coverage under their homeowner's policy or under a comprehensive personal liability policy but desire broader physical damage insurance on their boat. Inland Marine Floater can provide this protection. Although floaters are not standard they do contain some common features such as:

COVERED PROPERTY.

The insured selects the property to be insured. The floater can be written to cover the following:

- Hull
- Motor or Motors
- Boat Equipment

- Boat Accessories
- Boat Carrier
- Boat Trailer

Covered property is written on an actual cash value basis and may contain a deductible of:

- ✓ \$25.00
- ✓ \$50.00
- ✓ \$100.00
- ✓ Or more

COVERED PERILS

The floater can be written on named perils of risks of direct loss basis. Most floaters currently are written on the risks of direct loss basis. The coverage does not include the liability for bodily injury, loss of life, or illness of individuals.

It is assumed that the insured has proper liability insurance under a homeowner's or liability policy to cover any third party bodily injury claims. The floater, however, may provide collision damage liability insurance that protects the insured from a claim for property damage from the owner of another boat if the insured's boat happens to collide with another boat while it is afloat.

EXCLUSIONS

Outboard motor and boat insurance contracts do have exclusions. Some of the common exclusions are as follows:

BUSINESS PURSUITS

- No coverage will be afforded if the boat is used as a public conveyance for carrying passengers' compensation.
- No coverage will be provided if the boat is rented to others.
- Coverage is excluded for race boats or speed contests.

REPAIR OR SERVICE

Loss or damage from:

- Refinishing
- Renovating
- Repair is not covered. The person who is repairing the boat would be responsible for any damage

GENERAL RISKS OF DIRECT LOSS EXCLUSION

Coverage will not be provided for loss or damage from:

- Wear and tear
- Gradual deterioration
- Vermin
- Marine life
- Rust
- Corrosion
- Inherent vices
- Latent defect
- Mechanical breakdown
- Freezing
- Extremes of temperature

WATERCRAFT PACKAGE POLICIES

Many insurance companies have developed special boat owner's policies that combine liability coverage, physical damage coverage, and medical payments coverage.

Boat owner's policies contain certain common characteristics, which are:

PHYSICAL DAMAGE COVERAGE

Currently most boat owner's policies are written on a direct and accidental loss basis. The insurance company agrees to pay for direct or accidental loss due to covered property under the physical damage insuring agreement. All losses are covered except those specifically excluded.

The physical damage covers the boat, equipment, accessories, motor, and trailer

In addition, if the boat collides with another boat, gets damage from heavy winds, or is stolen, the loss is covered.

LIABILITY COVERAGE

Liability insurance that covers the insured for bodily injury and property damage, liability from a neglect ownership or operation of the boat, is included in a boat owner's policy. Should the insured accidentally damage another boat or injure swimmers for example, protection is provided under the liability coverage.

MEDICAL PAYMENTS COVERAGE

This is similar to the medical payments found in an automobile insurance contract. Medical payments will be made for all medical expenses incurred within three years from the date of a watercraft accident that causes bodily injury to a covered person.

Under medical payments coverage, a covered person is defined as the insured, a family member, or any person while occupying the covered watercraft.

Medical expenses will be paid for reasonable charges for the following:

- ✓ Medical
- ✓ Surgical
- ✓ X-ray
- ✓ Dental
- ✓ Ambulance
- ✓ Hospital
- ✓ Professional Nursing
- ✓ Prosthetic Devices
- ✓ Funeral Services

OTHER COVERAGES

The following may also be found in a boat owner's policy:

- ✓ Cost of removing a wrecked vessel
- ✓ Cost of removing a sunken vessel
- ✓ Life salvage

EXCLUSIONS

The following are commonly excluded in a boat owner's policy under physical damage coverage:

- ✓ Wear and Tear
- ✓ Inherent Vice
- ✓ Latent Defect
- ✓ Mechanical Breakdown
- ✓ War
- ✓ Nuclear Hazard
- ✓ Damage Caused by Repair (except fire)
- ✓ Damage Caused by Restoration Process (except fire)
- ✓ Carrying Persons for a Fee
- ✓ Carrying Property for a Fee
- ✓ Renting Covered Property
- ✓ Racing Covered Property (except sailboats)
- ✓ Speed testing Covered Property (except sailboats)
- ✓ Infidelity of Persons to Whom Covered Property is Entrusted
- ✓ Portable Electronic Equipment
- ✓ Photographic Equipment
- ✓ Water sport's Equipment
- ✓ Fishing Gear
- ✓ Cameras
- ✓ Fuel
- ✓ Portable Radios
- ✓ Fishing Equipment

The following are commonly excluded from a boat owner's policy under medical expense coverage:

- ✓ Intentional Injury
- ✓ Intentional Damage
- ✓ Renting the Watercraft to Others
- ✓ Carrying Persons for a Fee
- ✓ Carrying Property for a Fee
- ✓ Using Watercraft in a Race (except sailboats)
- ✓ Using Watercraft in a Speed Test (except sailboats)
- ✓ Losses Covered under Worker's Compensation
- ✓ Losses by a Nuclear Energy Liability Policy

- ✓ Contractual Liability

Focus Points

- o Covered property is written on an actual cash value basis.
- o Coverage excludes the liability for bodily injury, loss of life, or illness of individuals.
- o Outboard motor and boat insurance may provide collision damage liability insurance.
- o Boat owner's policies are written on a direct and accidental loss basis.
- o Under Boat Owners Insurance, all losses are covered except those specifically excluded.
- o Physical damage covers the boat, equipment, accessories, motor, and trailer
- o Boat Owner's policies include Liability insurance.
- o Medical payments coverage covers the insured, a family member, or any person occupying the covered watercraft.

CHAPTER 4: PERSONAL YACHT INSURANCE

This type of policy is for larger boats such as inboard motorboats and cabin cruisers. Personal Yacht insurance provides hull insurance, protection and indemnity insurance, optional coverage and warranties.

HULL INSURANCE

This protection refers to physical damage on the boat. This coverage also applies to sails, tackle, machinery, furniture, and the boat itself.

This insurance provides "all-risks" protection. For example if the boat is damaged by: heavy seas, collision, flood or sinking because of an insured peril, the loss is covered. A deductible of varying amounts will apply to all physical damage and losses.

PROTECTION AND INDEMNITY INSURANCE

This coverage provides the boat owner with coverage for bodily injury and property injury on an indemnity basis. If for example the boat were to smash into a marina and injures several persons the loss to the dock as well as any bodily injury would be covered under P&I.

OPTIONAL COVERAGES

You may add several options to your personal yacht policy, such as, medical payments coverage, liability of the insured to maritime workers injured in the course of employment, boat trailer insurance, land transportation insurance and water-skiing clause.

WARRANTIES

Several warranties and promises are provided with yacht insurance. Should a warranty be violated higher premiums may be required.

The major warranties on yacht insurance are as follows:

- Seaworthiness Warranty
 - The insured warrants that the vehicle is in seaworthy condition
 - Lay-up Warranty
 - The insured warrants the vehicle will not be in operation during certain periods, such as winter months
 - Navigational Limits
 - The vessel will be used only in territorial waters described in declarations
 - Private Pleasure Warranty
 - The insured warrants the vessel will not be hired or chartered
-

UNINSURED BOATERS COVERAGE

As is the case with automobile insurance where you can purchase uninsured motorist protection, boat packages also include an option for uninsured boat coverage. The company agrees to pay damages that a covered person is legally entitled to recover from an insured boat owner or operator due to bodily injury sustained by a covered person in a boating accident.

EXCLUSIONS

The uninsured boater's coverage has several exclusions. Bodily injury from the following are excluded:

- While occupying or struck by any watercraft owned by the insured or family member that is not insured under the policy
- If the bodily injury claim is settled without the insurance company's consent
- While operating a covered watercraft which is carrying persons or property for a fee
- While occupying a covered watercraft being rented to others
- Using a watercraft without a reasonable belief that the person is entitled to do so
- Occupying a watercraft without the reasonable belief that the person is entitled to do so.

In the event there should be a disagreement as to whether a covered person is legally entitled to recover damages from the uninsured boat owner or operator, or on the amount of damages, the coverage has an arbitration provision which states:

Each party selects an arbitrator. The two arbitrators then select a third arbitrator. They have thirty days to agree. If they go beyond thirty days a judge in a court of law appoints the arbitrator.

Focus Points

- Personal Yacht Insurance covers larger boats such as inboard motorboats and cabin cruisers.
- Personal Yacht insurance provides hull insurance, protection and indemnity insurance, optional coverage and warranties.
- Hull insurance covers physical damage to the sails, tackle, machinery, furniture, and the boat itself.
- Protection and indemnity insurance covers bodily injury and property injury on an indemnity basis.

CHAPTER 5: SPECIALIZED COVERAGE'S

Marine insurance is a broad term including ocean and inland marine insurance. The Nationwide Marine Insurance Definition, published by the National Association of Insurance Commissioners, includes imports, exports, domestic shipments, and means of communications, and personal and commercial property floaters as marine insurance.

OCEAN MARINE

Ocean marine insurance covers ships or hulls, goods or cargo, earnings (such as freight, passage money, commissions, or profit) and liability (known as protection and indemnity). The vessel owner or any party interested in or responsible for insurable property by reason of maritime perils may purchase this insurance.

PROTECTION AND INDEMNITY INSURANCE (P&I)

Is a broad form of marine liability insurance that covers the operator of a ship for such things as liability to crew members and other individuals on board the vessel, and for damage to fixed objects, such as docks, resulting from the insured's negligence.

INLAND MARINE INSURANCE

Is for coverage of property that involves an element of transportation. The property must be actually in transit, held by a bailee, at a fixed location that is an instrument of transportation, or be a movable type of goods that is often at different locations.

BUMBERSHOOT LIABILITY

Bumbershoot coverage is a particular form of umbrella liability designed for accounts where the principal exposure is marine and involves the operation of vessels and use of docks.

The Bumbershoot covers: protection and indemnity; general coverage, collision, salvage charges, sue and labor; all other legal and contractual liability including employers liability, liability under admiralty laws or the Longshoremen's Act, automobile liability, and those hazards usually associated with general liability insurance. Insured's net retention of at least \$100,000 usually required.

CHARTER BOATS

Standard protection and indemnity forms issued in conjunction with Hull insurance policies on vessels exclude coverage on the use of a boat for hire or charter. Under certain circumstances, a P & I form, broader in coverage than a standard general liability contract, is issued to an owner or operator of such a vessel used for carrying passengers for sightseeing, fishing, transportation, entertainment or marine observations on a fee basis.

Coverage for liability also may be arranged on an OL&T liability form with rates set in the specialty market at a surcharged rate. Vessels under 40 feet in length are rated at 50% of those over 40 feet. Coverage usually is subject to a deductible. Liability exposure is of more concern to underwriters than loss or damage to the hull.

Restaurant and serving of alcoholic beverages are also principal hazards on larger vessels.

SHIP CHARTERER LEGAL LIABILITY

This insurance is designed to protect a vessel charterer against liability incurred for loss of, or damage to, the vessel hired under the charter party. Liability is ordinarily limited to damage caused in loading or unloading or failure to provide a safe berth. Policies may be written on an open basis with a flat premium charged for each voyage, or each voyage may be placed separately.

SHIP REPAIRER LEGAL LIABILITY

Protects an individual ship repairer, marina or boat yard operator for legal liability to the vessel's owner for damage to the vessel being repaired. This "care, custody or control" coverage provides only property damage liability and may be extended to include insured's legal liability for damage to other property caused by a collision (or otherwise), while the vessel is being repaired or tested.

There are times when situations call for specialized coverage...the type of coverage that can only be realized with an Inland Marine policy.

Some of the types of coverage's that can be found in Inland Marine policies:

BUILDERS' RISK

Builders' Risk policies cover buildings or structures during the construction, renovation or repair process. While coverage is often tailored to meet the needs of each customer, the vast majority of policies also cover building materials destined to become a permanent part of the building or structure. This property is covered while in transit, at temporary storage locations and while stored at the job site.

Builders' Risk policies are an important insurance product within the construction industry because the vast majority of banks require evidence of Builders' Risk insurance prior to closing on a construction loan.

In addition, two of the most frequently used construction contracts (the Association of General Contractors and the American Institute of Architects Contract for Construction) contain specific provisions outlining requirements for Builders' Risk insurance.

Even putting these requirements aside, few if any companies can afford to invest in construction without insurance protection.

Any business entity with a financial interest in property under construction, renovation or repair needs Builders' Risk insurance. Typical policyholders include:

- Real Estate Developers
 - ✓ Building Owners
 - ✓ Home Builders
 - ✓ General Contractors
 - ✓ Municipalities
 - ✓ Colleges and Universities

COMPUTERIZED BUSINESS EQUIPMENT

Computerized Business Equipment policies can cover all types of automated equipment capable of accepting and processing data. While we typically think of computers as the primary subject of this coverage, automated manufacturing equipment, computerized medical equipment, flight simulators and any number of other specialized equipment can be eligible for coverage.

Coverage may also include the software and data used by this equipment as well as business income and extra expense exposures that may arise for a loss to such equipment or data. Coverage typically applies on premises, while in transit and while temporarily away from covered locations. Laptops and portable computers are covered worldwide.

Technology represents a significant investment to many businesses. Computerized Business Equipment coverage is important to any business entity that relies on technology in their daily operations. The greater the dependence on technology, the more important it becomes to purchase specialized coverage on such a critical aspect of consumers operations.

CONTRACTORS EQUIPMENT

Contractor's Equipment Coverage can cover scheduled, leased and miscellaneous property of the contractor. In addition, coverage is extended to include any similar property of others for which he is liable.

Coverage extensions can include:

- Additionally Acquired Equipment for up to a policy limit on the equipment, which the insured buys, leases, rents or borrows for defined period of days.
- Rental Expense Reimbursement, which pays up to a defined limit in expenses – rent – if covered equipment is damaged in a covered loss.
- Installation Floater coverage extends to property intended for installation while at job site, at any other location, or in transit.
- Valuable Papers coverage provides for such items as blueprints and other documents of value to the contractor.
- Contractors Equipment is owned or leased to perform a specific function. Use of the equipment is directly related to generating revenue, fulfilling a contract or providing maintenance. Without working equipment or the means to replace equipment as soon as possible, a contractor's obligations cannot be fulfilled.
- Contractors Equipment policy helps owners expedite the repair or replacement of damaged or stolen equipment. In addition, because of the high cost of the equipment many banks and lending institutions require insurance on the equipment.

Any business entity with a financial interest in construction or other heavy equipment needs Contractors Equipment insurance.

Typical policyholders include:

- ✓ Real Estate Developers
- ✓ Building Owners
- ✓ Home Builders
- ✓ General Contractors
- ✓ Municipalities
- ✓ Street and road contractors
- ✓ Excavation Contractors
- ✓ Port Facilities
- ✓ Warehouse Operators

FINE ARTS

Coverage for works of art at a permanent location, in transit and while loaned to others. Agreed Value Fine Arts coverage ensures that collections are treated properly with a form that addresses the specific collection needs, with availability of breakage coverage, special pairs and sets coverage, and flood and earthquake coverage.

For significant corporate collections, or for artwork and collectibles in commercial settings, Insurers offer comprehensive coverage for a broad spectrum of paintings, sculpture, prints and multiples, as well as more specialized collections of historical, cultural or technological significance.

Who Needs Fine Arts Coverage?

Corporations and commercial accounts may have valuable works of art not specially covered as Fine Arts under standard package policies and Marine coverage fits the bill.

INSTALLATION COVERAGE

Installation policies insure building materials and components, machinery, and specialized equipment while being installed in a building or structure, or erected or fabricated at a specific location. Typical types of property include heating, ventilating, air conditioning and electrical systems; and wallboard, tile, carpeting and other interior finish material.

More specialized installations include wastewater treatment facilities and controls, pipelines, electrical, telephone and cable television lines; and radio and cellular telephone towers.

Coverage is typically effective from the time the customer's financial interest in the property begins until their interest ceases, including while the property is in transit, at temporary storage locations and while stored at the job site.

The vast majority of Installation policies are written for subcontractors (trade subcontractors in particular). Any business entity having a financial interest in property being installed, erected or fabricated may have a need for Installation coverage.

Typical policyholders include:

- ✓ Specialty Contractors
- ✓ Government Authorities and Municipalities
- ✓ Utilities (Water, Gas, Telephone, Electrical)
- ✓ Manufacturers, wholesalers, and retailers of machinery, equipment and materials, who also install what they sell

Marine underwriting specialists have written all types of installation projects - from low hazard residential electrical systems and tenant finish-out, to helicopter assisted tower installations, to the delicate relocation of erosion threatened lighthouse.

Standard programs offer coverage against risks of direct physical loss or damage (subject to certain policy exclusions), or coverage tailored to a specific, complex project.

MANUFACTURERS

Manufacturers Output Policy (MOP) includes coverage for the personal property of a business at specific, as well as unnamed locations, including while in transit.

Personal property coverage includes such items as machinery, equipment, furniture, fixtures and stock, improvements, and includes any other similar property of others for which an insured is liable.

Coverage Extensions include: Accounts Receivable and Valuable Papers coverage's, and Fire Protection System Recharge Expenses.

MOTOR TRUCK CARGO LEGAL LIABILITY

Motor Truck Cargo policies insure common and contract carriers for loss or damage to cargo in their care, custody or control.

Coverage is provided on a legal liability basis as determined by the contract of carriage between the motor carrier and the shipper (Bill of Lading or other specially negotiated contract). Generally, a carrier is liable for the safe delivery of the property entrusted to them, not only while on their vehicles, but also while temporarily at terminals awaiting shipment.

An insurer's Motor Truck Cargo Legal Liability policy is designed to cover that liability on behalf of the carrier.

Anyone who carries the property of others in return for a tariff should have Motor Truck Cargo Liability including:

- ✓ Common Carriers
- ✓ Contract Carriers
- ✓ Non-trucking risks whom backhaul property of others on their own truck.

MUSEUMS

Some Marine policies offer coverage developed specifically to insure museum-quality objects.

The policy insures museum owned property at scheduled locations, on exhibition or on loan to other organizations. The policies also offer coverage's for property in transit and the property of others for which the policyholder is legally liable. Coverage is available for art, history, natural history, science and technology and sports museums.

Some insurers also offer coverage for specialized institutions such as aviation and automobile museums.

In the United States, there are more than 12,000 museums eligible for this coverage. The market is expected to expand as the number of specialty museums and local historical societies continues to grow. Many of these smaller museums have no coverage for their collections because they perceive that one-of-a-kind objects are invaluable and therefore uninsurable.

Although an exact replacement is not available, insurance can offer curators the opportunity to supplement the remaining collection with artifacts of the same genre to keep and preserve the mission of the museum. Insurers such as Travelers and other provide coverage for these types of unique situations. Whatever the risk, from local special interest museums to large national museums, companies such as Travelers provide Insurance coverage for the art world's special insurance needs.

SCHEDULED PROPERTY

Scheduled Property coverage is designed to cover property that is unique or unusual or is not typically covered under any other marine or property coverage. Coverage is available to protect against risks of direct physical loss or damage (subject to certain inland marine exclusions).

Any commercial property owner with property that travels from location to location or needs coverage for other than real property or contents is a candidate for Scheduled Property.

Scheduled Property is for any business entity that wants insurance protection for unique property ranging from structures outdoors to movable property.

Some of the unusual types of risks eligible for this coverage include:

- ✓ Circus rides
- ✓ Locomotives and rail cars
- ✓ Voting machines
- ✓ Transit systems
- ✓ Water storage tanks
- ✓ Antique and Racecars
- ✓ Ski lifts

Program can be tailored to the specific property. Scheduled Property is completely flexible in coverage scope. Coverage applies to property wherever it is located - at a specific location, in transit or at a temporary location. Valuation options of all types are available including agreed amount, actual cash value or replacement cost. Coverage is tailored to the specific types of property.

TRANSPORTATION

Transportation insurance typically covers a shipper's interest in their property while in transit by public motor carrier, contract carrier, railroad, air carrier, or while on their own vehicles.

The coverage form is often extended to provide insurance for loss to property while it is being loaded and unloaded.

A Transportation policy pays up to the limit of insurance, regardless of the extent of the carrier's legal liability or the carrier's ability to meet their financial obligations. In today's fast paced world,

Insured's don't have time to spend collecting reimbursement from a carrier in the event of a loss. Some Transportation policies also pay for certain losses, even when the carrier may not be liable, such as Acts of God (flood, earth movement, etc.). And if the insured ships F.O.B. and cannot collect the invoice amount from the consignee because of loss or damage during the shipment, the policy will cover the insured's interest in the lost or damaged property.

Any business that deals in a product, such as manufactures wholesalers' retailers and distributors need coverage for incoming and outgoing shipments:

WHOLESALE AND RETAILERS

Accounts Receivable Coverage covers the cost of re-establishing records of Accounts Receivable, as well as the actual loss caused by damage.

Camera and Musical Instrument Dealers Coverage protects merchandise while at the premises of the insured, in transit, or away in custody of employees.

Coverage is also provided for the property of others while in the insured's custody.

Equipment Dealers Coverage allows coverage for dealer's property such as mobile agricultural and construction equipment and related accessories.

Fine Art Dealers Coverage provides for dealer's stock and the property of others, which could consist of sculpture, paintings, drawings, lithographs and other types of fine prints, antiques or collectibles.

Floor Plan Coverage Form protects merchandise for sale that has been financed. This Inland Marine form covers the single interest of the dealer or the lending institution or covers their dual interest.

Furriers Block protects a furrier's stock – consisting mainly of furs, fur garments, garments trimmed with fur and fur accessories.

Jewelers Block covers merchandise while at the premises of the insured, in transit, away in custody of employees, and elsewhere.

Transportation Coverage Form covers property shipped via common carrier, or owned vehicles.

FOR REAL ESTATE OWNERS

Builders' Risk covers buildings undergoing renovation, including existing structures, in addition to new construction projects.

Equipment Floater covers mobile equipment used in the servicing of building.

Valuable Papers Coverage provides for inscribed, printed or written documents, manuscripts or records, including deeds, drawings, maps or mortgages.

FOR SERVICE SECTORS

Accounts Receivable Coverage protects the cost of reestablishing Accounts Receivable records as well as actual loss due to the inability to collect sums resulting from a loss or damage to these records.

Bailee Floater for insured's who take custody of property of others (e.g., repair shops, dry cleaners, etc.). Within the service sector, Inland Marine Floaters that extend to;

Electronic data processing equipment, data and media; miscellaneous property;

Physicians and Surgeons Coverage for the transportation of goods shipped via common carrier or owned vehicles, and coverage of valuable papers for inscribed, printed or written documents, manuscripts or records.

Focus Points

- o Marine insurance includes ocean and inland marine insurance.
- o Ocean marine insurance covers ships or hulls, goods or cargo, earnings and liability.
- o Inland Marine Insurance covers property that is transported.
- o Charterer Legal Liability protects a vessel charterer against liability for loss, or damage to the vessel hired under the charter party.
- o Ship Repairer Legal Liability protects a ship repairer, marina or boat yard operator from liability for damage to the vessel being repaired.
- o Builders' Risk policies cover buildings under construction, renovation or repair process.
- o Computerized Business Equipment policies cover all types of automated equipment.
- o Computerized Business Equipment may also include software and data.
- o Contractor's Equipment Coverage covers scheduled, leased and miscellaneous property of the contractor.
- o Fine Arts coverage protects art at a permanent location, in transit and while on loan.
- o Manufacturers Output includes coverage for property of a business at specific or unnamed locations and while in transit.
- o Motor Truck Cargo policies insure carriers for loss or damage to cargo.
- o Scheduled Property covers property not covered under other marine or property coverage's.
- o Transportation insurance covers shipper's property while in transit.

CHAPTER 6: OCEAN MARINE INSURANCE

Ocean marine policies were the first form of insurance coverage. They were written to provide financial protection for the owners of ships and cargoes in the event their property was lost at sea.

The cargo was insured from port to port. Ocean marine policies still offer this coverage today and include Ocean Cargo, Commercial Hull, Hull Builders Risk, Marina Operators, Boat Dealers, Ship Repairers, Stevedores, Wharfingers and Charterers.

Marine policies can be written to cover the movement of any legal goods. The property insured is not itemized in the policy, which is written to cover "goods and merchandise."

Certain types of property are not included under the general category of "goods and merchandise" and need to be specifically covered.

These not included items are things such as livestock, frozen foods, refrigerated meats, poultry, game, etc., as well as, specie, bullion, securities and similar property.

The marine policy may be written not only to cover the value of the shipped goods but also import duties and freight charges.

HAZARDS COVERED

PERILS OF THE SEA

Under this coverage came all perils which are peculiar to transportation and which cannot be prevented by any reasonable efforts of man. Perils of the sea must be fortuitous. That is due to an uncontrollable action of the sea, not within the control of any person.

FIRE

Fire is not a peril of the sea, but the policy covers this risk. There is no coverage against fire, which is due to the inherent combustibility of the goods being carried. Combustible cargoes sometimes are insured with special coverage specified in a policy.

BARRATRY OF THE MASTER

Violation of trust of the master is covered provided it is not done with connivance of the ship owner.

ASSAILING THIEVES

Although petty thievery is not covered by the policy, theft accompanied by violence is covered.

JETTISON

The throwing overboard of cargo is covered when it is done to preserve property from loss.

ALL OTHER PERILS

The policy covers "all other perils which shall come to the hurt, detriment or damage" of the goods. The clause would appear to make the policy cover against all risks, which is definitely not correct. It means only perils of a character similar to those insured.

EXPLOSION

Most marine policies specifically cover the risk of explosion, whether on land or sea.

LATENT DEFECTS IN MACHINERY, HULL, APPURTENANCES

Most marine policies are extended to cover damage caused by bursting of boilers, breakage of shafts or through any latent defects in the machinery, hull or equipment, and through faults and errors in navigation or management of the vessel.

OTHER TYPES OF COVERAGE'S

CHARTERERS LEGAL LIABILITY

When a shipper contracts with a ship owner to use their vessel, this arrangement is considered a charter.

Depending on the type of charter, the charterer is held legally responsible for certain liabilities and properties of the vessel. There are three types of charterers commonly used:

- ✓ Voyage Charter
- ✓ Time Charter
- ✓ Bareboat Charter.

Depending on the type of contract the charterer enters into, they may become liable for certain exposures involved in the operation of the vessel. A charterer who contracts the entire vessel for a single or series of consecutive voyages is considered a Voyage Charterer.

In a Voyage Charter, the shipper in most cases is liable for a safe berth, loading and the unloading. The ship owner retains the responsibility for navigation, operation of the vessel and all expenses.

A charterer who contracts to hire the entire vessel for a specific period of time is called a Time Charterer. In a Time Charter, the shipper is responsible for paying for the ship's fuel and for providing a safe berth at the port of delivery. The ship owner remains responsible for navigation and the expenses of operating the vessel.

A charterer who contracts to hire the entire vessel without a crew, stores or provisions is called a Bareboat Charterer. In a Bareboat Charter, the shipper is liable for the full operation of the vessel.

*Note: Charterers Legal Liability coverage forms are not standardized so it is important to study each company's program and work with an experienced agent who has access to an Ocean Marine underwriting specialist.

HULL PROTECTION & INDEMNITY

Hull policies cover physical damage losses to the vessel arising out of numerous perils.

Protection and Indemnity policies cover the liability of the vessel owner for bodily injury (including death) or property damage arising out of specific types of accidents.

Hull and Protection and Indemnity coverage is often tailored for each customer. Typically hull coverage is written together with the protection and indemnity coverage.

Hull policies are a necessary part of the shipping industry. Without hull coverage, a prospective buyer of a vessel will be unable to obtain a loan to finance the purchase. Hull coverage will protect the interests of the bank and the vessel owner if a loss does occur.

Protection and Indemnity (P & I) policies are also necessary. Without protection and indemnity coverage, most vessels would not be permitted to sail. The majority of labor unions require that a fleet have coverage for the crewmembers in case they become ill, injured, or are killed while employed by the vessel.

Without evidence of adequate Protection and Indemnity insurance, the vessels would not be manned and cargo would not leave the ports. Any commercial ship owner and/or operator of an inland/ocean going vessel needs Hull and Protection and Indemnity insurance.

Typical policyholders include:

- Container Vessel Owners
- Bulk Carrying Vessel Owners
- Tanker Vessel Owners
- Barge Owners
- Ferry Owners
- Heavy Lift Vessel Owners

Hull and Protection and Indemnity underwriting requires the assistance of underwriting specialists who take pride in understanding each customer's specific needs. We do use Industry standard coverage forms do not always meet the needs of a customer but must be tailor made to reflect a customer's specifications.

MARINA OPERATORS LEGAL LIABILITY

Marinas provide a number of services to the owners of private pleasure crafts including renting dock space, fueling, storage, launching and hauling.

The marina must exercise the appropriate care to protect their customers' pleasure craft, equipment on board and motors that are in their care, custody or control. If negligent in such duties, a marina may be held liable for any loss or damage to their customer's property.

Marina Operators Legal Liability covers the insured's liability for loss of or damage to customers' private pleasure watercraft, equipment on board and motors that are in their care, custody or control. Any individual or any entity with a financial interest in a marina or yacht club needs Marina Operators Legal Liability.

Typical policyholders include yacht club owners and marina owners.

OCEAN CARGO

Ocean Cargo policies cover physical loss or damage to goods and merchandise that are shipped by various types of carriers; i.e., rail, air, water, and motor truck. Besides just covering goods while in transit overseas, the coverage form can be broadened to cover the goods while temporarily stored at international and domestic warehouses, while being shipped domestically or while at a domestic or foreign processor.

Ocean Cargo coverage is tailored to meet the needs of each customer. Ocean Cargo policies are a necessary part of the shipping industry. Without Cargo coverage, international transactions would not take place.

When a bank finances the purchase of goods, the buyer is required to provide evidence of adequate insurance for the loan prior to any advancement of money.

Once proof of adequate insurance has been given to the bank, the shipment of the goods can commence. Ocean Cargo insurance typically protects the interests of the bank, the seller of the goods and the buyer of the goods.

Any individual or any entity with a financial interest in goods or merchandise being shipped internationally needs Ocean Cargo insurance.

Typical policyholders include:

- Multi National Companies
- Wholesalers and Distributors
- Manufacturers and Processors
- Shipping Companies
- Importers/Exporters
- Logistic and Intermeddle Freight Transportation Service Companies

Underwriting specialists must be understanding of each customer's exposures and must be sensitive to designing a cargo policy tailored to reflect that customer's specifications.

SHIP REPAIRERS LEGAL LIABILITY

A shipyard doing repairs on a vessel has certain responsibilities to the vessel owner for the safety of their property. The shipyard must anticipate the hazards to which the property is subject and must exercise the appropriate care to protect this property.

If negligent in such duties, the shipyard may be held liable for loss or damage to this property.

When a shipyard is repairing a customer's vessel, there is a bailment between the shipyard and vessel owner while the vessel is in the care, custody, or control of the shipyard. This bailment makes the shipyard liable for certain damages and they must exercise an ordinary degree of care to protect their customer's property.

The Ship Repairers Legal Liability coverage form provides liability coverage for this exposure.

Ocean Marine Specialists must work with each customer to develop a coverage form that fits the specifications of the customer. The insurer's Ocean marine claim surveyors, Adjusters and settling agents must all work together providing the customer the best coverage available to meet the customer's requirements.

Note: Ship Repairers Legal Liability coverage forms are not standardized so it is important to study each company's program and work with an experienced agent who has access to an Ocean Marine underwriting specialist.

STEVEDORES LEGAL LIABILITY

When a vessel enters a port, its cargo needs to be either loaded or unloaded safely and expeditiously so the vessel can set sail again with limited delays.

An independent contractor called a Stevedore is usually responsible for the loading and unloading operations at a port.

The Stevedore can be legally liable for damage to vessels, cargo, and property located on the premises they are conducting their operations on. Coverage provides protection to the Stevedore for their ordinary liability to exercise an appropriate degree of care for vessels, cargo and property in their care, custody or control.

Note: Stevedores Legal Liability coverage forms are not standardized so it is important to study each company's program and work with an experienced agent who has access to an Ocean Marine underwriting specialist.

TERMINAL OPERATORS LEGAL LIABILITY

A terminal operator can perform many functions including warehousing services such as "pick and pack" operations, labeling, inventory control and local trucking. In addition, they may provide a safe berth for vessels and have employees that load and unload vessels.

One common exposure that exists in all of these operations is the terminal operator's legal liability exposure while goods and property of others are in their care, custody or control.

A terminal operator provides an extended range of services that can include operations provided by a Wharfinger, Stevedore and Warehouseman. When determining coverage needs, it is important to examine the services that the insured provides their customers.

Note: Terminal Operators Legal Liability coverage forms are not standardized so it is important to study each company's program and work with an experienced agent who has access to an Ocean Marine underwriting specialist.

WHARFINGERS LEGAL LIABILITY

When a vessel enters a port it must have a safe berth before it can be loaded or unloaded. The Wharfinger (pronounced "war-fin-ger") provides the vessel owner with a safe berth watches over the vessel and exercises the appropriate care to protect the vessel from loss or damage.

The Wharfinger is held liable for the vessel while it is in their care, custody or control. They also have certain responsibilities for the safety of the vessel. This liability is the principal exposure covered by a Wharfingers policy.

Note: Wharfingers Legal Liability coverage forms are not standardized so it is important to study each company's program and work with an experienced agent who has access to an Ocean Marine underwriting specialist.

Focus Points

- o Ocean marine policies were the first form of insurance coverage.
- o Marine policies can be written to cover the movement of any legal goods.
- o Ocean Marine insurance covers charterers' legal liability.
- o Hull policies cover physical damage losses to the vessel.
- o Protection and Indemnity covers the vessel owner for bodily injury or property damage in specific types of accidents.
- o Most vessels are not permitted to sail with out Protection and Indemnity coverage.
- o Marina Operators Legal Liability covers for loss or damage to customers' watercraft, equipment and motors in their care.
- o Ocean Cargo policies cover physical loss or damage to goods shipped by various types of carriers.
- o Stevedores Legal Liability covers cargo that is loaded or unloaded from a vessel.

CHAPTER 7: LLOYD'S OF LONDON

Lloyd's is an insurance market unique in the world. Almost anything can be insured at Lloyd's: fleets of ships and aircraft, civil engineering projects, factories, oil rigs and refineries, personal lines risks as well as liability policies for most commercial eventualities, to name but a few of the thousand-and-one risks which are placed at Lloyd's each year.

The business flows from all parts of the world and represents an income of millions of pounds in premiums each working day.

Lloyd's is not a company. It has no shareholders and accepts no liability centrally for risks insured in the market. Lloyd's is a society of individual and corporate members each of whom accepts insurance risks as members of one or more underwriting syndicates.

Individual members are liable to the full extent of their private wealth to meet their insurance commitments, while the corporate entities trade with limited liability.

AN INTRODUCTION TO LLOYD'S

A proper understanding of the present-day Lloyd's, how it works, why it exists, is impossible to review without a brief glimpse of the past.

The origins of marine insurance are barely discernible in the mists of time, although the practice is known to have been introduced to England by the Lombard's in the sixteenth century.

The growing importance of London as a center of trade after the English Civil War led to a steady increase in the demand for insurance of ships and cargoes.

This coincided with the rise in popularity of coffee drinking in England, a custom that had far-reaching effects upon the nation's social and commercial life. The first London coffee house opened in 1652. From the time of King Charles's restoration to the throne in 1660, coffee houses proliferated until by the end of the century they were numbered in hundreds.

In contrast to the inns and taverns, which had always existed in profusion, coffee houses provided congenial meeting places for serious and clear-headed discussion. In the City their popularity as places for the transaction of business was quickly established. The

Royal Exchange, the traditional meeting place of merchants, offered little in the way of comfort and convenience and must have been frequently deserted in favor of the coffee house.

Business in those days was conducted very informally and the insurance of ships and cargoes was a fairly simple matter of hawking a policy around the City for subscription by anyone with the private means to take a share of the risk in return for a portion of the premium.

A merchant, with a ship to insure, would request an "insurance office" to act as a broker, taking the policy from one wealthy merchant to another until the risk was fully covered.

The broker's skill lay chiefly in ensuring that policies were underwritten only by men of sufficient financial integrity to meet their share of a claim – to the full extent, if need be, of their personal fortunes.

It was against this background that Lloyd's Coffee House made its appearance on Tower Street some time in 1688, the year that the 'bloodless revolution' brought William and Mary to the throne of England. Unfortunately, very little is known either about Edward Lloyd or his coffee house.

It was one of many similar establishments and, apart from occasional references in contemporary newspapers, the record is blank. The first mention of Lloyd's appears in the late 1680s when an advertisement in the London Gazette offers a reward of a guinea for information about stolen watches, claimable from 'Mr. Edward Lloyd's Coffee House on Tower Street'.

It seems very likely that, from the first, Edward Lloyd encouraged a clientele of ship's captains, merchants, ship owners and others with an interest in overseas trade. Coffee houses in general (and Lloyd's was surely no exception) were centers of discussion where, in the days before newspapers, the latest gossip could be heard. More than this, at a time when communications were laborious and unreliable, Edward Lloyd gained an enviable reputation for trustworthy shipping news.

This was one of the basic ingredients of successful underwriting and perhaps more than any other factor, ensured that 'Lloyd's coffee house', over and above its rivals, became the recognized place for obtaining marine insurance.

As far as is known, Edward Lloyd took no part in underwriting. He contented himself with providing congenial premises and the facilities for his patrons to do business, remaining a 'coffee-man' until his death in 1713.

Lloyd's chief bequest to posterity was his name and the coffee house, which bore it.

Up to 1720 there is nothing to suggest that underwriting was carried on exclusively in any one place. But in that year a piece of legislation was enacted by Parliament, which profoundly influenced the future of Lloyd's Coffee House as a center of marine insurance.

For some years previously there had been intermittent attempts to set up a securely based insurance corporation (or chartered company), which it was hoped, would bring some regularity to the disorderly commercial world of the early Georgian period.

At this time, too much wealth and too little employment for it had given rise to the wild investment speculation, which swept London and culminated in the collapse of the South Sea Company in 1720, ruining thousands of investors.

The 'South Sea Bubble' was the most spectacular of many frauds and failures of corporate enterprises at a time when disreputable companies ballooned and burst overnight. The 'Bubble Act' (so called because it was passed as the drama of the South Sea Company reached its climax) granted charters to the Royal Exchange Assurance and the London Assurance Companies, prohibiting marine insurance by any other corporation or business partnership.

The legislators had no intention, however, of curbing the underwriting activities of private individuals such as the respectable merchants who had traditionally subscribed their names to insurance policies.

Unlike companies and partnership groups, private underwriters on accepting a risk bound themselves 'each for their own part not for one another and, by long standing custom, the whole of their private estate was pledged as security to meet a claim. For these reasons the Act deliberately excluded 'private and particular' persons from its scope and Lloyd's can be fairly said to owe its future existence to this omission.

The threat presented by the two un-enterprising insurance corporations did not prove to be serious, though it probably caused the merchant underwriters to concentrate in a community of interest at the place most frequented by them – Lloyd's Coffee House, then located in Lombard Street.

BIRTH OF A SOCIETY OF UNDERWRITERS

As the eighteenth century drew on, the informal gathering of merchants at Lloyd's gradually assumed a more cohesive identity. But there was little or no restriction of the activities of the patrons and we can assume that a very mixed bag gathered under its roof. In those times a thin line divided respectable marine underwriting from the sort of insurance that would be regarded even beyond the scope of a bookmaker.

Gambling was still the outlet of excess wealth as it had been in the years before the 'South Sea Bubble' burst. Side by side with the insurer of ships and cargoes there existed men who would make a book on any eventuality – against an ailing monarch, for example, dying within a certain time, or perhaps a highwayman being caught and hanged.

In 1769, however, a number of Lloyd's more reputable customers decided to break away and set up a rival establishment in nearby Popes Head Alley devoted strictly to marine insurance. This step was one of the first signs of any community of interest among underwriters at the coffee house. It led rapidly to the establishment of a properly constituted society out of which evolved the business institution of today.

'New Lloyd's Coffee House' as it was called, soon proved to be too small. In 1771 a committee was elected to find new premises and 79 merchants, underwriters and brokers each paid £100 into the Bank of England for that purpose.

Three years the Committee in the Royal Exchange and 'New Lloyd's' leased later rooms left the coffee house for good. Although everyone still referred to 'Lloyd's Coffee House' for many years to come there is no doubt that it immediately took on the appearance of a place of business rather than one of refreshment. The modern Lloyd's had been born. For the next century the society of underwriters at Lloyd's evolved step by step, gradually assuming its present day form. Membership was regulated and the elected Committee given increased authority.

This period of evolution culminated in 1871 with the incorporation of Lloyd's by Act of Parliament. Up to then, Lloyd's constitution had been based on the 'Trust Deed', a legal document drawn up in 1811 and signed voluntarily by all subscribers to Lloyd's – or 'members' as they were called after 1843.

Lloyd's Act gave the Society a formal legal basis enabling it to acquire property and to make by-laws, which had the full authority of Parliament behind them. If the Trust Deed marked the end of the coffee house era, Lloyd's Act confirmed the existence of the modern business institution seen at Lloyd's today.

LLOYD'S ACT 1982

Lloyd's Act of 1871 has been followed by five further Acts to meet the Society's changing needs. The most recent of these, Lloyd's Act 1982, resulted from an inquiry into the society's constitution and the effectiveness of its powers of self-regulation.

The inquiry, established by Lloyd's in 1979 and chaired by a former High Court Judge, Sir Henry Fisher, recommended the formation of a new body, the Council of Lloyd's, to assume the rule-making and disciplinary functions hitherto vested in Lloyd's membership as a whole.

A Bill to give effect to this and other changes was overwhelmingly endorsed by the membership in November 1980 and enacted in July 1982 after lengthy debate and detailed scrutiny by committees of both Houses of Parliament.

THE HOMES OF LLOYD'S

When Edward Lloyd's business outgrew the original Tower Street coffee house he moved in 1691 to Lombard Street nearer to the heart of the City of London. By this time Lloyd's Coffee House had become one of the principal commercial coffee houses in the City.

Merchants, ship owners and captains, in fact everyone with an interest in maritime trade, were drawn to Lloyd's by the enterprising proprietor's extensive network of shipping information which was usually reliable in those less well informed times.

Over the next 80 years, under various owners and managers, Lloyd's Coffee House prospered and slowly evolved into a more formal society until in March 1774 the Subscribers to Lloyd's occupied new premises over the Royal Exchange in Cornhill.

With some interruption Lloyd's occupied premises there until 1928 when, having purchased the freehold of a site in Leadenhall Street, the market moved into a new building there, the first ever owned by the society.

By 1948 further expansion of Lloyd's necessitated the purchase of an adjacent site and in 1958 underwriting activities moved across Lime Street into a second new building. In 1978 Lloyd's again faced the prospect of unacceptable overcrowding and a decision was taken to redevelop the Leadenhall Street site of Lloyd's old building.

A leading architect Richard Rogers (now Lord Rogers) was appointed to design a new home for Lloyd's, which would enable the market to expand well into the first half of the 21st century and hopefully beyond. The new building, which is of advanced design and incorporates the latest developments in electronic technology, opened for business in May 1986. A formal opening ceremony was performed by HM The Queen the following November.

The Lloyd's market now operates on the ground floor and a number of galleries. The total possible underwriting area is 200,000 square feet (19,000 square meters). The first six gallery floors are constructed round a central atrium, which rises over 200 feet to a barrel-vaulted glass roof. The remaining six floors are stepped back and reveal the south window with its spectacular views across London.

THE GOVERNANCE OF LLOYD'S

Lloyd's has a three-tier system of governance. The Council of Lloyd's is a statutory body established under Lloyd's Act 1982 comprising members elected from and by the working and external membership and individuals nominated by Lloyd's and approved by the Governor of the Bank of England. The nominated members have no business connections with the Lloyd's market. The Council elects the Chairman and Deputy Chairmen from among their number.

Lloyd's Market Board is concerned with developing the business of the Lloyd's market, setting common standards for systems and ensuring that such processes as risk placing and claims settlement work efficiently and effectively.

Lloyd's Regulatory Board is responsible for developing regulatory practice and procedures and ensuring compliance throughout the society. The separation of regulation from business development was a key recommendation of the Lloyd's Task Force report published in 1992 and was directed at eliminating the perceived conflicts of interest made when both responsibilities were vested in the Council as a single body.

Responsibility for regulation of the Lloyd's market will in future reside with the Financial Services Authority (FSA).

SEQUENCE OF DEVELOPMENT

1688 First known reference to Edward Lloyd's coffee house in Tower Street (London Gazette 18-21 February 1688)

1691 Edward Lloyd moves his business to Lombard Street

1720 Royal charters granted to the Royal Exchange Assurance and London Assurance companies. No other business corporation, company or partnership allowed to carry out marine insurance; underwriting by private insurer – including frequenters of Lloyd's coffee house – was not prohibited

1734 Lloyd's list established as a regular weekly publication

1769 Establishment of New Lloyd's Coffee House in Popes Head Alley by professional underwriters

1771 Seventy-nine underwriters and brokers each subscribe £100 towards move to improved premises. Lloyd's thus becomes property of the subscribers rather than master of the coffee house. First Committee of Lloyd's, consisting of nine subscribers, elected

1774 Subscribers rent rooms in the Royal Exchange

1796 Committee resolves inter alia that two ordinary general meetings should be held each year and that the Committee should present an annual report and accounts

1811 General meeting of subscribers adopts a trust deed, giving Lloyd's a constitution; regulates admission to Lloyd's more strictly; and increases the Committee to 12 members, three to retire by rotation each year

1824 Parliament repeals Bill allowing existence of insurance companies other than Royal Exchange and London Assurance

1838 Royal Exchange (and many early Lloyd's records) destroyed by fire 10 January

1844 Lloyd's market returns to rebuilt Royal Exchange

1857 First deposit for security made with Committee by an underwriting member

1871 Lloyd's incorporated by an Act of Parliament

1873 Lloyd's seal affixed to every Lloyd's policy

Mid **1870's** Development of business written by syndicate

1880s Heath writes first Lloyd's reinsurance policy on American risks for English company doing business in the US

Circa 1887 First non-marine policies written at Lloyd's by Cuthbert Heath

1903 Committee accepts first non-marine deposit, establishing non-marine market on equal footing with marine business

1904 First Lloyd's motor policy issued. Membership 631

1906 San Francisco earthquake claims met by Lloyd's underwriters establishing Lloyd's reputation in the US

Circa 1906-7 Cuthbert Heath devises excess loss reinsurance following San Francisco claims

1908 Annual audit and premiums trust fund introduced (made compulsory by law under Assurance Companies Acts 1909-1946)

1911 First Lloyd's aviation policy issued

1921 Membership reaches 1,098

1923 Failure of Harrison syndicate following fraudulent underwriting. Whole market contributes to meet all valid claims

1925 Creation of Central Guarantee Fund

1928 Lloyd's transfers to new Leadenhall Street building opened by HM King George V and HM Queen Mary

1939 Lloyd's American Trust Fund established for US dollar premiums

1946 Membership reaches 2,079

1958 Market transfers to new Lime Street building 8 April (officially opened by HM Queen Elizabeth The Queen Mother 14 November 1957)

1962 Membership reaches 5,126

1965 4, September Hurricane Betsy

1968 First overall loss of £37.9 million (for 1965) announced. Committee admits non-UK or Commonwealth members

1969 Committee accepts UK women members

1970 Committee admits non-UK women members

1973 Women members allowed to work in the Room

1974 27 November HM Queen Elizabeth The Queen Mother elected first lady honorary member of Lloyd's. Woman brokers admitted to the Room

1977 Membership reaches 10,622; capacity £1,822 million

1978 Members 14,134 Capacity £2,417m Syndicates 363

March Sasse losses revealed £21 million)

8 November General meeting of members agrees establishment of working party to examine self-regulation at Lloyd's

1979 Members 17,279 Capacity £2,816m Syndicates 404

January 4th Sir Henry Fisher appointed chairman of working party

Formation of first Names action group (Sasse)

May 3rd HM Queen Elizabeth The Queen Mother opens Lloyd's Chatham building

1980 Members 18,552 Capacity £3,177m Syndicates 437

June 27th Fisher report published

November 4th Draft Lloyd's Bill based on Fisher proposals approved at EGM of Lloyd's members at Albert hall by majority of 99.6 per cent (First held outside Lloyd's since 1838)

1981 Members 19,137 Capacity £3,372m Syndicates 427

Lloyd's Bill

January 22nd House of Commons first reading

March 24th Second reading. Select Committee demands 'divestment (severing links between brokers and managing agents) and 'divorce' (severing links between managing agents and members' agents)

July 17th Lloyd's membership votes in favor of divestment and against divorce. Bill held over

1982 Members 20,145 Capacity £3,730m Syndicates 431 Lloyd's Bill

March 9th House of Commons third reading

July 23rd Receives Royal Assent to become Lloyd's Act 1982

October 27th EGM of members' votes to expel a member (CJ Moran) from market (first and only expulsion under Lloyd's Act 1871)

November 17th Election of first Council

December 13th Appointment of three nominated Council members

1983 Members 21,601 Capacity £4,181 Syndicates 409

January 5th First meeting of Council of Lloyd's appoints first Chief Executive Council passes by-laws covering inter alia investigations, misconduct and disciplinary proceedings

1984 Members 23,436 Capacity £4,987m Syndicates 399 Proposed divestment proposals published. Council passes by-laws covering inter alia syndicate annual reports; syndicate accounting and audit rules

June 11th Completion of first disciplinary case under Lloyd's Act 1982 (JA and RSL Pearman)

December 10th First disciplinary expulsion under Lloyd's Act 1982 (TR Brooks)

1985 Active members 26,019 Capacity £6,432m Syndicates 384 Further by-laws passed including Underwriting Agent's Byelaw

July 8th Completion of Howden disciplinary case (three expulsions)

November 11th Completion of PCW disciplinary case (two expulsions, one £1million fine)

1986 Active members 28,242 Capacity £8,291m Syndicates 370

January 10th Government establishes committee of inquiry into self-regulatory arrangements at Lloyd's, chaired by Sir Patrick Neill QC

May 27th Business commences in new building at One Lime Street

November 18th Building officially opened by HM The Queen

1987 Active members 30,936 Capacity £10,039m Syndicates 365

January 22nd Neill report including 70 recommendations published; Council accepts core recommendation on composition of Council

February 4th Council acts on 12 other recommendations

April 9th PCW settlement offer made to Names

June 10th London Insurance Market Network launched
October 16th European windstorm

1988 Lloyd's Tercentenary Active members 32,433 Capacity £10,740m Syndicates 376 Outhwaite Names' Association formed

July 6th Piper Alpha Explosion
December 23rd Lockerbie PanAm Boeing 747 disaster

1989 Active members 31,329 Capacity £10,622m Syndicates 401

March 24th Exxon Valdez disaster
September 15th Hurricane Hugo (US)
October 5th Lloyd's Names Review Committee established, later known as Hardship Committee
October 17th San Francisco earthquake
November 21st HRH Princess Anne elected honorary member of Lloyd's

1990 Active members 28,770 Capacity £10,742m Syndicates 401

January 25th, 3/25/28 February European storms
June 6th Council amends rules; a) to admit non-EC brokers; b) to facilitate new routes for placing business at Lloyd's
June 27th Overall profit of £509 million for 1987 announced
1991 Active members 26,539 Capacity £11,063m Syndicates 354
January 19/20th Market opens for weekend working (Gulf War)
June 26th Overall loss of £510 million for 1988 announced (first since 1967 account)

1992 Active members 22,259 Capacity £9,833m Syndicates 279

January 15th Task Force report published
February 21st Sir David Walker begins enquiry into London market excess loss of business
March 30th Electronic-placing support (EPS) goes live
June 24th Overall loss of £1,863 million for 1989 announced
June 30th First European broker admitted
August 28th Council receives vote of confidence in postal ballot (80.3 per cent of votes)
August 6th Council implements Morse plan on governance
September 11th Hurricane Andrew (US)

1993 Active members 19,537 Capacity £8,784m Syndicates 228

January 1st David Rowland (later Sir David Rowland) appointed first full-time remunerated Chairman of Lloyd's
June 26th Overall loss of £2,318 million for 1990 announced
July 5th Names call EGM on business plan; 75 per cent of votes support resolution to trade on
September 13th First Guide to Corporate Membership published
October 20th EGM of members' votes overwhelmingly for admission of corporate capital (95.6 per cent of votes)
December 7th £900 million settlement offer for Names announced

1994 Active members 17,634* Capacity £10,898m Syndicates 179

January 1st First corporate members commence underwriting with £1,595 million capacity
February 14th Settlement offer allowed to lapse after acceptance by only 38 per cent (by value) of Names
May 17th Overall loss of £2,048 million for 1991 announced
September 15th Financial recovery department established
October Old and open years project (NewCo) renamed 'Equitas'
October 4th Gooda Walker Names win negligence judgment
December 8th Council revives talks on further settlement

1995 Active members 14,984* Capacity £10,195m Syndicates 170

March 10th Feltrim Names win negligence judgment
May 23rd Overall loss of £1,193 million for 1992 announced
May 23rd Reconstruction and renewal plan announced including £2.8 billion settlement offer
May 25th Treasury and Civil Service Select Committee on financial services regulation publishes report on Lloyd's
July 31st First capacity auctions commence
August 1st New US trading arrangements approved by New York Insurance Department
October 9th First Lloyd's general representative in Japan appointed
October 10th Merrett Names win negligence judgment
December 8th Announcement of end to hardship scheme
December 22nd Lloyd's of London Press Ltd sold to management buy-out team for £82.5 million

1996 Active members 12,960* Capacity £9,993m Syndicates 167

February 6th Sale, for £180 million, and leaseback of 1986 building announced
March 8th indicative finality statements sent to 34,000 Names
March 29th Equitas receives conditional DTI authorization
May 10th Lloyd's increases settlement offer to £3.1 billion
June 20th Further indicative statement sent to Names; terms of final settlement explained
July 12th Record pure year of profit of £1,084 million for 1993 announced
July 15th 1993, 1994 and 1995 members vote on £440 million refundable special contributions to funding of plan. Offer increased to £3.2 billion.
July 31st Finality statements sent to Names
August 30th Council declares settlement offer unconditional following acceptance by 91 per cent of members worldwide
September 4th Chairman rings Lutine Bell three times to mark implementation of reconstruction and renewal and unconditional authorization of Equitas
December 30th Five new business units of Corporation of Lloyd's created

1997 Active members 10,161* Capacity £10,323m Syndicates 164

January 9th Lloyd's granted operating licenses in Japan
January 20th 1997 regulatory plan published
February 28th Conclusion of reconstruction and renewal accepted by 95 per cent of Names
May 30th Pure year profit of £1,013 million for 1994 announced
July 14th Lloyd's future direction: Statement of policy by the Council of Lloyd's published, expanding on nine principles for Lloyd's future development

1998 Active members 7,260* Capacity £10,168m Syndicates 155

January 21st Government announces independent external oversight of Lloyd's regulation by the Financial Services Authority
May 4th Pure year profit of £1,149m for 1995 announced

1999 Active members 4,712* Capacity £9,868m Syndicates 139

January 1st First captive syndicate commences underwriting (SmithKline Beecham)
April 19th Lloyd's security enhanced by the reinsurance of the Central Fund.
July 1st Nick Prettejohn appointed CEO
August 23rd Affirmation by Standard & Poors of A+ (Strong) rating. AM Best affirms its rating of A (Excellent) earlier in the year

2000 Active members 3,296* Capacity £10,045m Syndicates 123

January 12th Max Taylor, Chairman of Lloyd's becomes the first Briton to sit on the US Insurers Board
July 3rd General Insurance Standards Council (GISC) assumes regulatory responsibility for Lloyd's Brokers
July 6th AM Best reaffirms its rating of A (Excellent)
 *Including corporate members

THE HISTORY OF THE LUTINE BELL

For more than a century, the Lutine Bell has been synonymous with the name of Lloyd's, the world's leading insurance market. Traditionally rung to herald important announcements to underwriters and brokers in the Underwriting Room – one stroke for bad news and two for good – it is recognized throughout the world as the symbol of an organization whose fortunes are linked inextricably with natural and man-made catastrophes.

The bell was carried originally on board the French frigate La Lutine, which surrendered to the British at Toulon in 1793. Six years later as HMS Lutine, carrying a cargo of gold and silver bullion, she sank off the Dutch coast. Lloyd's underwriters who paid the claim in full insured the cargo, valued then at around £1 million.

There have been numerous salvage attempts on the vessel since she sank. These have yielded a number of gold and silver bars, the ship's rudder, from which a table and chair were made, and several other items including the captain's watch. In 1859 the wreck yielded its most important treasure, the ship's bell which was hung in the Underwriting Room which Lloyd's occupied in the Royal Exchange in the City during the 1890s and was rung when news of overdue ships arrived at Lloyd's.

The purpose of ringing the Lutine bell has often been misunderstood. For many years, whenever a vessel became overdue, underwriters involved in insuring the vessel would ask a specialist broker to reinsure some of their liability based on the possibility of the ship becoming a total loss. When reliable information about the vessel became available, the bell was rung once for bad news – such as a total loss – or twice for safe arrival or positive sighting. This ensured that all brokers and underwriters with an interest in the risk became aware of the news simultaneously.

Modern communications have ensured that the chances of a vessel becoming overdue are now very small. The bell was last rung once for the loss of an overdue ship in 1979, and it was last rung twice for a safe arrival in 1981.

The ringing of the Lutine bell is now restricted principally to ceremonial occasions.

The only occasion where the bell was rung three times was on 4 September 1996 when David Rowland, Chairman of Lloyd's accompanied by Anthony Nelson, then minister of State for Trade and Industry, announced the implementation of Lloyd's reconstruction and renewal program and the unconditional authorization of Equitas.

FACTS ABOUT THE LUTINE BELL

Lutine is a French word meaning 'elf' or 'sprite'. The bell weighs 106 pounds and measures 18 inches in diameter. It bears the inscription St Jean 1779, which may have been either Lutine's original name or the bell may have been a second-hand replacement.

The bell has hung in four successive Lloyd's Underwriting Rooms:

- The Royal Exchange 1890s-1928
- Lloyd's building in Leadenhall Street 1928-1958
- Lloyd's first Lime Street headquarters 1958-1986
- The present Lloyd's building since 1986

The last occasion on which the bell was rung twice for a vessel was 10 November 1981 when it was struck twice to announce news of contact with the overdue Liberian motor vessel Gloria.

The bell was last rung once for a vessel on 9 November 1979 when wreckage of the tanker Berge Vanga (228,000 tons dwt) was located in the south Atlantic. By a sad coincidence, the previous occasion was for the Berge Vanga's sister ship the Berge Istra (227,000 tons dwt) that sank in the Pacific after three explosions on 19 January 1976.

HM The Queen has rung the bell twice for good news on a number of royal occasions including the opening of the present building on 18 November 1986.

Although the Lutine bell's traditions are firmly rooted in Lloyd's marine market, it was rung:

- Twice to announce the safe splashdown of the US Apollo 8 space mission on December 27th, 1968
- Twice on 28 November 1973 to announce the release of eleven hostage from a hijacked Dutch Boeing 747
- Twice on 14 November 1984 when Lloyd's Silver Medal for Meritorious Services was presented to the crew of the NASA space shuttle Discovery who had successfully recovered two communications satellites from an incorrect orbit.

Lloyd's of London is the world's best known insurance brand, yet the least understood.

This is because Lloyd's is a market rather than a company. Lloyd's derives considerable strength from being a market but, as such, the manner in which it structures its finances and conducts its business can be difficult to understand when compared to insurance companies.

Generally, the Lloyd's market does not deal with its clients directly, but uses a global network of insurance brokers.

LLOYD'S TODAY

Lloyd's may be able to trace its roots to a 17th century coffee shop, but that has little bearing on the market's current practices.

Today, Lloyd's is home to some of the most skilled and experienced specialist underwriters in the world, leading the industry in creating new areas of insurance, such as kidnap and ransom, space and aviation and cyber-liability, in addition to covering more standard classes of insurance. In terms of how business actually works in the market, Lloyd's utilizes a range of modern IT systems for processing the millions of risks it deals with every year.

Certain classes of insurance can now be bought on-line from registered insurance professionals based at Lloyd's, including fine art and cargo. Lloyd's own website, www.Lloyds.com, allows insurance brokers and other professionals from all over the world to find information on available cover in the market.

LLOYD'S GLOBAL INSURANCE INDUSTRY

Any organization that has existed for over 300 years will have experienced many changes. Entire national economies and insurance industries have matured in the developing world, and new types of insurance have been invented, many by Lloyd's itself.

Today, over 90% of FTSE 100 companies have policies with Lloyd's (FTSE 100 and Dow Jones IA / Exchanging Ins- sure Services, as at Dec. 2002). The market also underwrites 29% of world aviation and 12% of world marine business (FTSE 100 and Dow Jones IA / Exchanging Ins- sure Services, as at Dec. 2002.)

The London market for insurance is the world's leading center for international insurance and reinsurance, and Lloyd's accounts for 52% of its gross premiums (International Financial Markets in the UK, as at May 2003 (pg. 9), Figure for 2001 est.)

In 2003, the Lloyd's market has grown to record size in terms of its ability to accept insurance premiums, which have reached a new high of \$23.2 billion (Lloyd's Members' Services Unit, as at Feb. 2003. Exchange rate: £1: \$1.61), spread across 71 syndicates (Lloyd's Members' Services Unit, as at Jan. 2003.)

Lloyd's share of the world's largest insurance market, the United States, is continuing to increase, with Lloyd's now the largest single insurer of 'surplus lines' business. This is insurance for which coverage is not available in the standard or 'admitted' U. S. market, generally because of the scale of risk to be covered or its specialized nature. 93% of companies in the Dow Jones Industrial Average have policies with Lloyd's (FTSE 100 and Dow Jones IA / Exchanging Ins- sure Services, as at Dec. 2002.)

LLOYD'S IN THE U. S.

Lloyd's relationship with the U. S. has been a long and innovative one. Today, Lloyd's is known in the U. S. primarily as the largest surplus lines insurer and one of the largest reinsures, but in reality, Lloyd's is much more. In the 1800's Lloyd's began by insuring ships and cargos, and over the next 100 years developed innovative cover such as kidnap and ransom insurance, bankers' blanket bonds and workers compensation insurance.

Last century saw Lloyd's provide insurance against natural catastrophes such as the 1906 San Francisco earthquake and more recently cover for classes of medical malpractice, directors and officers liability and terrorism insurance.

Throughout this long relationship with the U. S., Lloyd's has provided American businesses with creative solutions to their risk management needs. U. S. buyers of insurance from Lloyd's benefit from the added security of the U. S. Trust Funds, which at the end of 2002 totaled more than \$16.5 billion (Lloyd's Global Report 2002)

All surplus lines, reinsurance and licensed business written by Lloyd's are supported by these static regulatory deposits, which are funds Lloyd's maintains in trust for the benefit of the U. S. policyholder.

LLOYD'S FINANCIAL PERFORMANCE

In the past, financial analysts have commented that Lloyd's tends to outperform the rest of the insurance industry, doing better during profitable periods and under performing during poorer market conditions. This is due, in part, to Lloyd's willingness to underwrite new, difficult and complex risk, placing Lloyd's at the leading edge of the insurance industry.

Lloyd's newly introduced franchise system and business planning aim to improve the market's financial performance, giving more consistent results and long- term profitability.

Financial ratings agencies A. M. Best and Standard & Poor's certainly have sufficient confidence in Lloyd's to rate it A- (Excellent) and A (Strong) respectively, offering its clients first-class security. Lloyd's traditional three- year accounting system had made it difficult to compare its financial report on an annual basis. In 2002 Lloyd's published its results on an annual accounting basis, improving the transparency and comparability of Lloyd's to its peers. Lloyd's combined ratio of 98.6% for 2002 (Lloyd's Global Results 2002) is a significant achievement, and highlights the ability of Lloyd's to outperform others in the industry.

AN INTERNATIONAL INSTITUTION

Although it is synonymous with the City of London, Lloyd's is a truly global organization, attracting business and capital from around the world. The Lloyd's market conducts business in over 120 countries and has its own offices and staff in 25 countries. Lloyd's largest single market is the United States, which accounted for 35% of its business or \$8 billion in 2002, followed by the UK, Canada and Bermuda.

Of the capital that now supports Lloyd's, over 45% comes from non- UK sources, primarily the U. S. and Bermuda. Insurers from all over the world operate businesses at Lloyd's including Berkshire Hathaway (USA), Munich Re (Germany), Mitsui (Japan), AIG (USA) and ACE (Bermuda).

Lloyd's underwrites a huge range of businesses and projects internationally including oilrigs, underground transport networks, airlines and the world's top five manufacturers of personal computers.

LLOYD'S CAPITAL

When Lloyd's was founded in the 17th century, its financial backers were wealthy private individuals who staked their entire fortunes by trading with unlimited liability. (Under UK law, any sole trader has unlimited liability.) Because these individuals signed their names on early insurance contracts called slips, they became known as 'Names'.

The Names were Lloyd's sole backers until 1994 when the market voted to allow corporate capital into the market. Since then, the make-up of Lloyd's capital base has gone through a major change.

Today, 87% of the capital backing at Lloyd's comes from corporate bodies – primarily the international insurance industry. American and Bermudan companies supply 31% UK insurers 36% 14 and the remainder comes from other overseas companies and Names who have converted to limited liability by forming limited companies.

In 2003, the number of Names trading with unlimited liability has dropped to just over 2,000. It is no longer possible for any further unlimited liability Names to join the market.

The reality of Lloyd's in 2003 is a bold and vibrant picture. It is a thriving international business with the ability to accept \$23.2 billion in insurance premiums. Lloyd's is a business that 96% of the FTSE 100 and 93% of the Dow Jones Industrial Average chose for their insurance. It is not without good reason that Lloyd's has been the best-known brand in global insurance – for over 300 years. As it trades into the 21st century, Lloyd's continues to be at the forefront of world insurance.

Lloyd's premium income was \$26.1 billion in 2002,

LLOYD'S BUSINESS BY CLASS

- Accident & Health 4%
- Motor and Third Party Liability 2%
- Motor and Other Classes 7%
- Marine, aviation & transport 14%
- Fire and other damage property 22%
- Third Party Liability 23%
- Other 3%
- Reinsurance Acceptance 25%

LLOYD'S BUSINESS BY REGION

- USA 35%
- UK 32%
- EUROPE 14%
- Other Americas 9%
- Asia/ Africa 7%
- Rest of World 3%

Source: Lloyd's Market Reporting Figures as of 2002. Source: Lloyd's Market Reporting

LLOYD'S U. S. BUSINESS BY CATEGORY 2002

- Surplus lines 50%
- Reinsurance 37%
- Exempt lines 11%
- State licensed 2%

Figures as at 31 December 2002. Source: Lloyd's Worldwide Markets

Lloyd's America, Inc. is not licensed as an insurer in any state. Underwriters at Lloyd's are licensed only in Kentucky, Illinois and U. S. Virgin Islands, and are approved surplus lines insurers in all U. S. jurisdictions except Kentucky and U. S. Virgin Islands. Any surplus lines business transacted with Lloyd's must be through a licensed surplus lines broker. Lloyd's is regulated in the United Kingdom by the FSA. www.Lloyds.com/America

LLOYD'S OF CHAIN SECURITY

All premiums received are held in trust for the protection of policyholders. These liquid assets are available to meet claims and other underwriting liabilities of the member. This forms the first link in Lloyd's chain of security. All members are required to hold additional capital at Lloyd's as further security for their underwriting. This forms the second link. Members' other assets are also available to meet claims, forming the third link.

Lloyd's operates a central fund, which is available at the discretion of the Council of Lloyd's, to meet any portion of any claim that is not met from the first three sources.

This, and other Lloyd's central assets, constitutes the fourth link in Lloyd's chain of security.

Security is of paramount importance to all policyholders.

The structure of security at Lloyd's is determined by the way the Lloyd's market is constituted. Lloyd's is a society of members who underwrite insurance in groups, known as syndicates, but each member is liable for their own share of each policy and not for those of other members.

The reputation of Lloyd's for two leading now recognizes first class security independent international ratings agencies, A. M. Best and Standard & Poor's, who rate Lloyd's A- (Excellent) and A (Strong) respectively. These ratings reflect the strength of the total resources of the Lloyd's market of \$43.5 billion.

SECURITY IS PARAMOUNT

Premiums Trust Funds: \$27,657m* Payment of claims takes precedence over distribution of profits.

All premiums and reserves at syndicate level are held in premiums trust funds or overseas regulatory deposits. Profits are distributed only when a year of account is closed, normally after three years.

Members' premiums trust funds and overseas regulatory deposits held at syndicate level form the first link in the chain. This is where all the premium income and any additional reserves are held in trust for the benefit of policyholders. Monies are invested conservatively in order that they are available as soon as required.

Other than paying claims, these funds can be used only to meet permitted expenses and outgoings, for example, reinsurance premiums, underwriting expenses and to fund the overseas regulatory deposits, which also form part of the first link in the chain.

Members are unable to receive profits from the funds until the underwriting account has been closed, three years later, and all outstanding liabilities have been provided for.

*All figures correct as at 31 December 2002. Exchange rate = £1: \$1.61

MEMBERS' FUNDS AT LLOYD'S

Capital requirements are determined for each member by Lloyd's risk-based capital methodology, subject to prescribed minimum levels.

Capital held at Lloyd's: \$14,438m* Additional funds are held in trust as security for members' underwriting liabilities. In case the resources in the premiums trust funds prove insufficient to meet obligations to policyholders, every member, both corporate and individual, is required to hold additional capital at Lloyd's. This is also held in trust for the protection of policyholders.

To qualify for inclusion, these assets must be readily realizable. They include cash, securities, letters of credit, and bank and insurance company guarantees.

The amount of capital required is determined by the nature and amount of risk the member underwrites. Those underwriting riskier business are required to have more funds at Lloyd's.

Other assets owned by individual members of Lloyd's are also available to meet claims on the policies they have underwritten, should the funds in the first two links prove insufficient.

Individual members trade with unlimited liability and are liable to the full extent of their personal wealth. This is not shown in Lloyd's accounts, which record only the wealth that has been declared to Lloyd's.

Corporate members are liable to the extent of their resources. They are often the subsidiaries of leading insurance companies, formed specially to participate in the Lloyd's market.

Although aggregate numbers are shown, the first three links each operate on a several basis. Each member's resources are only available to meet their share of claims.

MEMBERS' OTHER ASSETS

Additional assets, not necessarily held at Lloyd's. Frequently members, both corporate and individual, have additional assets that are also available if required to meet claims.

Individual members underwrite with unlimited liability. A corporate member may also have assets beyond its funds at Lloyd's, which can be called upon to meet its underwriting liabilities.

Members' other declared assets: \$452m*

Members' other resources are also available to meet claims.

LLOYD'S CENTRAL ASSETS

The Central Fund is available, at the discretion of the Council of Lloyd's, in the event that a claim cannot be met from the premiums trust funds or members' funds at Lloyd's.

Resources available to the fund:

- \$766m* net assets, principally in cash and conservative investments
- Up to 3% of a member's premium limit from the premiums trust funds

The Central Fund is available to back Lloyd's policies issued after 1993. Policies issued before that date have been reinsured by Equitas, an independent FSA- authorized insurance company.

Other assets of the Society of Lloyd's are also available to meet members' underwriting liabilities as a last resort.

*All figures correct as at 31 December 2002. Exchange rate = £1: \$1.61

The Central Fund is available at the discretion of the Council of Lloyd's to meet any portion of any member's liabilities that they are unable to meet in full.

As at 31 December 2002 the Central Fund stood at \$766m*

The Council is also able to call from members' premiums trust funds an amount of up to 3% of a member's premium limit in any one year. Other assets of the Corporation, totaling \$140m*, are available to meet underwriting liabilities.

Lloyd's net central assets: \$906m*

- Lloyd's American Trust Funds \$780m
- Lloyd's Dollar Trust Funds \$3,825m
- Credit for Reinsurance and Surplus Lines Trust Funds \$11,280m
- Joint Asset Trust Funds \$433m
- Illinois Trust Fund \$459m
- Kentucky Trust Fund \$72m

Lloyd's is required to maintain regulatory deposits in the U. S. to support its surplus lines and reinsurance business as well as its licensed business emanating from Illinois and Kentucky.

These U. S. site Trust Funds are static funds, not working funds. Lloyd's maintains these funds in trust while simultaneously paying claims and expenses out of its working premiums trust funds. The static funds are adjusted on a quarterly basis. The most significant regulatory deposits maintained by Lloyd's in the U. S. are those supporting its surplus lines and reinsurance business. These deposits include the Surplus Lines Trust Funds, which are several deposits maintained by Lloyd's syndicates, and are funded at a minimum of 30% of gross liabilities.

The Credit for Reinsurance Trust Funds are also several deposits maintained by Lloyd's syndicates, and are funded at 100% of gross liabilities which includes IBNR. In addition, separate Joint Asset Trust Funds are maintained for surplus lines business at a minimum of \$250 million and for reinsurance at a minimum of \$100 million.

A stringent system of solvency and control Lloyd's operates a stringent system of solvency controls to ensure it meets its own high standards, those of the Financial Services Authority (FSA) and of other regulatory authorities.

All members have an obligation to maintain sufficient assets in trust to meet their underwriting liabilities. The annual solvency process requires the managing agent of each syndicate to estimate all current and future liabilities. An actuary independently validates these estimates.

Lloyd's unique system of security means that the total assets available to meet claims compares very favorably with conventional insurance companies and comparison is made easier by the Lloyd's security ratings from A. M. Best and Standard & Poor's. These ratings apply to all syndicates, regardless of their individual performance.

GLOBALIZATION – THE INTERDEPENDENCY OF THE US AND EUROPEAN INSURANCE INDUSTRIES

This segment is taken from a speech by Lord Levene, Chairman of Lloyd's at a speech to the European Insurance Summit in October of 2003.

" A decade or so ago, a word emerged from the undergrowth of the English language. It was globalization. New, exciting, but at the same time rather disturbing, the g-word was on everyone's lips.

Why was there this sudden interest in this new word? Maybe it was the realization that the world was becoming a much smaller place.

Global businesses could sell global brands aided by global communications. We could communicate with the other side of the world at the touch of a button. Distance was dying borders, evaporating, the world was shrinking. Or so we were told at the time. A decade on, the froth and the hype have gone and we can now take a cool, hard look at what globalization has meant for the insurance industry.

This morning, I want to do just that. I want to begin by asking a question: just how interdependent is our industry in this global age? Second, how have global links grown, and what does this mean for the different parties? What are the challenges for the industry? And, finally, what does the future hold?

Rather than talk about this in the abstract, I let us focus on the relationship between the European and North American industries. So I will do exactly that, speaking from the perspective of a European insurer and re-insurer.

THE EXTENT OF INTER-DEPENDENCE

So, let us begin by answering that first question: to what extent are the US, European and global insurance industries interlinked?

Adjectives such as entwined, interdependent, enmeshed cannot reflect the real extent to which our industry is now truly global. So we have to resort to facts and figures.

Globalization does not simply mean that the world has become a smaller place: it means that our marketplace has, in some respects, shrunk.

There are fewer re-insurers doing more business. In 1990, the world's largest five re-insurers accounted for 21% of global premium (*1). By 2001, the largest five accounted for some 57% - a huge jump in a decade. And the trend continues (*2). These re-insurers are truly global players. The same thing has been happening in the broking sector. The pressures of globalization have thrown old competitors together, as analysis of Lloyd's brokers over the past decade or so show.

Of the twenty largest firms in 1992, only six are left now after merging, consolidating, or taking each other over (*3). Of today's largest firms, most have headquarters either in the US or London. Almost all operate on the global stage, with strong worldwide reach. And we have seen the rise of the mega-brokers, such as Marsh and Aon, whose worldwide wave of acquisitions has helped them grow into insurance giants.

So much for the global strength and reach of the industry. But to what extent are they interdependent? Consider European and North American re-insurers. Are we two hermetically sealed industries, Europeans doing business here and Americans doing business there? The answer is "no, emphatically not".

A recent report from the Reinsurance Association of America (*4) – the RAA – shows that, in 2002, over 4,000 foreign insurers from 96 different jurisdictions participated in the US market. They accounted for \$46.2 billion in premiums; nearly double the figure from two years before.

Most of that foreign reinsurance came from Bermuda, the United Kingdom, Ireland and Switzerland. The UK itself accounted for \$3.9 billion of reinsurance premiums, much of which found their way to Lloyd's of London.

Europe's strength is also notable in direct insurance. Overseas insurers, or alien insurers as they are known under the US regulatory system, account for over a third of US specialist direct insurance.

Last year, the amount of surplus lines premium Lloyd's wrote in the US rose to \$8.2 billion, our largest figure ever, up 15 per cent on 2001 (*5). This makes the US Lloyd's largest single market. But what do all these facts mean in practice? Let me give

an example from Lloyd's business, as it demonstrates the point well. 93% (*6) of companies listed in the Dow Jones Industrial Average have policies with Lloyd's. Now that is, as an American might say, one hell of a relationship.

So the US-European relationship in the insurance industry is quite unique. I challenge you to think of another sector in which the US, the world's greatest trading power, is so dependent on Europe.

Let us put the level of dependency into perspective. US imports for cross-border insurance services outpace exports by a factor of over three to one. The reverse is true for banking and securities, where exports outpace imports by the same factor. In fact, the World Trade Organization figures show that the US imports a huge 48 billion dollars of insurance services each year (*7).

Of course, there is one tragic, horrific event, which illustrated the US's dependence on the financial strength, security and resilience of European insurers and re-insurers: 9/11.

Of the 10 insurers facing the highest gross losses from 9/11, only two are American (*8). Of the other eight, one is Bermudan, two are Japanese, and the remaining five are European – Lloyd's included. In terms of the losses they sustained, the two US insurers net losses are 3.4 billion dollars; between them the European insurers have a net loss of over 10 billion dollars. Lloyd's has the single largest loss of any insurer and to date, have paid 4.2 billion dollars in claims, which I hope is helping to re-build Manhattan (*9).

So, the conclusion could not be clearer: the two continents' insurance industries are woven almost seamlessly together.

DRIVERS AND SIGNIFICANCE OF THE RELATIONSHIP

But how have global links grown, and what does this mean for the different parties?

One factor that has led to the creation of the 'global insurer' is the changing nature of risk itself. 9/11 showed that today's risks are greater and more complex than ever before.

Risks on this sort of scale require a global response, which a single economy cannot bear. So the advantages of sharing risk across worldwide markets are obvious. In the case of 9/11, the losses were very well spread. Imagine if this had not been the case. The fallout would have been much worse for the US and perhaps the wider global insurance sector.

The domestic market could have collapsed as carriers failed and many more were impaired. Other financial markets, such as bond markets, would have been severely disrupted. And confidence in the insurance mechanism could ultimately have been lost. Fortunately, this was not so. The US market was able to trade on, and the US and European industries banding together increased their ability to provide protection exponentially.

9/11 also provides a good example of the respective strengths of the US and European markets. In the dark days that followed, amid the confusion and grief and the emergence of what we might one day consider to be a new world order, terrorism cover was excluded from virtually every commercial policy. Not only were businesses having to deal with their own personal shock – and in many cases tragic losses of life – they were grappling with a set of risks, aggregations and almost infinite possibilities that frankly made nonsense of much of what underwriters had been trained to believe and base their calculations upon.

This episode highlighted how risk-hungry the European market is. On a daily basis it considers unique and specialized risks. This has bred a different type of underwriting – underwriting, which is prepared to think outside the box.

And in the case of London, the interplay of broker and underwriter – their face-to-face negotiations – leads to enhanced flexibility and a willingness to do business.

Does the American insurance industry lack that attitude? No, not entirely. But it certainly does not have it in such abundance and in such a strong concentration as the square mile of the City of London.

Does it not have re-insurance expertise? Yes, it does, but not with the same depth of experience that the European markets can offer.

Why is this so? Probably because the American and European insurance markets have their roots in very different eras and different customer needs.

The London market first sprang up during the mid-1600s when the first coffee shops – early Starbucks, but not from Seattle – sprang up in our capital city and business was done on these premises. But from those early days of writing policies to cover ships and their cargoes on epic voyages around the then sketchily mapped world, the European system of risk taking has

led to a market able to write risks such as terrorism, war, kidnap & ransom, political risk, civil risk, cyber-liability – and even the odd TV game show.

The American industry, by contrast, lacked the geographical focus that could be achieved in the major European capital cities and tended to do more personal business – homeowners, farmsteads, ranches, small businesses. After all, why chance your luck on the high-risk business when the underwriters back in Europe could deal with that? So, from these early foundations, our two markets have grown together and continued to focus on their own areas of expertise.

Third, today's customer needs are different. Today's commercial environment is an international one. Today's companies are multi-nationals. Some of the world's most successful and most powerful companies are the result of cross-border mergers and acquisitions, and the most valuable brands have a world-wide reach we thought unimaginable even a decade ago.

Seven of the top ten Global 500 and five of the top ten Fortune 500 companies represent major cross-border activity (*10). Think of the Anglo-Dutch Royal Dutch/ Shell Group or acquisition of British retailer Asda by American Wal-Mart.

These new, vast balance sheets create vast levels of risk, and these companies need insurers and re-insurers who have the scale, and the know-how to take it on. Driven partly by this demand, and partly by the same economic imperatives, our industry has responded. The capital environment for the insurance sector is different.

The speed at which capital can move – and the distance that it is prepared to travel in search of a good return – has increased radically. We saw that in the aftermath of 9/11 when fresh capital was injected into our industry, often with amazing speed.

Where did the capital end up? I have no doubt that some of it was supplied to domestic US carriers. But much of it found a home for itself in other markets, most notably Bermuda and London. At Lloyd's alone, capital has increased by 20% in the last two years (*11). Today, North America provides the Lloyd's market with a substantial amount of capital. Over 30 per cent of the capital backing Lloyd's comes from the US and Bermuda (*12).

The common denominator here is that capital is no longer restricted by national boundaries, and travels to where it can most efficiently and most profitably be deployed.

THE CHALLENGES

What, then, are the challenges created by this level of interdependency between the North American and European markets?

Some people ask whether our increasingly interdependent nature – particularly within the reinsurance sector - could pose a serious systemic risk to our future. If one domino in the wall of insurance fell, would others soon follow?

9/11 helped to allay those fears. It reminded us that the leading re-insurers are geographically well spread. The top 25 reinsurance groups ranked by premium derive from nine countries. Premiums written in 2001 amounted to \$98 billion. Out of that total, German re-insurers wrote 29 percent, U.S. companies 27 percent and the Swiss and British wrote 9 percent each (*13). Other studies support this evidence too.

A recent AM Best study looked at the cause of nearly 700 US industry insolvencies between the late 1960s and late 90s (*14). It found that there was no single cause of company failure.

Of course, Enron showed us that no one is "too big too fail" but there seems to be no evidence of re-insurer contagion. The financial collapse of even a 'Top 20' world re-insurer probably poses no systemic threat to the UK, European or world insurance markets. When the EU looked at solvency issues it identified a number of factors, which had contributed to the collapse of insurance undertakings, but all but one were wholly unconnected with reinsurance (*15).

That said globalization has made communication more demanding. And adding fuel to this fire is the rise of e-commerce. What took weeks or days now takes seconds. Brokers and clients communicate across different time zones. An insurer in the US can use the Internet to reinsure themselves with re-insurers in Europe.

The result? A web of commercial transactions, which binds global industries together in a new and powerful way. It is a web that will only grow tighter and more all encompassing, as the power of our technology grows stronger. Lloyd's is taking this challenge very seriously. Kinnect is Lloyd's-backed scheme to bring a previously unknown degree of interconnectivity between the IT systems of brokers and underwriters in the US and United Kingdom.

Interconnectivity means communicating with one another – what you and I are doing now, I hope. But that is not something that we have, as an industry, been very good at. Kinnect will allow IT systems, which have never talked to each other to do

exactly that. The geographical emphasis is very much on the European and US markets. And in talking to each other, risk data will be transferred easily and accurately, thus creating massive savings in time and resources.

Another challenge we need to confront is the need to share skills. On this, we have learnt a lot from the Americans. America has provided us with a style of doing business that is more in keeping with the 21st century. So many of the management ideas and concepts we rely upon today come from the United States. Once upon a time, Europe was described as the workshop of the world.

Today, the United States is the think-tank of the world. The same applies to service standards. The US is rightly known as the country with the highest customer service standards in the world.

We in Europe have to play 'catch up'. Once upon a time, poor service standards were not a matter of concern for us. After all, they needed us. But some of those issues I mentioned earlier – globalization, e-commerce, the interdependency with the US – have made it an issue. We have to provide services standards that match those anywhere else in the world. But while we Europeans need to change how we work, America needs to change too.

For there are also difficulties for Europeans doing business with America. Firstly, litigation. The Europeans may have invented it, but the Americans took it to a totally new level. Linked to this is the compensation culture.

Let me give you an example.

My home in London is over 200 years old. Down in its basement, there is mold growing.

How do I deal with it? Well, once every few years, I get it painted over. No more, no less. I do not sue anybody, nor do I seek compensation.

That approach is probably the norm in Europe, but it probably no longer is in the US.

On a more serious note, the US tort system now costs around 200 billion dollars a year. That's equivalent to a 5% tax on wages and is forecast to rise to 250 billion dollars by 2005. That creates difficulty for those of us doing business with the United States.

Difficult because of its scale. Difficult because of the uncertainty it creates (*16).

If you don't believe me, look at the fact that 23 billion dollars was added to US industry reserves alone last year because of adverse prior year loss development on casualty lines (*17). A fair proportion of it relates specifically to losses spiraling retrospectively because of asbestos, and the trend has continued into 2003.

Second, there remain barriers to trade when dealing with the US. These are barriers, which do not exist in our own markets. Today, insurers and their intermediaries are generally free to trade across the European Union.

This system is not perfect. But, if you compare now with the past, when markets were segregated, when insurers had to comply with different laws and price controls in different member states; when there was a bewildering and diverse set of national and financial rules to be complied with... by comparison with that, today's system does represent substantial progress towards a single market for insurers, and increasingly re-insurers and intermediaries too.

However, the system of regulation in the US causes some difficulty for foreign re-insurers. One of the major costs which we face there is the obligation to localize funds, whether for surplus lines business or in relation to reinsurance – where the frankly absurd American Credit for Reinsurance laws require foreign companies to over-fund by enormous amounts under a gross liability system even when they are placing retrocession back into the US market.

Such systems create complexity, and drive up the cost of doing business and that cost is ultimately passed onto the consumer, potentially limiting choice of markets for today's multi-national clients.

THE FUTURE

So, finally, how will Europe's relations with America change in the future? First, Europe is changing rapidly. Europe's influence will grow as we build a single market, in which insurers, re-insurers and brokers can trade throughout the economic region – the so-called passport system of trading.

Meanwhile, the EU itself is growing to be a union of 25 nations. I can't begin to imagine what a GDP of \$30 trillion (*18) actually feels like, but it means that Europe will soon represent the world's largest commercial market (*19) - and its power can only increase. Add to that the move towards the common currency of the euro, and it is clear that Europe has a key role at the center of the global insurance and reinsurance industry. Meanwhile, we need to keep an eye on significant changes elsewhere in the world.

China is currently one of the world's fastest growing economies. In ten years' time, China's insurance market is likely to be worth around 40 billion dollars (*20). That's why we at Lloyd's have applied for a re-insurance license there.

Significant other markets in Asia too are deregulating and opening up, creating new opportunities for European insurers. Of course it takes time before markets march in step with the rest of the global sector. Deregulation cannot happen overnight. Leaving aside the regulatory infrastructure, professionalism and skills take time to develop.

But consider Singapore. Its financial sector development has been a key factor in its impressive economic success over the past three decades, aided by a strategic location in a fast growing region, a skilled labor force, political and economic stability, and a strong commitment to openness.

Many of us would agree that the economics of insurance in a number of the developing markets must change before business becomes generally attractive to underwrite.

So, in the medium to longer term, markets in Asia will start to provide both opportunities to European insurers and re-insurers, and competition for our own industries.

Finally, all of these trends have important implications for insurance regulation. As the global market becomes forever more interdependent, regulators cannot hope to be familiar, in detail, with every carrier around the world. Reliance on high quality, home country supervision becomes a necessity if regulators are to allow their market the advantages of free access to offshore balance sheets.

Organizations such as the IAIS and OECD are now actively promoting greater co-operation between regulatory authorities, greater information sharing, and the setting of minimum standards for regulatory standards.

And of course, with another round of WTO discussions now under way, more countries will be entering the arena of liberalized trade in financial services, and more corporate balance sheets requiring access to global markets, this work must continue and gather momentum.

These are a few examples of the forces acting on the interdependency.

How they will change it overall, I cannot say for sure, but change it they will. Time will tell. Just like its global customers, the insurance and reinsurance industry has become increasingly international, operating irrespective of national borders.

If companies and nations are to manage and spread their risk effectively, they need access to global balance sheets and that same principle applies whether we are talking about terrorism, European flood risk, or Japanese earthquake risk.

However, the interdependency between the North American insurance industry and its European counterpart will continue to be a rock at the very heart of the global industry.

It is a unique relationship that exists in few other sectors of the economy. It is a relationship founded on mutual benefit and economic history. Its practical nature is highlighted by the events of September 11.

Globalization and e-commerce will strengthen that interdependency. The consolidation of Europe and the rise of European single currency will undoubtedly alter it (*21) but let me end with the following observation.

Yes, there was hype a decade ago about globalization. It was not a new trend. After all, the three hundred year history of Lloyd's has been one in which a coffee shop has become a market for global insurance.

But although the trend was not new, the pace of change certainly was. In a matter of years, thanks to technology, and new markets opening up, global competition became more intense.

Today, no large company can shield itself from that competition. No large company can afford to pull up the drawbridge, and hide behind national boundaries, hoping the rest of the world will go away.

Our sector has been transformed over the last decade. That's not really surprising. Insurance is a natural fit for globalization. Sharing risks that others face on the other side of the Channel, the Atlantic or the World has been our stock in trade for centuries. The difference today is the pace of trade, the size of the risk, and the complexity of the issues we face.

Some see globalization as a malevolent force. In insurance, that is far from the case. By strengthening the links between countries, our industry can help those whom it serves.

For proof, you only need to look at our ability to cover the losses of 9/11.

Insurance is an industry founded on the concept of the many banding together to provide protection for losses suffered by the few.

That is an idea that was born well before globalization was a word on people's lips. And thanks to the forces of globalization, it has a new, stronger lease of life. "

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*7 World Trade Organization website, Special Report on Financial Services, viewed 10/03,

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LLOYD'S MEMBERS

Members of Lloyd's of London provide the supporting capital on which the market is built. Corporate members include investment institutions and international insurance companies. Individual members are known as "Names". Capital provided by members of Lloyd's is used to underwrite insurance risks.

UNDERWRITING SYNDICATES

An insurance syndicate is a group of Lloyd's members, corporate or individual, who provide capital to back the liabilities they insure. Syndicates are annual ventures. Syndicates operate as independent business units within the Lloyd's market and are run by managing agents, who appoint the underwriting team, which writes risk on behalf of the syndicate membership.

There were 71 insurance underwriting syndicates operating within the market, covering many specialty areas including:

- Marine
- Aviation
- Catastrophe
- Professional indemnity
- Motor

Syndicates tailor solutions to respond to the specific risks of the client base, which in 2003 includes 96% of FTSE 100 companies and 93% of the Dow Jones Industrial Average companies. (Source: FTSE 100 and Dow Jones IA / Xchanging Insure Services, December 2002)

Syndicates compete for business, thus offering unparalleled choice, flexibility and continuing innovation. Syndicates cover either all or a portion of the risk and are staffed by underwriters, the insurance professionals on whose expertise and judgment the market depends.

MANAGING AGENTS

Syndicates are run by managing agents who are given a franchise to operate within the Lloyd's market.

Some managing agents are quoted companies listed on the stock exchange, while others are private companies. In some instances, managing agents act as capital providers to the syndicates they manage and so have a multi-faceted role as corporate members of the market, agents and in due course, franchisees.

LLOYD'S BROKERS

Accredited Lloyd's brokers place risk in the Lloyd's market on behalf of clients. These brokers use their specialist knowledge to negotiate competitive terms and conditions for clients.

There are over 150 firms of brokers (figures as at 1 November, 2002) working at Lloyd's, all of who have a good understanding of the Lloyd's market and many of who specialize in particular risk categories.

Lloyd's operates an accreditation process for brokers seeking access to the Lloyd's Market. All brokers must be GISC or equivalent registered. To safeguard investors, Lloyd's performs a careful assessment of all applicant brokers, affirming their reputation and financial standing and investigating the character and suitability of officers and employees before making the decision to accredit.

Firms receive provisional accreditation for three years before becoming entitled to use the term "Lloyd's broker".

LOCAL BROKERS

Any insurance broker can access the expertise and resources of Lloyd's by making contact with an accredited Lloyd's broker.

REGULATION OF LLOYD'S

The UK Financial Services Authority (FSA), under the Financial Services and Markets Act 2000, regulates Lloyd's of London.

The FSA oversees Lloyd's regulation to ensure consistency with general standards in financial services. In practical terms however, in order to avoid unnecessary duplication, the FSA delegates a substantial part of its regulatory activity to the Council of Lloyd's and focuses on a supervisory role.

The Council of Lloyd's is the governing body of the Society, under the Lloyd's Act 1982.

Much of the market's rule structure is embedded in a series of by-laws passed by the Council. In recent years however, these have been supplemented by the introduction of core principles for underwriting agents and a number of codes of conduct are published to the market in a Codes Handbook.

Changes to regulatory requirements are communicated to the market by means of regulatory bulletins. The Risk Management Division of the Corporation of Lloyd's undertakes Day to day supervision of the market.

PLACING RISK

Before a risk can be placed in the market a number of interactions must take place.

The customer (which might be an individual, company or other Lloyd's of London syndicate) approaches a Lloyd's accredited broker with the details of a risk to be insured.

The Lloyd's broker approaches a specialist underwriter (a leader) in the relevant class of business to discuss premium, terms and conditions. If the underwriter is interested, a proposal will be made to accept a percentage of the total risk. A number of underwriters may accept portions of one risk. This is known as a subscription market. The broker feeds back information to the customer to enable the customer to place an order.

The broker prepares a "slip" with the details of the insurance, which is signed by the lead underwriter. The broker then approaches the other (following) underwriters with a view to obtaining written lines of insurance, which will total 100% or more of the risk. XI processes the slip and the broker adjusts or "signs down" the lines if they have exceeded 100% of the risk.

The premium is paid by the insured to the broker, who deducts any agreed brokerage fee and submits the net amount to Lloyd's Central Accounting (LCA) as part of a regular bulk settlement process.

LCA allocates the premium to the managing agent of the syndicates involved.

OVERSEAS CLIENTS

Lloyd's is licensed to do business in certain countries.

All US business underwritten at Lloyd's must be placed in accordance with US regulatory requirements and coverage must comply with local law.

New insurance enquiries from US residents should be directed to an insurance agent or broker who is licensed to conduct business in the relevant state.

WHO INSURES WITH LLOYD'S?

Lloyd's syndicates insure the world's leading businesses:

- Top 8 motor vehicle manufacturers
- Top 10 global pharmaceutical companies
- Top 7 airlines
- Top 8 global banks
- 78% of the top global electronics manufacturers
- 71% of manufacturing businesses

RISK MANAGEMENT

Risk Management identifies, monitors and addresses risks that could threaten the achievement of Lloyd's franchise objectives. The Risk Management division reports to the Director of Finance, Risk Management and Operations and is structured as follows:

- Admissions
- Cover holders
- Broker Services
- Operational Risk
- Risk Review
- Risk Analysis
- Loss Modeling

ADMISSIONS

The Admissions department is responsible for identifying and managing the risks to Lloyd's at the point at which firms and individuals are admitted to the market, or when they wish to make significant changes to the nature of their participation.

In accordance with Franchise Board standards, Admissions manages the process of admitting corporate members, syndicates, underwriting agents and underwriters and operates a system of individual registration for senior market personnel. The department also assesses and grants certain permissions, including those for mergers and increases in the fees and profit commissions charged by agents.

COVER HOLDERS

The Coverholders department is responsible for identifying and managing the risks to Lloyd's in relation to firms worldwide who wish to have the authority to accept insurance business or issue insurance documentation on behalf of Lloyd's underwriters. The department acts as a focal point for the market for any issues concerning Coverholders and their binding authorities.

BROKER SERVICES

Broker Services is responsible for handling new applications for accreditation as a Lloyd's broker and the re-accreditation and annual review of existing Lloyd's brokers.

OPERATIONAL RISK

This department identifies, monitors and works with market participants to address operational risks that threaten individual businesses within the market, and potentially Lloyd's itself.

The department conducts reviews of agents and syndicates, focusing on the key risk areas. Review findings are reported back to those concerned and remedial measures agreed where necessary. Feedback is given to the market on widespread issues arising from reviews.

RISK REVIEW

This department conducts specialized reviews of risk issues that may affect the whole of the Lloyd's market or significant sections of it. For example, the department might assess, across the market, the adequacy of arrangements for business continuity. The results are fed back to market participants with the intention of identifying and spreading good practice.

RISK ANALYSIS AND LOSS MODELING

These areas work closely together to monitor systemic and aggregate risks across the whole or major parts of the Lloyd's market.

The first step in this process is gathering comprehensive data from the market on business written and reinsurance arrangements. The data feeds into detailed modeling of various risk events and scenarios to detect areas of potential concern.

In the event of an actual catastrophe occurring, the information base and risk model facilitates timely and accurate estimates of Lloyd's exposure.

CORE PRINCIPLES FOR UNDERWRITING AGENTS

INTEGRITY

An agent should observe high standards of integrity and deal openly and fairly.

SKILL, CARE AND DILIGENCE

An agent should act with due skill, care and diligence.

MARKET CONDUCT

An agent should observe high standards of conduct and should take all reasonable steps to avoid causing harm to the standing or reputation of Lloyd's.

CONDUCT TOWARDS MEMBERS

An agent should conduct the affairs of each of the members for whom it acts in a manner, which does not unfairly prejudice the interests of any such member.

INFORMATION

An agent should seek from members it advises any information about their circumstances and objectives which might reasonably be expected to be relevant in enabling it to fulfill its responsibilities to them. An agent should also take all reasonable steps to give members it advises or for whom it exercises discretion, in a comprehensible and timely way, any information needed to enable them to make balanced and informed decisions.

An agent should also be ready to provide members with a full and fair account of the fulfillment of its responsibilities to them. (This principle does not require an agent to give the member concerned greater rights of access to documents and information than that member has under any agreement with the agent.)

CONFLICTS OF INTEREST

An agent should seek to avoid any conflict of interest arising, but where a conflict does arise, should make comprehensible and timely disclosure of that conflict and of the steps to be taken to ensure the fair treatment of any members affected. An agent should not unfairly put its own interest above its duty to any members for whom it acts.

ASSETS

An agent should deal with assets and rights received or held on behalf of a member prudently and in accordance with the terms of any applicable trust deed or agreement with the member.

FINANCIAL RESOURCES

An agent should maintain adequate financial resources to meet its commitments and to withstand the normal risks to which it is subject.

INTERNAL ORGANIZATION

An agent should organize and control its internal affairs in a responsible manner, maintaining proper records and systems for the conduct of its business and the management of risk. It should have adequate arrangements to ensure that staff and others whom it employs are suitable, adequately trained and properly supervised and that it has well-defined compliance procedures.

RELATIONS WITH LLOYD'S

An agent should deal with Lloyd's in an open and co-operative manner and keep Lloyd's promptly informed of anything concerning the agent which Lloyd's might reasonably be expected to be disclosed to it.

LLOYD'S UNVEIL POLITICAL VIOLENCE COVERAGE

Five Lloyd's syndicates have teamed up with international broker BPL Global to offer multinationals comprehensive terrorism and political violence insurance on international land-based assets.

Reflecting increasing world instability and addressing the blurred distinction between different forms of political violence, the policy covers the full spectrum of political violence. The coverage has a global application, but is particularly effective for risks in emerging markets.

Key features of the new policy wording include coverage for a broad range of political violence acts, of which terrorism is only one.

Other acts include:

- Civil commotion
- Riot and looting
- Uprisings, rebellions and coups
- War and civil war

The policy also offers:

- Increased continuity through no cancellation provisions
- A fixed premium for the policy period
- Mid-year renewal options
- A pay-out even if the policyholder is unable to rebuild a property

The coverage has the flexibility to be tailored to meet specific needs.

This new coverage is being underwritten by leading specialist insurers at Lloyd's including: Beazley Furlong Limited, Catlin Underwriting Agencies Limited, Hiscox Syndicates Limited, Liberty Syndicate Management Limited and Wellington Underwriting Plc.

CHAPTER 8: PERSONAL UMBRELLA LIABILITY INSURANCE

A serious personal liability lawsuit can reach catastrophic levels. There have been judgments that do exceed the liability limits carried by the insured. Once these liability limits are exhausted the insured is often forced to pay a substantial amount out of his pocket. Thus, the need for protection against catastrophic lawsuits. Those that usually need this protection are:

- Highly paid executives
- Physicians
- Surgeons
- Dentists
- Attorneys

Do not be mistaken in the assumption that only those listed above need this protection. Considering the increased frequency of liability lawsuits and the complexities of modern living most people require this protection.

NATURE OF PERSONAL UMBRELLA INSURANCE

The umbrella package is designed to provide the insured with coverage in the event of:

- A catastrophic claim
- A lawsuit
- A judgment

The amount of umbrella coverage can range from \$1,000,000.00 to \$10,000,000.00.

The contract usually covers the entire family worldwide. The umbrella typically covers liability losses associated with the:

- Home
- Automobile
- Boats
- Recreational Vehicles
- Sports
- Other Personal Activities

While it is true that an umbrella policy is not a standard contract they do have some common features such as:

- A self-insured retention must be met with certain losses covered by the umbrella policy but not covered by an underlying insurance
- The umbrella policy provides excess coverage over basic underlying policies, such as personal auto, and homeowner's insurance
- Coverage is broad and includes coverage for some losses not covered by underlying contracts

EXCESS LIABILITY INSURANCE

The umbrella policy pays only after the limits of the underlying policy are exhausted. Some umbrella policies require that the insured carry certain minimum amounts of liability on the basic underlying contracts. For example on an automobile policy the minimum required on the basic contract could be:

- \$100,000.00 per person bodily injury liability
- \$300,000.00 per occurrence bodily injury liability
- \$25,000.00 for property damage liability
- A combined single limit of \$300,000.00

On a homeowner's policy the minimum required on the basic contract could be:

\$100,000.00 of personal liability.

If a watercraft is involved liability exposure requirements may be \$500,000.00 of single limit underlying coverage.

BROAD COVERAGE

With respect to personal loss exposures, the personal umbrella policy provides broad coverage. The personal policy coverage also covers certain losses that the underlying contract may not cover after a self-insured retention of deductible is met. These losses include:

- Personal injury
- Libel claims
- Slander
- Defamation of Character
- False Arrest
- False Imprisonment
- Humiliation

Here are five examples of claims that may be paid by umbrella insurance companies:

- The insured slandered two police officers
 - The insured borrowed a tractor and damaged it. After a self-insured retention was met the umbrella covered the loss
 - The mast on a rented boat broke during a race and seriously injured a crewmember. Primary coverage was not available to the insured
 - The insured rents a car in England and is involved in a serious accident. The personal umbrella covers the loss since only limited underlying coverage was available
 - The insured's spouse rents a motorcycle and is involved in a serious accident. Since the underlying automobile/homeowner contracts do not cover the ensuing third-party claim, the umbrella pays
-

SELF-INSURED RETENTION

When an umbrella policy and not an underlying insurance policy cover a loss, a self-insured retention or deductible must be met. As a rule this deductible is at least \$250.00 per occurrence and can be higher.

PERSONAL UMBRELLA COVERAGE'S

- Personal injury liability
- Property damage liability
- Defense costs

PERSONAL LIABILITY INJURY

The insured's liability for personal injury is covered under the personal umbrella policy. Personal injury is defined to include:

- Bodily Injury
 - Sickness
 - Disease
 - Disability
 - Shock
 - Mental Anguish
 - Mental Injury
-

This definition can also include:

- False Arrest
- False Imprisonment
- Wrongful Entry
- Wrongful Eviction
- Malicious Prosecution
- Humiliation
- Libel
- Slander
- Defamation of Character
- Invasion of Privacy
- Assault and Battery (not intentionally committed or directed by a covered person)

PROPERTY DAMAGE LIABILITY

Property damage can be defined as physical injury to tangible property and includes loss of use of the injured property. The umbrella insurance company agrees to pay losses for which the insured is legally liable and which exceed the retained limit.

The retained limit is either:

The total of all applicable limits of all required underlying contracts and any other insurance available to a covered person, or

The self-insured retention if the loss is not covered by the underlying insurance.

DEFENSE COSTS

Typically, legal defense costs in addition to the policy limits are paid with the personal umbrella policy. Defense costs include:

- Payment of attorney's fees
- Premiums on appeal bonds
- Court costs
- Interest on the judgment
- Legal costs

However, some personal umbrella policies will include the cost of defending the insured as part of the total loss. It is possible that in a catastrophic judgment the insured may have to absorb part of the loss. Most umbrella policies will provide and pay the legal defense costs of a covered loss if that loss is not covered by any underlying insurance.

EXCLUSIONS

Here are some of the more common exclusions found in personal umbrella policies:

- Worker's compensation
- Fellow employee
- Care, custody or control
- Nuclear energy
- Intentional acts
- Aircraft
- Watercraft
- Business pursuits
- Professional liability
- Officers and directors
- Recreational vehicles

WORKERS COMPENSATION

Any obligation the insured is legally liable for under workers compensation, disability benefits, or similar law is not covered.

FELLOW EMPLOYEE

Some personal umbrella contracts exclude coverage for any insured (other than the named insured) who injures a fellow employee in the course of employment arising out of the use of a:

- Automobile
- Watercraft
- Aircraft

CARE, CUSTODY OR CONTROL

Damage to property a covered person owns is excluded under all personal umbrella contracts. Most contracts also exclude damage to a non-owned aircraft and non-owned watercraft in the insured's possession. However most umbrellas will cover damage to:

- Property rented to
- Property used by
- Property in the care of an insured

(The Three above exclude aircraft and watercraft.)

NUCLEAR ENERGY

All personal umbrella policies have nuclear energy exclusion.

INTENTIONAL ACTS

Any act directed by or committed by a covered person with the intent to cause personal injury or property damage will not be covered.

AIRCRAFT

Any liability arising out of:

- Ownership
- Maintenance
- Use
- Loading
- Unloading an aircraft is excluded from coverage

WATERCRAFT

Larger watercraft are usually excluded such as:

- Inboard watercraft
- Inboard/outboard watercraft exceeding 50 horsepower
- Outboard motors of more than 25 horsepower
- Sailing vessels of more than 26 feet long

BUSINESS PURSUITS

While liability arising out of business activity or business property is usually excluded, this exclusion does not apply to the insured's or family members use of a private automobile.

PROFESSIONAL LIABILITY

While many insurance companies do not offer this coverage and virtually all umbrella policies exclude professional liability, some companies will cover certain professional liability loss with an endorsement and by charging a higher premium.

OFFICERS AND DIRECTORS

This exclusion does not apply to a non-profit corporation or organization. It does exclude coverage for an act or failure to act as:

- An officer
- A Trustee
- A Director of a corporation or an association

RECREATIONAL VEHICLES

Liability arising as a result of ownership or maintenance of golf carts is excluded.

Focus Points

- Personal Umbrella Insurance provides coverage from catastrophic claim, lawsuit or judgment.
- Personal Umbrella Insurance usually covers the entire family worldwide.
- Umbrella policies pay after the limits of the underlying policy are exhausted.
- When an umbrella policy covers a loss a deductible must be met.
- Liability for personal injury is covered under the personal umbrella policy.
- Property damage is defined as physical injury to property and includes loss of use of the injured property.
- Umbrella coverage pays losses for which the insured is liable and which exceed the retained limit.
- Umbrella policies will pay the legal defense costs of a covered loss with some exceptions.
- Obligations liable under workers comp. or similar programs are not covered under Umbrella policies.

- o Personal Umbrella policies exclude coverage to the insured's personal property.
- o All personal umbrella policies have nuclear energy exclusion.
- o Liability from business property or business activity is excluded from Personal Umbrella coverage.

CHAPTER 9: THE SPECIAL MULTI-PERIL POLICY (SMP)

The evolution of commercial package policies and programs can be traced to the development and implementation of the homeowners' package, which protects an individual's personal property and personal liability.

HISTORY OF THE POLICY

When the first commercial policies, which were (and still are) called the special multi-peril policy (SMP), became available, small, medium and large businesses were rated in exactly the same way. The SMP was the sole commercial policy package on the market.

Thus, a small business with only ten employees and a large company with hundreds of workers were rated in the same way and were insured under identical SMP forms.

Although the SMP covered many perils, for some small- and medium-sized businesses, the coverage included protection against risks that these business owners would never require because these businesses, by their very size, are exposed to fewer risks than large companies.

As a result, small- and medium-sized business owners paid for coverage's that they did not need, and, therefore, paid the same premiums that large companies paid. Even though the SMP was a convenient, discounted policy since it combined several single-line forms of insurance, small- and medium-sized business owners wasted money because they were paying for coverage's that they would likely never use.

BUSINESS SIZE AS IT RELATES TO THE SMP

While many small- and medium-sized businesses find the coverage's of the SMP to be the best policy for insuring their businesses, this in no way means that large businesses do not find the SMP to be a viable way for insuring itself against property or liability. Although some of these large companies are not eligible for the SMP program, many large businesses do indeed qualify for the program.

However, some large companies, which are otherwise eligible, have insurance requirements beyond the scope of the SMP program. This is, of course, to be expected if these companies are exposed to risks that the SMP does not include as part of its protection. Or, interested business owners who operate large companies may discover that even though they are interested in the plan, they are not able to purchase the additional required coverage through endorsement or optional coverage's.

ADVANTAGES OF THE SMP APPROACH

When deciding whether to go with a single-line or a multiple-line type of coverage, the commercial policyholder will discover that when his insurance needs are combined as a multiple-line package, he will benefit from lower costs, from more complete coverage in a single policy contract, and from flexibility of choice when selecting optional coverage's.

REDUCED COSTS

Reduction in cost is probably the most important and most attractive feature of the SMP program. The reduction in premium costs can be ascribed to these elements: the selection process, the handling of just one policy, careful examination of class characteristics and through the reduction of risks.

REDUCING COSTS THROUGH THE SELECTION PROCESS

Eligible policyholders are screened during the underwriting selection. For example, business owners, who because of their type of business or because of the types of risk to which their business is exposed, probably will be eliminated immediately. Insurance companies who screen applicants so that their underwriters eliminate poor risks and select only the better risks usually will benefit from cost reductions ranging from 15 to 30 percent.

These are up-front reductions in initial premiums. Because SMPs are written by both dividend and no-dividend paying insurance companies, some policyholders may gain additional savings through receiving earned dividends.

Another factor in cost reductions is that SMP policyholders, as a statistical class, are not a well-defined class or a permanent group consisting of those whose businesses that are exposed to similar risks.

Rather, they are a constantly changing group that is exposed to similar risks. The insurance company's selection process tends to ensure a particular group will statistically show a better than average loss ratio, meaning that SMP policyholders have less exposure to risk and, therefore, file less claims.

REDUCING COSTS BY HANDLING ONE POLICY AND BY EXAMINING CLASS CHARACTERISTICS

Cost reduction is also attributable to two additional factors. First, both the insurance company and the insurance agent or broker benefit from processing reductions since they will manage only one policy instead of perhaps two to ten policies as they would have to do with single-line policies.

Second, another cost reduction occurs because, overall, the losses suffered by the SMP class are less costly and fewer in number than the losses suffered by other classes with similar coverage's that are written under a series of separate policies. These savings, both the cost of handling one policy rather than several and the decreased chances of the SMP class suffering a loss, are passed on to the policyholder usually in the form of reduced premiums.

REDUCING COSTS BY CUTTING RISKS

The selection process, as described above, is repeated at renewal time. At that time, the loss experience (or claims filed or losses suffered) and inspection reports of the condition of the business owner's property and equipment (among other areas of examination) of each policyholder are taken into account when deciding whether each business still qualifies for the SMP program and its discounted premium.

Obviously, it is necessary for an SMP policyholder to maintain his premises in excellent condition and to demonstrate he is receptive, concerned, alert to loss prevention recommendations, and willing to implement suggested improvements in an effort to reduce exposure to loss. He must exhibit these desired characteristics if he wishes to continue benefiting from the reductions in insurance costs an SMP provides.

To illustrate this point, suppose that a business owner is advised by the insurance company's representative to buy and to install a better locking mechanism for the cabinet where he stores the guns that he sells. The representative may even urge the policyholder to purchase one of several products that the insurance company has already deemed to be the best, or the most effective, locking mechanisms available in the current marketplace.

The policyholder should comply with the representative's suggested improvement since the representative will probably note in the policyholder's file that the recommendation was made on a particular date. Sometimes, the representative, because he considers the risk of damage or loss to be significant, may even mandate that the locking mechanism must be installed by a specific time on a named day.

This does not mean that the insurance company will constantly be making suggestions for improvement to the business owner's property or that the insurance company will infringe upon the business owner's right to conduct business as he sees fit. Rather, it is one of the insurance company's methods for reducing exposure to risk, thereby lowering premiums and reducing the chances of a loss occurring. In that way, the class's loss experience is reduced, or at the very least not increased, because businesses are willing to implement the insurance companies' recommendations for risk reduction. Finally, not complying with such suggestions could mean that the business might lose its SMP coverage since the business owner is, in effect, increasing the chances of risk and loss for his class.

A SINGLE POLICY CONTRACT

Another main advantage of the SMP policy is that this policy covers most of the business operations' exposure. One policy means only one expiration date to worry about, one premium payment (or a planned series if a payment plan is used), one insurance policy file, and, consequently, low probability that the business owner will have periods of time where his coverage lapses. Also, one policy combining several coverage's gives the policyholder's account a higher profile with the insurance company's underwriter.

Theoretically, a well-written SMP, together with a workers' compensation policy and an appropriate automobile for business usage policy, encompasses all of the insurance needs (other than employee benefits) for most small- to medium-sized business enterprises in one document.

However, an SMP is not a package, which automatically provides business owners with all of their necessary coverage's. Selecting a policy requires thoughtful decisions, review and updating as the business owner's situation changes.

FLEXIBILITY OF CHOICE

Flexibility of choice, the third advantage, makes it necessary for the policyholder and his agent or broker to carefully review his business needs to ensure that selected coverage's respond adequately to his needs.

For example, in the mandatory property section, an insured must decide whether the desired coverage is going to be all-risk, named peril, or just fire and extended coverage. If the insured chooses the latter coverage, then he must determine whether there is a need for protection against sprinkler leakage or some other water or earthquake protection by way of either an endorsement or as an optional coverage.

Finally, business owners who choose either the named peril or the all-risk form must review available optional coverage's or endorsements before deciding whether this extra coverage's are necessary.

ELIGIBILITY

Today's SMP policy program consists of eight different classification groups, each group offering its own package discount. The group in which a business is placed affects the premium that the business owner will pay. For the most part, the same policy forms are employed for each of the eight groups.

BUSINESSES THAT QUALIFY FOR AN SMP

Eligible insured are grouped into eight trade group classifications, which determine the size of the applicable discount:

- Apartment houses.
- Contractors.
- Motel-hotel operations.
- Industrial and processing plants.
- Institutions.
- Mercantile operations.
- Offices.
- Service firms.

The package discounts that apply to each group vary by group and by state. Discounts are periodically recalculated to reflect the loss experience of the group or of the class as a whole. For example, it is possible for a group to have a package factor of 1.00 (no discount) or, if the loss experience of the group is low, a factor of perhaps .65 (a discount of 35 percent).

BUSINESSES THAT DO NOT QUALIFY FOR AN SMP

The 1977 revision to the SMP program changed the eligibility rules so that more insured's could qualify for the program. Prior to this, the eligibility rules, while not impossible to meet, were much more strict.

Presently, only a few classes are excluded from purchasing an SMP. These include:

- Boarding or rooming houses and other residential properties that consist of fewer than three apartment units.
- Farms and farming operations (this is because a separate commercial package policy exists for farmers).
- Automobile filling or service stations; automobile repairing or rebuilding operations; automobile, motor home and motorcycle dealers; and parking lots or garages unless they are incidental to the otherwise eligible class.
- Grain elevators, grain tanks and grain warehouses.
- Properties or businesses which can be categorized in one of five ways:
 - a. Highly protected risks.
 - b. Petroleum properties.
 - c. Petrochemical plants.
 - d. Electric generating stations.
 - e. Natural gas.

Of course, this list does not indicate that these five categories of business are ineligible for any type of commercial insurance; it only defines those establishments that are ineligible for participation in the SMP program. Other policies that more adequately and comprehensively address the coverage needs of these types of businesses have been created specifically for that purpose and are available at most insurance companies that offer business owners' insurance.

DEFINING THE TWO TYPES OF PROPERTY

There are two broad categories of property, which must be considered—real, and personal business property. Business owners must recognize the differences in these types of property, as this is essential for understanding property coverage's in Section I.

REAL PROPERTY COVERAGE

Nearly all real property is included in the definition of "building(s)" on the SMP coverage forms. This includes buildings; structures; additions; fixtures; permanent equipment and machinery used for maintenance and/or service of the building; materials and supplies intended for use in construction; alterations or repairs; yard fixtures; fire extinguishing apparatus; appliances used for refrigeration, ventilating or cooking; dishwashing and laundering equipment; and floor coverings.

All of these property types must be located on the insured's premises if the business owner is to benefit from his policy's protection.

Basic exclusions from building equipment are swimming pools, fences, piers, docks, wharves, walks, cost of excavation, building foundations and underground pipes. These types of properties, like other exclusions, may be protected against loss by purchasing a separate policy (depending on the type of property that it is), an endorsement or optional coverage.

BUSINESS PERSONAL PROPERTY COVERAGE

Coverage is available through the SMP for business personal property, which is usual to the insured's occupancy or to business operations. Included also are tenant improvements in buildings not owned by the insured, and a limited extension to the personal property of others that is in his care, custody, or control at the time of the loss is also included. In most situations, as with real property, personal property coverage is limited to property that is located on the insured premises.

The type of personal property covered under Section I consist of, but is not limited to, stocks (inventories) of merchandise and of raw materials, supplies and fittings, and furniture as well as fixtures, equipment and machinery.

Basic exclusions are animals and pets; watercraft; automobiles, vehicles or trailers licensed for highway use; aircraft; personal property while waterborne; household and individual personal property; and accounts, bills, currency, deeds, evidence of debt, money and securities. Valuable papers, money and securities coverage is available under Section III or by means of various crime endorsements.

These types of coverage's may be included if the business owner opts to purchase a separate policy (if required), an endorsement or optional coverage.

PROPERTY COVERAGE (SECTION I)

There are two types of SMP forms from which a business owner might choose. A business owner might choose the standard, or named peril approach, or he may opt for the all-risk approach. Each of these forms covers different perils, so a business owner must carefully weigh whether the additional cost of the all-risk form better suits his insurance needs than the less expensive, but also less comprehensive, named peril form.

THE STANDARD (NAMED PERIL) FORM OF PROPERTY COVERAGE

Combining several different peril forms provides coverage for both buildings and personal property. The basic forms are the general building form and the general personal property forms.

Under these two forms, insurance coverage is on a named peril basis. These perils include fire, lightning, windstorm, hail, explosion and smoke; aircraft or vehicle damage; riot, riot attending a strike, or civil commotion; and vandalism or malicious mischief. Exclusions of electrical injury, interruption of power, earth movement, flood, or any enforcement of ordinance or law regarding the use, the construction, or the repair of a building limit coverage.

At the insured's or insurance company's request, vandalism and malicious mischief, which is usually covered, may be excluded, which deletes this peril from the general form.

THE ALL-RISK FORM OF PROPERTY COVERAGE

As an alternative to the named peril approach, an insured may consider coverage on an all-risks basis. The special building form and special personal property forms provide these types of coverage's at an additional cost. Although this form offers a wide variety of coverage, certain exclusions will always be included as part of the policy.

The exclusions are losses that are caused by the following:

- Enforcement of local or state ordinances regulating construction.
- Electrical injury to electrical appliances caused by an artificially generated current.
- Flood, earthquake, sewer backup or water below the surface of the ground.
- Wear and tear, gradual deterioration, rust, corrosion, mold, wet or dry rot, or inherent or latent defect.
- Smog.
- Smoke, vapor or gas from agricultural or industrial operations.
- Mechanical breakdown, including rupture or bursting caused by centrifugal force.
- Settling, cracking, shrinkage, bulging or expansion of pavements, foundations, walls, floors or ceilings.
- Animals, birds, vermin or other insects.

- Explosion of steam boilers, steam pipes or engines.
- Vandalism and malicious mischief to any building that is vacant or that is unoccupied for more than 30 days.
- Continuous or repeated seepage or leakage from water or steam from plumbing, heating and air conditioning, or other equipment.
- Theft of any property that is not an integral part of a building at the time of the loss.
- Unexplained or mysterious disappearance of property.
- Loss that is caused directly or indirectly by an interruption of power.

ADDITIONAL OPTIONAL COVERAGES

An insured may purchase added endorsements or optional coverages so that he may more adequately meet his insurance needs. Because the policyholder is adding coverage to his basic policy, the business owner must pay an additional cost for each of these endorsements or optional coverages.

An insured's endorsements are usually found on the declarations page of his policy, so when the purchaser receives his policy, he should make sure that all the additional coverages he purchased are specifically listed on the declarations page so that he does not misunderstand his policy's coverage.

ACCOUNTS RECEIVABLE, VALUABLE PAPERS AND RECORDS ENDORSEMENTS

These endorsements provide coverage on an all-risk basis, are similar to inland marine floater endorsements, and are examined on an individual basis.

The accounts receivable endorsement provides coverage for all money that customers owe a business, and these figures include interest and collection expenses in case the insured is unable to make collection because of a direct loss or because of damage to the accounts receivable records. Depending on the needs of the insured, both reporting and non-reporting forms, which are discussed below, are obtainable.

The valuable paper and records endorsement provides business owners with insurance coverage for valuable papers and records while these are on the insured premises. Included are documents and records, books, maps, films, drawings, abstracts, deeds, mortgages and manuscripts. However, money and securities are excluded.

The perils insured against are protected on an all-risk basis from direct physical loss. A separate limit of liability is allowed for specific articles, and a blanket limit is available to provide coverage for all items, which are not specified. There also exists a limited extension provision for coverage of such property while away from the insured premises (usually 10 percent of the combined limits not to exceed \$5,000).

Broad Form Storekeepers Endorsement

Designed to provide limited fidelity and burglary coverage for small mercantile stores, this endorsement is applicable to business owners who employ less than five employees.

Business Interruption Insurance

Business interruption insurance includes a broad category of specific losses of use or time element insurance coverage. These are designed to indemnify, or to compensate financially, the insured for a loss of earnings (as the policy defines loss of earnings), tuition fees, rents, or the extra expenses involved in continuing operations in case an insured's premises are damaged by an insured peril. Under the SMP program, several business interruption forms are available so that business owners may better select the necessary business interruption endorsement that their businesses require.

For example, coverage may be added to business interruption insurance by adding to the policy a gross earnings endorsement, which covers gross earnings less non-continuing expenses, for the actual loss sustained by the insured from the interruption of business. As with all gross earnings forms, included as part of the policy's coverage is a coinsurance (sometimes called a contribution) clause in the amount of 50, 60, 70 or 80 percent of the business's annual gross earnings. Failure of any kind to maintain an adequate amount of insurance in respect to the selected coinsurance percentage will result in a claim payment penalty for a sustained loss.

Coverage for ordinary payroll expense either may be excluded or limited to a period of 90 consecutive days following damage to the insured premises. If not specifically included in the policy as a coverage, the business owner's employees will

not be paid unless he can prove that paying the payroll is essential to continuing or to speeding the resumption of business operations.

Business interruption coverage also may be written on an earnings endorsement, which protects the business owner against actual losses suffered (gross earnings less non-continuing expenses) with no coinsurance requirement. However, recovery is restricted to a percentage of the limit of liability that is applicable on a monthly basis.

The business owner may select 16.67 percent, 25 percent or 33.33 percent depending on how long he estimates that it would take to repair or to restore the premises to its original condition. Coverage under this endorsement ensures that the insured is protected against perils that might damage or destroy the building and/or its contents.
Builders' Risk Endorsement

Another endorsement, the SMP builders' risk endorsement, consists of two forms which can be applied either to the named peril or to the all-risk policy. For named peril policyholders, the appropriate form is called the completed value form, and for business owners who carry an all-risk policy, the SMP special builders' risk completed value form (for all-risk policies), is available. The builders' risk endorsement is designed to provide property insurance coverage's for builders' risk exposures while they are constructing a new building or an insignificant addition. All but insignificant additions or new buildings must be specifically added by endorsement.

CHURCH THEFT ENDORSEMENT

This endorsement is designed to provide coverage for a church against theft or attempted theft of money, securities, or any other property while at the church, in a bank or night depository, or in the care or custody of an authorized person. The form is subject to definitions and exclusions, which should be reviewed. Coverage's can be provided at an agreed value for specified articles and/or at a specified limit for all other property.

COMBINED BUSINESS INTERRUPTION AND EXTRA EXPENSE ENDORSEMENT

The combined business interruption and extra expense endorsement provides coverage for both business interruption and for extra expense losses with a single, specified limit of liability which is explicitly stated in the endorsement.

An insured may select from specified percentage options such as those found in the business interruption's gross earnings endorsement. Usually, these percentages are based on the amount of time a business owner estimates would be necessary for restoration.

CONDOMINIUM OPERATIONS ENDORSEMENT

The condominium operations endorsement has been developed through the use of several special arrangement forms which are intended to meet the needs of certain insured's.

The SMP condominium operations endorsement (an additional policy provisions endorsement) is available to provide named peril or all-risk property coverage for condominium operations. These forms follow the named peril and the all-risk forms discussed earlier with special terms and conditions that have been included to meet the needs of the condominium association that oversees the maintenance and general upkeep of its premises.

EARTHQUAKE EXTENSION ENDORSEMENT

An earthquake extension endorsement can be added to afford coverage that is intended to meet the needs of certain insured's both under the named peril and the all-risk forms. This coverage is applicable only to the insured premises.

EXTRA EXPENSE ENDORSEMENT

Some companies might find it advantageous to purchase insurance protection for extra expenses incurred so that they can continue their operations should their insured premises be damaged or destroyed. The extra expense endorsement available under the SMP program provides this type of coverage.

This coverage should be considered either in lieu of or in addition to business interruption insurance for those businesses where a shutdown is unacceptable and which would cause a complete cessation of business activities. In such situations, the insured will incur expenses for leasing temporary facilities and for resources that will be necessary and that enable the insured to continue servicing customers.

Coverage is limited on a monthly basis (not more than 40 percent of the endorsement's limit for any one month or less) and generally follows the perils insured in Section I.

Remember that the expense portion of business interruption policies only covers extra expenses incurred to the extent that they reduce the loss of net profit. Accordingly, some types of businesses might need this endorsement in addition to the business interruption endorsement.

INLAND MARINE COVERAGE ENDORSEMENTS

There are several optional inland marine coverage endorsements, which can be added to Section I.

These provide coverage for both personal property and for the property of others that is in the care, custody or control of the insured. Coverage is provided on an all-risk basis and is limited by specific exclusions, terms and conditions. These endorsements closely follow the usual inland marine property floater contracts.

The specific endorsements available are the radium floater, the fine arts floater, the musical instruments floater, the neon sign endorsement, the glass coverage endorsement, and the physicians and surgeon's equipment endorsement.

LIABILITY FOR GUESTS' PROPERTY ENDORSEMENT

Although this endorsement contains specific exclusions and limitations, the liability for guests' property endorsement provides coverage for an innkeeper's liability for loss or damage to property of guests while this property is within the insured premises or while in the possession of the insured's care, custody or control.

LOSS OF RENTS ENDORSEMENT

This endorsement provides coverage for loss that an insured might sustain if tenants are unable to rent his insured property because of damage or destruction to the premises by an insured peril.

Coverage is usually bound by the enacting of a predetermined contribution clause, which essentially functions as a coinsurance clause. Also, the insurance company is not liable for a greater proportion of any loss than the stated limit of liability; multiplying the rental values from the previous 12 months by the pre-determined coinsurance clause produces this amount.

MERCANTILE OPEN STOCK BURGLARY ENDORSEMENT

Because a business's personal property may be exposed to loss that is caused by burglary, robbery or theft, there are several extension endorsements that can be added to Section I of the SMP policy to protect against loss by crime. These endorsements are available under Section I, or in some cases, under Section III, which deals exclusively with crime coverage's and which is discussed in greater detail below.

Coverage's under this endorsement closely parallel those that a person would find in a separate, or single-line, policy. Also, the mercantile open stock burglary endorsement may be combined with the general personal property form so that coverage is provided for the business owner's merchandise, furniture and fixtures, and equipment that exist at the insured property.

A watchman protects this property against loss caused by burglary or robbery while the premises are not open for business. If the all-risk form covers personal property, this endorsement is not needed because that type of policy includes as part of its basic protection this coverage.

MERCANTILE OPEN STOCK BURGLARY AND THEFT ENDORSEMENT

This endorsement provides coverage for loss or damage to merchandise, furniture, fixtures and equipment that are located at the insured property for two situations. The first is for burglary or robbery of a watchman while the premises are closed for business, and the second is for protection against theft or attempted theft regardless of whether or not the premises are open for business.

As stated in the previous endorsement, this endorsement is not needed if the insured purchases an all-risk form since the all-risk form already protects the insured from this type of loss.

MERCANTILE ROBBERY AND SAFE BURGLARY ENDORSEMENT

This endorsement provides coverage for loss of money, securities and other property both inside and outside the insured premises; it includes as part of its coverage the burglary of a safe.

OPTIONAL PERILS COVERAGE ENDORSEMENT

An optional perils coverage endorsement is available on the named perils form for both buildings and personal property protection.

Additional perils covered by this form are:

- Breakage of glass (which is part of the building and subject to limitations);
- falling objects (loss or damage to personal property in the open is not included);
- weight of ice, snow or sleet;
- water damage (however, coverage is included for accidental discharge of water or steam from plumbing, heating or air conditioning system, but discharge from automatic sprinkler systems is excluded from coverage); and

- loss caused by collapse of the building structure itself.

REPLACEMENT COST COVERAGE ENDORSEMENT

No matter which of the two forms—the named peril or the all-risk—that a business owner chooses, one important consideration is the method for establishing the value of insured property at the time of a loss. Unless specifically endorsed or stated in the coverage form, all property will be valued according to its ACV rather than on its replacement cost.

Also, the precise definition of ACV depends upon the type of property under consideration. There are variations in the application of ACV depending on whether real, personal, finished good, or stock (inventory) properties are being valued.

This basis of adjustment may be modified, however, by the attachment of the replacement cost coverage endorsement. Under this endorsement, insured property involved in a loss will be adjusted on the basis of the amount necessary to repair or to replace the damaged property, and reimbursement is restricted only to the policy's limit of liability without regard to the actual age of the property at the time of the loss.

Business owners should be aware that this endorsement does not delete or replace any coinsurance requirement, that it is not extended to certain types of property such as stock, property of others, valuable papers, records or fine arts, and that he, the business owner, no matter which method for establishing value that his policy uses, must first pay his deductible.

REPORTING FORMS ENDORSEMENT

Another available provision under both forms is the addition of a reporting form endorsement, which converts basic property coverage forms to a reporting basis. Two separate forms—the specific rate form and the average rate reporting endorsements form—comprise the reporting endorsement.

This endorsement is convenient for business owners whose personal property values fluctuate and for business owners who have difficulty in determining the correct amounts of insurance. Business owners who opt for this endorsement are allowed to identify their business cycles, which generally range from peak to slow seasons.

By using a reporting form, a business owner can establish a limit of insurance that sufficiently covers the maximum values of the insured property at a given time. The insured reports the actual value of the business at stated periods, and a premium is charged on the average value at risk during the entire year rather than business owners paying high premiums year round because they have increased risks during particular months of the year.

For example, a Christmas ornament business's busiest season is around the Christmas holidays, when it, therefore, has an increased exposure to risk. Exposure to risk is significantly less during the summer since this type of store is not busy then.

To calculate the premium, the insurance company calculates the business's average risk during the year by averaging its busy with its slow periods rather than requiring the business to pay a premium that is based solely on the increased business activity during the Christmas season.

As a result, the insured knows that his business has the benefit of adequate coverage during both peak and slower periods. Furthermore, the business owner will pay a fair premium that is based on the actual value of the annual average of risk exposure rather than paying a much higher premium that is based on higher risk exposure during only specific months of the year.

SPRINKLER LEAKAGE ENDORSEMENT

The sprinkler leakage endorsement provides protection for insured property against named perils that cause damage to the business owner's property from leakage or discharge of water (or other substance) from an automatic fire protection system.

It also includes coverage for loss or damage resulting from the collapse of a tank, which is part of the sprinkler system. This endorsement contains specified limits of liability, coinsurance percentages, conditions, and exclusions and must be separately requested and priced when developing the SMP contract).

TUITION FEES ENDORSEMENT

The tuition fees endorsement provides coverage for lost tuition fees that an educational institution might suffer if the school's physical facilities are damaged and unusable because of loss by an insured peril. The basis of recovery is the amount of the actual loss sustained from the date of loss to the opening of the school year that begins after the premises' restoration is complete. Coverage is available on an 80 percent or on a 100 percent coinsurance basis.

GENERAL LIABILITY COVERAGE (SECTION II)

The SMP, in Section II, describes general liability insurance and is a mandatory coverage; just as property coverage is in Section I.

Typically, coverage is written on a comprehensive general liability (CGL) basis for any occurrence which is attributable to one of two causes—one is the ownership, maintenance or use of the insured premises, and the second is for business operations that are necessary or incidental to the named insured's commercial activities.

Furthermore, the SMP's liability coverage extends to the business's products and completed operations exposures unless the insurance policy specifically states that these are excluded for some reason. Coverage is on a combined single limit basis although one may purchase separate limits for bodily injury and property damage if he feels that this better suits his particular needs.

Again, business owners should always confer with their insurance companies' underwriters so that they will be well informed about their liability coverage and whether they carry the standard or the all-risk package in Section II of their policy.

Also, they should ask if their insurance company has created its own form which details what is protected on their premises or in their business operations. Another good question to ask concerns any other optional coverage's or endorsements that are obtainable so they might broaden the scope of the policy's basic coverage.

In the personal injury section of coverage, business owners will usually find that the following coverage's are included: an employer's non-owned automobile, an automobile fleet (employers should always ask what number of cars determines a fleet), professional liability, comprehensive medical payments, contractual liability, independent contractors, and elevator collision.

Of course, policies differ from company to company, so not all of these will be found in every policy's liability section.

GENERAL LIABILITY COVERAGE

General liability covers exposures such as lawsuits occurring because of slips or falls on the insured premises, injuries that occur because of operating equipment, and certain liabilities, which are assumed already to be under contract or agreement. As stated above, this coverage also extends to protect a business owner against liability that is caused from the use or consumption of products that his business produces or sells.

However, if the underwriters feel that the product's liability exposure is too severe to be covered under the CGL section, they will exclude the product(s) from the SMP and will require that the business owner purchase a separate products liability policy altogether.

GENERAL AND SPECIAL LIABILITY EXCLUSIONS

The SMP does not cover claims for injury to employees because this must be covered under a separate workers' compensation policy. Remember that workers' compensation is not included in the SMP policy. This is a separate policy, not available under endorsement or optional coverage, which business owners must purchase in addition to their SMP policy.

This is true also for employee benefit programs and for liability that occurs as a result of operating automobiles or trucks. This coverage's, like workers' compensation, are not available by endorsement or optional coverage and must be insured under an employee benefits program or under an automobile for business usage liability policy.

Several special exposures such as liability for errors or omissions by professionals are not protected under Section II of the SMP. Section II of an SMP does not cover professional errors in professions such as architecture, engineering, the medical or legal field, or accounting. Instead, a separate professional liability policy is necessary if a business owner wants to protect himself against exposure to these risks.

To avoid any future problems and to protect against common or special liabilities, when the business owner is setting up his policy, he must fully describe his property and operations to an experienced, knowledgeable and dependable insurance agent and rely upon the agent's professional advice to be sure of proper protection.

CRIME COVERAGE (SECTION III)

Crime coverage, available under Section III, is entirely an optional coverage. Its purpose is to provide coverage for money and securities, negotiable instruments, and employee dishonesty. Protection against loss by crime is intended to closely parallel the single-line coverage's, which are available under separate policies or under the three-D policy (dishonesty, destruction or disappearance).

As mentioned in the property section, both property forms, the named peril and the all-risk, exclude crime coverage since it is covered under Section III. Furthermore, the SMP offers only limited coverage for these exposures under the various crime endorsements at an additional cost.

Some businesses, however, might decide not to include this section as part of their SMP policy because they might need broader coverage than what is available, they may desire higher limits than what this section offers, or they simply may not

even be eligible for coverage under the limited endorsements that they could add because the underwriters have decided that risk of loss is too great for their business.

On the other hand, the SMP package discount may make it sensible for some business owners to include the crime coverage in this section.

There are three basic coverage's under this section: the comprehensive crime coverage endorsement, the blanket crime coverage endorsement, and the public employers blanket endorsement.

A blanket form is a form of contract between an insured and an insurance company, which provides coverage for similar types of property at different locations or for different types of property located at the same location.

Also, the public employers blanket endorsement provides coverage for all employees or for a class of employees without their being specifically named.

The main difference between the comprehensive crime and the blanket crime endorsements is that under the blanket form, all insurance agreements, which are broadly defined as the promises made by the insurance company to the insured, are mandatory protected from loss.

Under the comprehensive crime endorsement, the insured may select specific coverage agreements and varying limits of liability and coverage for employee dishonesty on a blanket position basis. The blanket position coverage for employee dishonesty under this endorsement also allows the stated limit of liability to be applied to each employee rather than to the employees as a group.

Therefore, for example, if three employees acted together to steal \$30,000, \$10,000 blanket position coverage would cover the loss in full since each of the employees is considered to be a separate entity. In contrast, the blanket limit of liability applies on a per occurrence basis for any one loss, regardless of the number of employees involved. In the previous example, a \$30,000 commercial blanket bond would be required to cover the loss in full.

In addition to providing coverage for loss by extortion unless it has been specifically excluded, following are the coverage's that are available under the comprehensive crime endorsement, which consists of five kinds of protection against loss caused by criminal acts. These five categories can be selected separately. In fact, business owners may opt for only several of these because some of these coverage's are more comprehensive than others.

These five categories are:

- 1A) Employee Dishonesty (commercial blanket). This agreement provides coverage for loss of money, securities and other property because of any dishonest or fraudulent acts by the insured's employee(s). The stated limit is the amount that can be applied to each occurrence, regardless of the number of employees, which may be involved. The limit would typically apply to each occurrence, not to each employee.
- 1B) Employee Dishonesty (blanket position). Coverage under this agreement is similar to that provided under 1A. However, the limit of liability is applied on a per employee rather than on a per occurrence basis. All employees of the insured are covered and are considered to be a separate entity. If the limit was \$10,000 and three employees were involved, the amount applicable would be \$30,000 if \$10,000 had been stolen.
- 2) Money and Securities Loss Inside the Premises. This provides coverage up to the specified limit for loss of money and securities by destruction, disappearance, or wrongful abstraction inside the insured premises or at any banking premises.
- 3) Money and Securities. Loss Outside the Premises. Coverage under this agreement is the same as that available under 2, except that it covers money and securities that are outside the premises, that are being transported by a messenger, that are in the home of a messenger, or that are in an armored car.
- 4) Money Orders and Counterfeit Paper Currency Coverage. This agreement provides coverage for the insured against loss due to the acceptance, in good faith, of any counterfeit money or money orders while in the course of business.
- 5) Depositors Forgery Coverage. Coverage under this agreement is provided for the insured or for the bank, when a savings or checking account is maintained, for loss, which occurs as a result of forgery of checks, drafts or other negotiable instruments.

- 6) Lastly, coverage under these agreements is not always inclusive. Business owners must carefully review these forms for the endorsement's specific limitations and exclusions. Furthermore, the consideration of deductibles should not be overlooked.

BOILER AND MACHINERY COVERAGE (SECTION IV)

Boiler and machinery coverage, Section IV of the SMP, is optional and, if selected, is eligible for the SMP package discount. Usually coverage is provided or recommended on the basis of a survey that is completed by the insurance company and is based on a business owner's responses. The specific limits, locations and terms are outlined on a separate declarations endorsement.

When setting up his policy, a business owner should always describe in detail his business operations to an agent because he may not realize his normal business operations may require his purchasing insurance which protects boilers, refrigeration equipment, electrical apparatus and other kinds of machinery.

By disclosing information details about the way his company operates, he avoids future disaster that might have been protected against had he carried the proper insurance coverage.

Some insurance companies will not insure this type of coverage but, through another insurance company who specializes in this area of insurance, will obtain a cooperative arrangement. The company that specializes in boiler and machinery insurance will provide the underwriting, pricing and loss control services. In fact, even though the insurance is provided through another company, this endorsement may be added to the business owner's policy at the package discount.

Finally, coverage is written on an ACV basis unless the business owner prefers protecting his equipment on a repair and replacement cost basis, which must be added by endorsement.

Boilers

The SMP boiler and machinery coverage endorsement includes coverage for all boilers, unfired pressure, vessels and piping that are either in use or that is connected and ready for use. Because almost all fire and extended coverage policies exclude damage that results from explosion of boilers or other pressure vessels, this coverage is needed if insured property contains any heating boiler, process boiler, or any steam generator that operates under pressure.

Another important consideration when deciding whether or not to add this endorsement is that the liability coverage in Section II specifically excludes liability, which occurs as a result of these kinds of explosions. The addition of this protection also includes the insured's liability for damage to the property of others and any associated defense costs if a lawsuit should be brought against the company or the business owner.

MACHINERY

Machinery coverage insures against damage and costs that result from the breakdown of machinery while it is on the premises. The equipment to be insured must be scheduled, or itemized, on the policy. Business owners, in an effort to protect their business operations, usually insure only those machines that are abnormally expensive, time consuming to repair or are critical to their business operations.

The coverage extends to damage to surrounding property, which, like boiler coverage, is excluded in basic fire and extended coverage policies. It is wise to ask if the insurance company has a good boiler and machinery inspection service, for these inspections can be as important as the coverage's themselves.

Coverage on other types of machinery is usually available through an additional object group's endorsement. Equipment under this endorsement must be scheduled on the policy.

ADDITIONAL COVERAGES

Business interruptions coverage may be available under Section IV on a daily or a weekly indemnity basis. Extra expense coverage also may be purchased for the period a business owner estimates it would take for him to continue his operations elsewhere while his usual premises are being restored to their original state.

In addition, coverage may be available for prevention of occupancy and consequential damage that might occur by a company who leases its premises or which occurs if a business must continue its operations at a different location while the premises are being restored to their original state.

IMPACT AND FUTURE OF THE SMP PROGRAM

As mentioned previously, the SMP, introduced in most states in 1960, was the first standard package policy for commercial enterprises. The package as originally introduced continued with only minimal modifications until 1977, when a fairly comprehensive revision was made. Because the policy was accomplishing effectively what it was intended to do, the concept and the structure of the policy did not significantly change; the only obvious changes were that eligibility rules were broadened and policy forms were simplified to increase their readability.

The impact of the SMP program has been significant. This is evidenced by the notable increase in premium dollars that insurance companies have written for their policyholders. Also, one must remember those two other successful policies, the BOP and farmers' insurance, originated from the SMP.

It is unlikely there will be significant coverage and eligibility revision in the SMP program for several years. However, periodic minor changes and updates will be made to its current form. Eligibility is now quite broad, the coverage options are stabilized, and cost savings have been established. The only likely adjustments in the foreseeable future might be slight modifications made to package discounts for individual business groups.

FOCUS POINTS

- o Business owners must assess their insurance needs from two standpoints-exposure to loss and also consider the limits of liability that the policy contains.
- o Business owners must weigh the advantages of lower premiums against having high deductibles or low limits of protection.
- o When the first commercial policies, special multi-peril policy (SMP), became available, small, medium and large businesses were rated in exactly the same way.
- o In the beginning the SMP was the sole commercial policy package on the market.
- o Because the SMP covered many perils, small- and medium-sized businesses-included protection against risks that these business owners would never require. They paid for coverage's that they did not need,
- o When deciding to go with a single-line or a multiple-line type of coverage, the commercial policyholder will discover that when his needs are combined as a multiple-line package, he will benefit from lower costs, from more complete coverage, and from flexibility of choice when selecting optional coverage's.
- o Reduction in cost is one of the more important and attractive features of the SMP.
- o The reduction in premium costs can be ascribed to the selection process, the handling of just one policy, careful examination of class characteristics and through the reduction of risks.
- o Eligible policyholders are screened during the underwriting selection.
- o Insurance companies who screen applicants through underwriters eliminate poor risks and select only the better risks, usually benefit from cost reductions of 15 to 30 percent.
- o A main advantage of the SMP policy is that this policy covers most of the business operations' exposure.
- o Today's SMP policy program consists of eight different classification groups, each group offering its own package discount.
- o The group in which a business is placed affects the premium that the business owner will pay.
- o The eight trade group classifications which determine the size of the applicable discount includes Apartment houses, Contractors, Motel-hotel operations, Industrial and processing plants, Institutions, Mercantile operations, Offices, Service firms.
- o The package discounts that apply to each group vary by group and by state.
- o Discounts are periodically recalculated to reflect the loss experience of the group or of the class as a whole.
- o The 1977 revision to the SMP program changed the eligibility rules so that more insured's could qualify for the program.
- o Classes excluded from an SMP include Boarding, rooming houses and other residential properties of fewer than three apartment units. Farms and farming operations. Automobile filling or service stations; automobile repairing or rebuilding operations; automobile, motor home and motorcycle dealers; and parking lots or garages unless they are incidental to the otherwise eligible class. Grain elevators, grain tanks and grain warehouses.

- o Classes excluded from an SMP include Properties or businesses that can be categorized in one of five ways: Highly protected risks, Petroleum properties, Petrochemical plants, and Electric generating stations, Natural gas.
- o Nearly all real property is included in the definition of "building(s)" on the SMP coverage forms. This includes buildings; structures; additions; fixtures; permanent equipment and machinery used for maintenance and/or service of the building; materials and supplies intended for use in construction; alterations or repairs; yard fixtures; fire extinguishing apparatus; appliances used for refrigeration, ventilating or cooking; dishwashing and laundering equipment; and floor coverings.
- o Basic exclusions from building equipment are swimming pools, fences, piers, docks, wharves, walks, cost of excavation, building foundations and underground pipes.
- o The type of personal property covered under Section I consist of, but is not limited to, stocks (inventories) of merchandise and of raw materials, supplies and fittings, and furniture as well as fixtures, equipment and machinery.
- o Basic exclusions are animals and pets; watercraft; automobiles, vehicles or trailers licensed for highway use; aircraft; personal property while waterborne; household and individual personal property; and accounts, bills, currency, deeds, evidence of debt, money and securities.
- o There are two types of SMP -the standard, or named peril approach, or the all-risk approach.
- o Combining several different peril forms provides coverage for both buildings and personal property.
- o The basic forms are the general building form and the general personal property forms.
- o Under these two forms, insurance coverage is on a named peril basis. These perils include fire, lightning, windstorm, hail, explosion and smoke; aircraft or vehicle damage; riot, riot attending a strike, or civil commotion; and vandalism or malicious mischief.
- o Exclusions of electrical injury, interruption of power, earth movement, flood, or any enforcement of ordinance or law regarding the use, the construction, or the repair of a building limit coverage.
- o As an alternative to the named peril approach is coverage on an all-risks basis. Special building form and special personal property forms provide these types of coverage's at an additional cost.
- o The accounts receivable endorsement provides coverage for all money that customers owe a business, and these figures include interest and collection expenses in case the insured is unable to make collection because of a direct loss or because of damage to the accounts receivable records.
- o The valuable paper and records endorsement provides business owners with insurance coverage for valuable papers and records while these are on the insured premises.
- o The perils insured against are protected on an all-risk basis from direct physical loss. A separate limit of liability is allowed for specific articles, and a blanket limit is available to provide coverage's for all items, which are not specified.
- o Broad Form Storekeepers Endorsement is designed to provide limited fidelity and burglary coverage for small mercantile stores, this endorsement is applicable to business owners who employ less than five employees.
- o Business interruption insurance includes a broad category of specific losses of use or time element insurance coverage.
- o Business interruption is designed to indemnify, or to compensate financially, the insured for a loss of earnings (as the policy defines loss of earnings), tuition fees, rents, or the extra expenses involved in continuing operations in case an insured's premises are damaged by an insured peril.
- o Coverage for ordinary payroll expense either may be excluded or limited to a period of 90 consecutive days following damage to the insured premises. If not specifically included in the policy as a coverage, the business owner's employees will not be paid unless he can prove that paying the payroll is essential to continuing or to speeding the resumption of business operations.
- o Business interruption coverage also may be written on an earnings endorsement, which protects the business owner against actual losses suffered (gross earnings less non-continuing expenses) with no coinsurance requirement.

- The SMP builders' risk endorsement consists of two forms, which can be applied either to the named peril or to the all-risk policy. For named peril policyholders, the appropriate form is called the completed value form, and for business owners who carry an all-risk policy, the SMP special builders' risk completed value form (for all-risk policies), is available.
- The builders' risk endorsement is designed to provide property insurance coverage's for builders' risk exposures while they are constructing a new building or an insignificant addition.
- The combined business interruption and extra expense endorsement provides coverage for both business interruption and for extra expense losses with a single, specified limit of liability which is explicitly stated in the endorsement.
- The SMP condominium operations endorsement (an additional policy provisions endorsement) is available to provide named peril or all-risk property coverage for condominium operations.
- An earthquake extension endorsement can be added to afford coverage that is intended to meet the needs of certain insured's both under the named peril and the all-risk forms. This coverage is applicable only to the insured premises.
- The loss of rent endorsement provides coverage for loss that an insured might sustain if tenants are unable to rent his insured property because of damage or destruction to the premises by an insured peril.
- An optional perils coverage endorsement is available on the named perils form for both buildings and personal property protection.
- Unless specifically endorsed or stated in the coverage form, all property will be valued according to its ACV rather than on its replacement cost.
- The precise definition of ACV depends upon the type of property under consideration. There are variations in the application of ACV depending on whether real, personal, finished good, or stock (inventory) properties are being valued.
- This basis of adjustment may be modified, however, by the attachment of the replacement cost coverage endorsement. Under this endorsement, insured property involved in a loss will be adjusted on the basis of the amount necessary to repair or to replace the damaged property, and reimbursement is restricted only to the policy's limit of liability without regard to the actual age of the property at the time of the loss.
- The sprinkler leakage endorsement provides protection for insured property against leakage or discharge of water (or other substance) from an automatic fire protection system
- The tuition fees endorsement provides coverage for lost tuition fees that an educational institution might suffer if the school's physical facilities are damaged and unusable because of loss by an insured peril.
- The SMP, in Section II, describes general liability insurance and is a mandatory coverage; just as property coverage is in Section I.
- Typically, coverage is written on a comprehensive general liability (CGL) basis for any occurrence which is attributable to one of two causes—one is the ownership, maintenance or use of the insured premises, and the second is for business operations that are necessary or incidental to the named insured's commercial activities.
- SMP's liability coverage extends to the business's products and completed operations exposures unless the insurance policy specifically states that these are excluded for some reason. Coverage is on a combined single limit basis although one may purchase separate limits for bodily injury and property damage if he feels that this better suits his particular needs.
- In the personal injury section of coverage, business owners will usually find that the following coverage's are included: an employer's non-owned automobile, an automobile fleet (employers should always ask what number of cars determines a fleet), professional liability, comprehensive medical payments, contractual liability, independent contractors, and elevator collision.

- o General liability covers exposures such as lawsuits occurring because of slips or falls on the insured premises, injuries which occur because of operating equipment, and certain liabilities which are assumed already to be under contract or agreement
- o The SMP does not cover claims for injury to employees because this must be covered under a separate workers' compensation policy.
- o Several special exposures such as liability for errors or omissions by professionals are not protected under Section II of the SMP.
- o Crime coverage, an optional coverage, provides coverage for money and securities, negotiable instruments, and employee dishonesty.
- o There are three basic coverage's under crime coverage: the comprehensive crime coverage endorsement, the blanket crime coverage endorsement, and the public employers blanket endorsement.
- o A blanket form is a form of contract between an insured and an insurance company, which provides coverage for similar types of property at different locations or for different types of property located at the same location.
- o Under the blanket crime form, all insurance agreements, which are broadly defined as the promises made by the insurance company to the insured, are mandatory protected from loss.
- o Under the comprehensive crime endorsement, the insured may select specific coverage agreements and varying limits of liability and coverage for employee dishonesty on a blanket position basis.
- o The blanket position coverage for employee dishonesty under the comprehensive endorsement allows the stated limit of liability to be applied to each employee rather than to the employees as a group.
- o In addition to providing coverage for loss by extortion unless it has been specifically excluded, following are the coverage's that are available under the comprehensive crime endorsement: Employee Dishonesty, Money and Securities Loss Inside the Premises, Money and Securities-Loss Outside the Premises. Money Orders and Counterfeit Paper Currency Coverage, Depositors Forgery Coverage.
- o Boiler and machinery coverage, Section IV of the SMP, is optional and, if selected, is eligible for the SMP package discount.
- o The SMP boiler and machinery coverage endorsement includes coverage for all boilers, unfired pressure, vessels and piping that are either in use or that is connected and ready for use. Because almost all fire and extended coverage policies exclude damage that results from explosion of boilers or other pressure vehicles, this coverage is needed if insured property contains any heating boiler, process boiler, or any steam generator that operates under pressure.
- o Machinery coverage insures against damage and costs that result from the breakdown of machinery while it is on the premises.
- o Business interruptions coverage may be available under Section IV on a daily or a weekly indemnity basis
- o The SMP, introduced in most states in 1960, was the first standard package policy for commercial enterprises.
- o The SMP package as originally introduced continued with only minimal modifications until 1977. The only obvious changes were that eligibility rules were broadened and policy forms were simplified to increase their readability.

CHAPTER 10: OBJECTIVES OF UNDERWRITING

Changes are inevitable. The reasons for traditional underwriting practices sound perfectly logical to an experienced underwriter. But the questioning of laws and regulations are forcing changes. Former underwriting practices must give way to new concepts.

MAJOR GOALS

Underwriting of all types is designed to accomplish three major goals.

It helps the company to achieve underwriting gains.

It contributes to society.

It assists in maintaining a strong, solvent industry, which can serve the public in the future.

Each of these goals must be recognized and understood before changes in practices can be successfully adapted to the new regulations and pressures.

UNDERWRITING GAINS

The first goal of underwriting is to help to achieve underwriting gains.

In stock companies, these gains can be called "profits." With mutual companies and reciprocals, the gains result in increased dividends or surplus. In all cases, the goal is to be able to show a modest gain after losses and expenses are paid.

Underwriting contributes to these gains by selecting applicants who fit within the parameters of the rates, which have been developed. Every rate structure contemplates a certain type or class of risk.

Underwriting has the responsibility of accepting and retaining those properties and exposures, which fit the expected pattern. Underwriting gains cannot be achieved by accepting applicants whose probability of loss is greater than that which is anticipated by the rates.

Applying contract provisions, which are contemplated by the rate structure, can make a further contribution. Coverage cannot be unduly broadened, exclusions cannot be removed and conditions cannot be waived without jeopardizing the expected underwriting gains.

Rates, contracts and selection are closely related. Improper use of any of them can destroy all hope of underwriting gains. If any of the three is inadequate, one or both of the others must be adjusted accordingly, or underwriting losses will occur.

Total responsibility does not fall on underwriters. Those who promulgate rates and those who draft contracts carry a share of the burden. But in the final analysis, it is the underwriter who must select applicants who fit the rates and contract provisions, which are designed to produce underwriting gains. If artificial restraints are imposed on underwriting, either rate must be increased or contracts restricted; otherwise underwriting gains cannot be realized.

CONTRIBUTION TO SOCIETY

Insurance contributes a great deal to society. In fact, it is difficult to imagine how this civilization could exist without insurance. Society benefits from insurance by the reduction in uncertainty which insurance provides. With this lessening of uncertainty, people can buy and furnish houses, establish manufacturing and processing firms, stock warehouses and retail establishments, and conduct the distribution of goods.

If this uncertainty was not reduced, people could not embark on these ventures. Perhaps more importantly, lending institutions would not be able to finance these enterprises, so anything beyond a cottage-type of business would be almost impossible.

Most of the recent strides in industrial and technological fields would have been unthinkable, and most consumers would not have been able to accumulate the volume of goods, which marks the affluence of society.

Insurance supplies a good share of the funds, which finance long-term investments. The accumulation of capital, which is needed to guarantee the payment of future losses, can be used to promote expansion in home ownership as well as in business and industrial fields.

Another major benefit of insurance is the competition, which results from the stability and reduction of uncertainty, which are present in our economy. Small firms can compete with large enterprises because they do not need to accumulate large sums of money to help survive disasters. The protection given to insurance permits every firm to survive both heavy losses to property and claims for liabilities. Thus funds can be used for growth, and society benefits from the resulting competition.

Underwriters are the focal point through which most of the benefits of insurance are supplied to society. It is underwriters who arrange to protect almost every conceivable type of loss and in amounts of insurance, which meet the needs of society. When new exposures to loss arise, underwriters develop methods of insuring those exposures.

A major contribution of underwriting is being certain that the insurance needs of society are met. This imposes a burden upon underwriters to conduct their operations in such a manner that society does benefit from insurance. Availability, affordability, capacity and solvency are some of the goals of underwriting.

Two important aims of underwriters are to support activities, which will benefit society, and to oppose changes, which will tend to restrict these benefits. Not only underwriters must analyze the immediate results of changes but also their long-range effects.

Every underwriting action and every underwriting rule or guide should be considered in light of the ultimate effect on society as a whole.

Changes in society and in its demands are having an effect on underwriting practices. Adaptation to these pressures will be required if underwriting is to survive. The leader of a producer's organization, in a speech referring to the current mood of the "day of the consumer," said:

"...The forces impacting on the industry will stimulate a review of its responsibilities.... some authorities believe that the insurance industry did such a great job of convincing people of the need for insurance that it is now regarded as a necessity to which the public is entitled. If insurance today is a social and economic necessity, then the industry has an obligation to society. While insurance products and services are needed, there is reason for improvement."

MAINTAIN A STRONG INSURANCE INDUSTRY

The greatest contribution that underwriters can make to their companies and to society is to help maintain a strong and solvent insurance industry.

Underwriting gains, as discussed above, are an essential element in maintaining this strength. Another factor is steady, solid growth; this requires an analysis of markets and a selection of applicants who represent a broad, desirable spread. Still another element is an ability to meet the needs of buyers of insurance, for only in this way can insurance companies survive.

In all of these areas underwriting contributes best when it classifies and accepts applicants on the basis of reasonable criteria, equitably applied. A constant objective of underwriting must be to analyze selection standards, change the standards and classifications when conditions require and administer them fairly in daily activities.

Society benefits directly from the existence of strong and stable insurance companies. Only this type of insurer can meet the needs as described earlier. The future demands of a changing society will place new burdens on the insurance industry.

New energy requirements, advanced technologies, the challenges of space travel, the opportunities for increased leisure activities, the opening of markets in undeveloped lands and all of the other possibilities which will be presented by the brave new world to come—all will require even more insurance protection than is available today. A strong, solvent insurance industry is a necessity if artificial brakes are not to be applied to these many new possibilities for fortune and growth.

The future of underwriting is the analysis of characteristics of applicants in order to find meaningful factors upon which to base underwriting selection. This is the challenge of the future for underwriters. Laws and regulations will impose new rules. Pressures will cause others to lose their effectiveness. But underwriting must survive if a strong insurance industry is to exist. This will require adaptation by underwriters, through the use of revised approaches, which will achieve the established objectives.

The Chairman of the Texas Insurance Board, in speaking about the related subject of rates, made this thoughtful statement, which applies to all aspects of insurance:

"It is as important to guarantee the consumers of this state a strong, viable insurance industry as it is to guarantee equitable rates. No artificially suppressed rate can ultimately be beneficial to our state's policyholders."

ALTERNATIVE COURSES OF ACTION

Underwriters can react in many different ways to rules and regulations, which are adopted. If they do not consider carefully the ultimate consequences, they may react in ways, which will damage their reputations. In the long run, the damage will be irrevocable and will affect the entire insurance industry.

UNDERWRITING INDIVIDUALS

The only really viable alternative is to underwrite with more applied intelligence and knowledge. This will include securing more facts, evaluating applicants as individuals, making objective analyses and taking prompt action in conformity with the laws and regulations.

As a starting point, underwriters must know why certain rules or guides were used in the past. For example, the applicant's occupation was not a factor because there wasn't anything wrong with people who were engaged in those occupations.

They were not wicked, dishonest nor abhorrent. Rather, experience has shown that persons in those occupations tended to be unstable. They moved around a great deal.

This instability can be a problem to insurers, so caution was used in accepting applicants who were engaged in those occupations. The occupation should not have been a firm rule but just a guide (although it is likely that some underwriters used it as an unacceptable factor).

Suppose that occupation is prohibited as a factor in underwriting. The instability of the applicant may still be a problem. If this is discovered to be the case, the application may need to be rejected. The reason for the rejection is not occupation, but instability. The latter can be indicated by factors other than occupation and may need more investigation to discover.

Occupation cannot be used as a reason for underwriting action, but it can still point out the need for more facts, which may make the application unacceptable. If unstable conditions are not found, and other factors are not present, the application should be accepted.

The key to better underwriting is to secure all relevant information. No longer will it be enough to find out a few facts, such as occupation, and then take action.

Both objective and subjective material can be secured, depending upon the circumstances and the management of the insurer.

Objective information the most reliable data is that received from objective outside sources. Motor vehicle reports and accident information from the file is the most common for vehicle insurance. The condition of the property, photographs, a doctor's report of physical impairments and the length of driving experience are other examples for various lines.

Subjective information Purely personal and private information may be used under some circumstances. Ordinarily, this is best if secured from the applicant, not from outside sources. The application, telephone verification and a renewal questionnaire are devices, which are used to get facts from applicants and policyholders.

Some insurers have used psychologically oriented self-completion questionnaires as investigative tools for new applicants, particularly for personal automobile insurance. Some of these sources may arouse antagonism from applicants or producers, but they are illustrations of the sources that are available.

Right to privacy laws and other restraints imposed by government can restrict the information, which can be secured. This situation only makes the underwriter's job more difficult and requires more innovation to locate permissible data. The first step in underwriting still requires the securing of as much relevant information as is necessary or available.

UNDERWRITING BY CLASS, BY INDIVIDUAL RISK

The second step is analysis of the information. There are two different ways of looking at applications: by class and by individual risk.

Traditionally, personal lines have been subject to class underwriting. This means that classes or groups are identified as being problems and are not written. Underwriters recognize that some individuals in each class would be acceptable.

However, it would be more expensive to locate them, and there is usually not much information readily available upon which to make the decision. If an exception is made and a loss occurs, criticism may result. On the other hand, there will be no criticism if the applicant is rejected.

Commercial lines more commonly use individual risk underwriting. More complex factors are present, and premiums are high enough to permit more investigation. In most companies, certain groups have been identified as presenting problems, and these may be on an unacceptable list.

Still, exceptions are made for meritorious applicants based on individual characteristics. This pattern is common among larger commercial risks; smaller ones may be handled more on a class basis.

This traditional difference between class and individual risk underwriting is disappearing in today's social and regulatory climate. People no longer tolerate being handled as members of a class without regard to individual characteristics.

Many of the laws and regulations are aimed at precisely this factor. Since some physically impaired people are good drivers, it is no longer permissible to reject them simply because other physically impaired people may be problem drivers.

Rather, the rules prohibiting the use of certain characteristics require that each person be considered on the basis of individual factors alone.

The analysis of applicants, under government regulations, must include a study of individual characteristics, not just the group to which the applicant belongs. This does not necessarily involve a great deal more time and expense.

Rather, it takes only a little more effort to consider if the applicant is different, in some relevant way, from the other risks of the same type. If so, the differences must be analyzed.

This type of analysis is new for most underwriters, particularly those handling personal lines. Education, training and frequent audits will be needed.

The third step in underwriting is to make a decision and take action. This can be a perilous part of the process, or it can be a golden opportunity to serve the public and the industry.

The manner in which underwriting guides are written and the way that the reasons for adverse action are stated can be very important. This is the point at which the true intentions of the companies are measured. Underwriters should avoid using words like "location," "sex," "age" and "marital status" when rejecting or canceling insurance. These may be factors to be considered in the evaluation, but they cannot be used as the primary reason for rejection. Reasons must be given, and these should be specific.

Underwriters must stop using such general terms as "condition of the property." The public insists upon knowing why adverse action is taken. The reasons must be clearly explained. Action must be taken promptly. Restrictions place a burden on underwriters to avoid procrastination. Many states prohibit cancellation of new policies after a "discovery period"—usually about 60 days.

Non-renewals are often permitted only if notice is sent to the policyholder well in advance of the expiration date. These rules require prompt and firm action, preventing the delays, which previously marked the decision-making process of some underwriters.

In summary, underwriters must avoid the specific use of factors, which are prohibited, although these factors may be used as indicators along the path. Applicants and policyholders must be analyzed as individuals, not as members of a class or group. Actions must be taken promptly, and always in compliance with the laws. Rejection or cancellation may be taken only for relevant reasons, and never because of factors, which are prohibited. The reasons must be explained in specific terms.

The previously mentioned are the general approaches, which must be followed by underwriters under government restraints. As a first step, management of the company should outline general principles, indicating how underwriting is to be conducted.

These principles, which should be stated in broad terms, will give the necessary guidance to underwriters.

It is obvious that compliance with all laws and regulations should be the cornerstone of these principles. Then, general statements are needed as to the degree of investigation to be followed, the method of communicating decisions and the handling of complaints. Such a statement of principles will supplement the underwriters' knowledge of general approaches to be used and will provide a broad base of guidance for future underwriting.

SPECIFIC PRACTICES

Desk underwriters need specific instructions on practices to be followed when they encounter situations of the types described in previous sections. While general statements are helpful, they are inadequate for the day-to-day handling of individual risks.

Statements of general principles must first be developed and adopted by insurance company management. Such statements are needed before desk underwriters can make decisions, which follow the wishes of management. Without such statements, underwriters can be expected to continue the old practices which have led to the current atmosphere of criticism and demands for change.

Desk underwriters, using the statement of principles, must make decisions on individual risks. This is the focal point of all of the sound and fury being heard throughout the country. This is the level at which the decisions are made on individual risks. If those decisions are in compliance with both the laws and the expectations of the public and the regulators, all will be well. If they are not, further restrictions will be imposed. Those restrictions will have an even greater impact on the ability of insurers to decide upon the types of business, which they wish to write.

Underwriters must learn of the laws and regulations affecting the insurance being considered. Controls must be established to be certain that both new and existing laws and regulations are communicated to all underwriters. Next, supervisors must conduct enough audits to be certain that desk underwriters are following all of the applicable laws and regulations.

Much more than this is needed, however, if underwriting is to survive as it is known today. The spirit as well as the letter of laws and regulations must be followed. Most rules have loopholes if someone looks hard enough for them. If underwriters find loopholes in laws or regulations and underwrite on that basis, further restrictions will be adopted to close the loopholes.

Complaints and criticisms must be heard. When reasonable adaptations to underwriting practices can be made to meet those objections, this should be done. Not every complaint must be met, or no underwriting could exist for long. The problem is to separate those, which are reasonable and logical from those, which are not. The application of these principles will not be easy. The reasons for each type of criticism must be known. The old practices must be modified in many respects.

The following sections contain recommendations for means of handling the major types of complaints.

LOSS HISTORY

The record of past losses remains as one of the best factors, which underwriters can use in the selection process. It is factual, relevant and well accepted as a factor, which reasonably separates one risk from another.

At the same time, underwriters must realize that not all losses can be considered. Some losses are perceived by the public as being of types, which do not reflect adversely on the individual involved. If the loss was not recent, or if the applicant was not at fault, its importance is diminished or removed.

ACCIDENT RECORD

Automobile underwriters should continue to use accident records as one of the primary selection tools. When facts are available, most accidents are reliable indicators of desirability and are generally accepted as such.

Modifications in some past rules or guides are needed, however. Underwriters must not consider those types of accidents, which do not have a clear relationship to possible future accidents. Also, they must not use the types of accidents, which are specifically prohibited by statute or regulation.

FAULT

The question of fault is most important. Although statistical studies do not separate accidents by fault, and underwriters may feel that all accidents indicate a driving pattern, the public does not see the relevance of not-at-fault accidents.

Most underwriters, for some time, have given little weight to the most obvious of the not-at-fault accidents. They disregard those where an applicant was struck while legally parked or while stopped for a traffic signal. In the future, the definition of not-at-fault accidents must be expanded.

An applicant who recovers in full from another party is of the firm opinion that no fault should be affixed on his or her behalf. Underwriters must take such factors into account and not consider those accidents where an applicant was not charged with fault.

The determination of fault is not easy, particularly with accidents that occur before risk is insured. Sometimes the determination can be made only by securing a copy of a police report or by contacting the previous insurer. These sources may be expensive and may even be prohibited. This leaves the underwriter with no alternative but to accept the description of the accident as given by the applicant, subject to verification by a motor vehicle report, as much as possible.

Modern traffic conditions lead to many accidents where fault is difficult to ascertain. Events happen quickly and each party may feel that the other person was completely at fault. It will not be acceptable for underwriters to disregard these feelings and assume a degree of fault where both parties appeared to share the blame.

Applicants who feel that they were faultless in an accident will resent being underwritten on the basis of an at-fault accident. This resentment could be translated into legislation, which would deny all accident information in the underwriting process.

The value of past accidents as predictors of the future is too great to jeopardize by some "close calls." If fault does not appear to fall on the applicant, the underwriter should ignore it. The alternative may be the loss of this vital factor altogether.

NUMBER OF ACCIDENTS

Underwriters not only consider every accident, they sometimes decide that one accident in the experience is too many to permit acceptance. Companies attempting super-selection may state that an applicant is unacceptable if there have been any accidents during the past two or three years. This approach may be too severe for the future. The traffic congestion of today, especially in the larger cities, makes it extremely difficult to avoid an occasional small accident.

A blind spot during a lane change, vision obscured by a wet window in the rain, a sudden change in a traffic signal, an unexpected stopping of traffic—all can result in accidents. A driver who is usually very careful and who has been accident-free for years may incur one incident of this type. All that is required is a moment's inattention or carelessness.

It would not be reasonable to refuse insurance to an applicant who has incurred just one loss of this type. Two or more accidents might be; but only one accident, perhaps in many years, does not make a driver a poor risk in the minds of most people.

The solution is to consider more carefully the type of loss rather than just the number. If that one loss occurred shortly after midnight on a Saturday night and was the result of apparent high speed and possible drinking, the underwriter would be justified in being concerned. On the other hand, if the loss happened at 5:15 on a Tuesday evening and was a small rear-end accident on a crowded expressway, it is difficult to maintain that this is a good indication of possible future accidents.

Underwriters must stop playing a "numbers game" and start analyzing the losses. Two or three small accidents scattered over a three-year period may be less indicative of future loss involvement than one recent accident where the circumstances indicate that a driving problem exists.

No known legislation has attempted to control the number or type of accidents, which can be considered in underwriting. This situation does not mean that these factors can be disregarded. Abuse of the privilege of considering accidents in the selection process may lead to restrictions.

Automobile underwriting today requires more than a simple statement on the maximum number of accidents permitted during a specified period. Underwriters must secure all pertinent information concerning details of accidents from whatever sources are reasonably available. They then must analyze the losses to see if an indication of a poor driving pattern exists. If it does, underwriting action can be taken with little fear of challenge. But if it does not, there may be severe criticism of action taken solely because the loss is on record. Continuing action of the latter type may lead to restrictive legislation or regulation.

COMMERCIAL/PERSONAL

The analysis of individual losses, rather than merely counting the number, will take care of the problem between commercial and personal risks in most cases. An applicant, who incurs accidents because of poor driving, whether in a truck or a car, should bear the responsibility under all types of vehicle insurance.

If the underwriter looks at the facts surrounding each loss, most of the pressure to disregard accidents from another line of insurance will disappear.

Naturally, where laws prohibit consideration of accidents from another line, such as "emergency vehicles," there is no opportunity to use such losses in the selection of risks.

PROPERTY LOSSES

Consideration of the degree of fault or responsibility should be a part of the underwriting process on property as well as automobile claims. The type of loss and the circumstances surrounding the loss are clues to the degree to which the applicant could have prevented the loss. Although there is no known legislation on the use of property losses, underwriters should not take advantage of this situation. Reckless disregard of factors causing a loss could lead to restrictions, and these probably will be stricter than underwriters would impose on themselves. Thus, isolated losses from factors beyond the control of the applicant should be disregarded or used with care. If conditions have changed, this fact should be part of the analysis. Intelligent underwriting requires nothing less.

At the same time, a pattern of losses may reveal conditions, which are likely to lead to future losses. Repeated windstorm or hail losses may indicate that the location of property is in a "pocket" where such losses are common. Repeated crime losses may show that the neighborhood is conducive to those types of losses and that the pattern can be expected to continue.

Normal underwriting practices should continue, but tempered with careful consideration of the circumstances surrounding the loss, not just a tabulation of the number of losses.

LIABILITY LOSSES

Both personal and commercial liability losses should be handled much the same as property loss. Laws have not yet been enacted to regulate the use of the latter losses, but unreasonable application of underwriting rules could lead to controls.

The facts surrounding losses should be analyzed carefully. If there is no pattern, and the loss was beyond the control of a reasonable person, the underwriter should not make the decision on that loss alone. On the other hand, a pattern of loss, or failure to take normal precaution against injury, is valid underwriting criteria.

RECOMMENDATIONS FOR IMPROVEMENT

Property and liability losses often are the result of unsafe conditions. Rather than refuse insurance because of these conditions, or raise the premium, it would be better for underwriters to recommend improvements, which would reduce future losses.

This approach recognizes a responsibility on the part of underwriters to furnish insurance whenever possible and also to reduce losses and injuries.

Underwriters who analyze losses often are able to see conditions, which should be corrected. If these are not obvious, and it is momentarily worthwhile, engineers or inspectors can be used to identify unsafe practices, and their reports can be part of the analysis of the cause of the loss. In addition, such reports can be the basis of recommendations for improvement.

The underwriter, wishing to serve the public and avoid undue regulation, will do more than accept or reject applications. An effort will be made to write insurance, tailoring the contract and the rate to the risk. An important part of this approach is to discover areas where conditions can be improved and to recommend action to the applicant.

Additional expense will be incurred by this approach. However, more business will be written, and fewer losses might be incurred. More importantly, this approach will help to fulfill the duty of supplying coverage in the most economical fashion to every deserving risk.

Universal use of this approach will go a long way toward limiting future adverse legislation and regulation.

TRAFFIC VIOLATIONS

Underwriters can continue to use traffic violations in selection and rating. This use is subject to specific state laws or regulations, which limit certain types of violations. Where possible, however, underwriters should use judgment in their consideration of violations. The emphasis should be on those convictions, which appear to have some element of future accident predictability.

Equipment violations should be given little weight. They may indicate a careless attitude, an "I-don't-care" approach to automobile safety. Where this appears to be the case, further investigation is needed to determine the facts. In other cases, equipment violations should be ignored.

Even the more serious types of violations should be analyzed with care. An isolated case of a relatively minor type may indicate only a brief lapse of care or even the presence of a speed trap. By contrast, a long record of violations calls for close scrutiny.

A speeding citation at 2 a.m. is ordinarily more serious than one at 2 p.m., and running a red light at midnight can be more of an indication of an adverse driving pattern than going through a yellow light at noon.

Convictions rather than citations should be used whenever possible. Where both are available, convictions should be considered. Where convictions are not available, or would require considerable additional expense to secure, citations may be used, but with adjustments based on indications that no conviction was actually handed down. In all of these cases, state laws and regulations must govern the actions of underwriters.

If speeds in excess of 55 miles per hour are to be disregarded, underwriters should completely ignore them. Where the prohibition applies only to rating, consideration can be given in selection. If the prohibition applies to both, the underwriter must pay no heed to the incident.

NON-VERIFIABLE RECORD

The use of a non-verifiable driving record is sound underwriting, unless the practice is prohibited. Only by a verifiable record can the driving ability be determined.

Such rules must be applied in a reasonable, nondiscriminatory fashion. The time period must not be excessive; three years is a maximum period in most cases. The rule must apply to all applicants and not be used as a screening device for youthful operators.

Thus, assume a middle-aged couple with a clean accident and conviction record but with only one of them who drives. If the other spouse then gets another car and starts to drive, the non-verifiable rule must be applied, exactly as it would be if the new driver were a youth just starting to drive.

By applying the rule in a reasonable and nondiscriminatory fashion underwriters will be employing a good tool and will still be incurring a minimum exposure to laws or regulations, which would prohibit the practice.

SOURCES OF INFORMATION

In determining the record of traffic violations, it is crucial that underwriters use all reliable sources of information. Motor vehicle reports, or MVR's are the best source. They must be secured where it is important to see the traffic record. Arrangements should be made to secure MVR's as quickly and inexpensively as possible.

Arrangements can often be made to secure MVR information directly from the computers of the state motor vehicle departments, either directly by the insurer or through a service organization. Prompt information is of great value in effective selection of applicants.

Some traffic violation information, like some accident data, is not always available through an MVR. For example, some traffic courts have adopted the procedure of sending violators to a traffic school. Upon completion of the course, the record of the violation is destroyed. No entry is ever made on the MVR.

This procedure may be effective from the standpoint of law enforcement officials, but it destroys the concept of underwriting on the basis of past driving performance. Underwriters must establish techniques for securing information on all traffic violations as much as possible. Proper questioning on the application is one source. Effective investigation technique is another.

DRIVING RECORD

The most significant factor, which can be used in underwriting and rating, is the driving record. Traffic violations are the major component of driving records, although accidents are usually included. Almost everyone who agrees that some type of selection and rating differences are justified will concur that the driving record is most critical.

Finally, a risk should not be accepted if a driver's license is suspended or revoked. To supply insurance to such persons is to encourage them to drive in violation of law. When investigation reveals that the license of a driver is not valid, the application should be rejected.

The only exception is a case where it is represented that the person without a license will not drive. If this is verified, the factor can be disregarded. After the license is reinstated, the underwriter should analyze the reason for suspension or revocation and not reject the applicant only because of the previous action by licensing authorities.

CONDITION OF PROPERTY

Underwriters have more opportunity to practice individual risk selection on the basis of property condition than on most other factors. By avoiding arbitrary rules and looking at specific risk characteristics, underwriters can improve their selection practices and still meet the objections of regulators. Both automobile and property lines are subject to underwriting on the basis of property condition.

CONDITION OF AUTOMOBILE

Good underwriting requires consideration of the automobile's condition. It is important that judgment be applied uniformly and that only relevant conditions be taken into account. Mechanical deficiencies should be handled carefully.

If critical functions are involved, such as brakes or lights, the risk should not be accepted. Public safety, as well as insurance principles, requires that automobiles with serious deficiencies such as the foregoing should not be encouraged to operate on the streets.

The proper underwriting technique is not to merely reject insurance. Such action may cause the owner to drive without insurance or to seek another insurer, which may not discover the problem. Rather, the underwriter should point out the deficiency, suggest that it be corrected and offer to write the insurance when correction is made. In this manner, the financial exposures of the public and the owner will be protected, and the insurer will write another policy.

Before this corrective action can be taken, the condition must be identified. If the facts are reported on the application, the underwriter can act immediately. If not, the condition can be determined only by an inspection on a new submission if it is economically feasible to do so.

On existing policies, a claims report may indicate the existence of problems. In either case, it is important that the underwriter secure the facts. Then the alternatives can be considered and one of these should certainly be to recommend correction of the mechanical deficiency as a condition to writing or continuing insurance.

Un-repaired damage can be handled in the same way. Minor damage can be ignored, except perhaps to note its existence so that it is not included again under the settlement of a later loss. More serious damage can be dangerous to pedestrians or occupants. Again, the best procedure is not to reject coverage automatically, but to be certain that the facts are correct and to then recommend correction. If repairs are made, the risk will be satisfactory from that standpoint, and a policy might be saved.

Underwriters should not conclude that, as a class, people who do not correct mechanical defects or repair body damage are undesirable. There may be many reasons why improvements have not been made.

If the specific condition of an individual automobile is poor, insurance should not be written. But if correction is made, this factor should be disregarded. Underwriting consideration should be given to the actual condition of the vehicle, not the underwriter's opinion as to why the deficiency was not corrected until an underwriter made a demand.

Altered cars, or those decorated, do not necessarily indicate an undesirable risk. Some operators of these vehicles are inclined to speed and take chances in close situations, but others are good, safe drivers.

The fact that a person likes a showy car does not mean that person also drives in a careless fashion. This is a factor, which should be checked carefully but then underwritten on the facts of each individual case.

When underwriters of automobile insurance are considering a vehicle's condition, two rules must be followed. The first is to get the facts, to find out what is actually the case on a specific risk rather than to make assumptions based on experience with the class.

The second rule is to apply judgment to each risk based on its individual characteristics, and not because it is a member of a group of risks. As with the driving record, the condition of a specific risk being considered is a critical factor. This applies to the mechanical condition, any un-repaired damage and any showy alterations.

CONDITION OF BUILDINGS

The condition of buildings must be underwritten carefully. Deficiencies, which present an abnormal degree of risk, must be corrected before insurance can be written. On the other hand, underwriters must guard against taking action solely on the basis of outward appearances.

Uncut grass and peeling paint may be indicative of a careless attitude, which may also be reflected in frayed wiring and overloaded circuits. These conditions may also indicate a temporary illness of the applicant or a temporary financial reversal, neither, of which has adverse implications from an underwriting standpoint.

It is justified to refuse writing insurance where the condition of property is so poor that the chance of loss is materially increased. It is not justified to reject a risk because the condition of the building does not measure up to the standard of neatness, which an underwriter feels is desirable.

Neither the property application itself nor a related line such as automobile should be rejected merely because the housekeeping is poor by an underwriter's standards, provided the condition does not really increase the chance of a loss.

Furthermore, outright rejection is undesirable in cases where the condition of property is so poor that insurance cannot be written. Rather, the underwriter should point out the types of improvements, which could be made to achieve acceptability. Reasonable demands for improvements will benefit all parties and are perfectly legitimate. Again, however, the demands must be reasonable and not arbitrary.

Underwriters must recognize that standards of neatness vary by individuals, and those only repairs, which actually affect the exposure to losses, must be demanded. When problem areas such as poor wiring and other so-called faults of management are identified, the property owner should be notified. This gives the owners an opportunity to correct the problem. Then, if correction is made, the coverage can be written.

This approach accomplishes several things: more business is written, property owners are educated on proper methods of maintaining buildings and public relations are improved. This course of action is much better than merely rejecting the risk, if the condition is one, which can be improved.

The facts must be obtained before such decisions can be made. Sometimes the answers on the application are sufficient, particularly if a photograph of property is also available. Other times, an inspection is needed. The producer, a field

underwriter or special agent, or an inspection company can do these. Regardless of the method used, it is essential that the underwriter have the facts available before taking action on the condition of the property.

As a matter of procedure, the facts should be obtained, usually by physical inspection, before rejecting a risk because of poor condition, whether this involves actual unsafe conditions or poor maintenance of the building.

AGE OF BUILDINGS

The age of a building is not a reliable indication of its desirability as an insurance risk, other than new or almost-new structures. After a few years, deterioration sets in, but repairs or renovation can offset it. Age is an indication that there may be problems. An older home, perhaps one over 25 years of age, should be checked carefully. There may be problems in wiring, overloading of circuits or in the heating system.

On the other hand, each of these potential problems can be corrected. A house can be rewired, new circuits can be added and a new heating system can be installed. With such improvements, a 40-year-old house may be safer than one, which is 25 years old. Only proper inspection can determine if these improvements have been made.

The acceptability of a property risk should not be based on its age alone. If it is older, but the critical parts have been modernized and the building has been maintained properly, the age should not be a factor.

Two areas may be affected by the age of a building. One is the rate and the other is the type of coverage being offered.

Rates can vary by the degree of exposure to loss. A 4-year-old house, which has not been modernized, is ordinarily more susceptible to fire losses than a five-year-old house, and the rates can vary. If the older home has been completely rewired and has received a new heating system, the chances of a fire loss are approximately the same as for the newer structure. Other perils may be different, so a greater problem can be caused by the perils included in a policy.

VALUE OF BUILDINGS

It is imperative that underwriters determine the approximate value of buildings before writing insurance. Securing proper insurance-to-value is the key to the profitable writing of property insurance.

When a co-insurance clause or average clause, is used making the insured a co-insurer if the amount of insurance is less than the required amount protects the underwriter. This protection applies only to the payment of loss, not to protection from criticism or condemnation when misunderstandings occur.

Property should almost never be written with a co-insurance clause if an obvious deficiency is present. Some circumstances may exist where a policy is knowingly issued for less than the required amount, but these cases should be rare, and the specific agreement of the insured should be secured in every case, preferably in writing.

The 80 percent requirement of the replacement cost provision that applies to the homeowner's policy is a type of co-insurance clause.

Underwriters, following the above principles, do not knowingly want to under-insure a dwelling under these forms. This raises the problem of availability of a desired coverage: homeowners' policies.

Underwriters do not want to write a policy for less than 80 percent of replacement cost. Applicants do not want to pay premiums for amounts of insurance, which are substantially higher than were paid for the property or than could be realized at time of sale. Even if property owners would want to carry that much insurance, the problem then exists that they might expect to profit from a loss, which increases the moral hazard.

At the same time, there is strong pressure to offer homeowners coverage to all people who desire them. To do otherwise is to appear to deny a type of insurance to some individuals solely because of property value. This has the earmarks of unfair discrimination against lower income people. The answer is to develop and use a homeowners' policy, which does not contain the replacement cost provision. Structures can be insured for actual cash value.

Under the statement of principles and objectives on insurance redlining, which was formulated by the NAIC Redlining Task Force and subsequently adopted by the NAIC, it is the position of the latter that:

"As alternative forms of property and automobile insurance coverage for individuals are developed, consideration should be given to such coverage as:

An actual cash value (ACV) home-owners' insurance policy which would include basic coverage of fire, extended coverage, vandalism and malicious mischief, burglary or crime coverage, and liability coverage. Homeowners' insurance policies providing replacement cost coverage on partial losses up to the actual cash value of the real property..."

Policies of this suggested nature are currently being drafted. Underwriters to furnish coverage to owners of lower value homes should use these policies.

Whether on fire forms or homeowners' policies, the foregoing solution still leaves problems with the minimum amounts of insurance, which can be written. Reasonable minimum amounts can be used, partly because the minimum amounts of premium needed to cover expenses and the point below which property is simply uninsurable in any but a specialty market.

A strong tendency exists for underwriters to keep pushing the minimum amount of insurance upward. As building costs increase, the cut-off point for desirability rises; values rise with building costs.

Special handling should be taken with owners of small or low-valued homes. The others should be accommodated in the regular market. Underwriters should resist the tendency to set ever-increasing minimum values and should try to offer insurance to most risks. Rates and minimum premiums may need to be raised if the statistics justify this action, but acceptability should not be affected. The value of a building, above a reasonable minimum, should not be a factor in underwriting. The risk should be eligible, and acceptability should be based on other factors.

Valued policy laws require special handling as well. Underwriters must avoid over-insurance in order to reduce or eliminate the temptation for arson. This can be accomplished only by an inspection of every structure on which there is any suspicion that the amount of insurance requested is in excess of the value.

Inspections for this purpose will not encounter opposition from the regulators, quite the opposite. An avowed purpose of the laws is to require inspections to be certain that the amount of insurance is in line with the value.

The various state FAIR plans also could create problems when property values are not verified, especially when insurance policies can be purchased for any amount requested by the insured-owner.

When the amount of insurance exceeds the value of property, the situation may create an incentive for arson with profit in mind. While desk underwriters cannot modify the rules of these state plans, they can be aware of the potential problem when handling their voluntary business.

OCCUPANCY OF BUILDINGS

Underwriters are justified in considering the occupancy of buildings, provided the considerations are based on fact are not arbitrary.

Dwelling risks with commercial types of occupancies present different characteristics than those with only residential occupants. Some of these business pursuits may have little impact on desirability, but others can substantially increase the chance of loss.

Underwriters who have identified the differences and who feel that some exposures are greater than they want can consider these occupancies as unacceptable. Little criticism can be expected if the rules are based on objective factors. However, a preferable course of action is to accept the risk and charge a higher premium if this can be accomplished.

Tenant-occupied dwellings may well require different rates than owner-occupied ones. As for acceptability, there may be reasons for refusing to write tenant-occupied property; an example might be when theft losses on such occupancies are higher than the rates that are expected to handle the exposure.

The problem with using such rules is that they may seem to be actually based on other factors, such as the neighborhood in which the property is located. These rules ordinarily are satisfactory if based on actual experience and if applied uniformly to all such risks.

Vacancy can be a problem in both personal and commercial risks. Extended vacancy of a building can lead to deterioration, vandalism and a temptation for arson. Underwriters are justified in rejecting applications for insurance where extended vacancy exists.

This action is even permitted by state FAIR plans where very few underwriting criteria are allowed. However, this rule must be tempered with reason, and no declination is justified if the vacancy is for a limited time only between changes of occupants.

Commercial risks must be written on the basis of occupancy. Nevertheless, this should just be the starting point. Almost all occupancies can be improved by the use of protective measures. The blanket listing of occupancies as being unacceptable, without consideration of the individual risk characteristics, can only lead to criticism and more regulation.

It is much better for underwriters to try to find a means of accepting every applicant rather than to exclude some risks by type of occupancy alone. This approach means that more inspections will be needed along with a careful preparation of recommendations and verification that they have been completed.

If reasonable and necessary improvements are not made, the underwriter will not be forced to accept the risk. But if substantial compliance with recommendations is verified, the risk should be accepted. Rates may need to vary by occupancy, but the insurance should be made available.

The use of protective devices is encouraged. Underwriters should require alarms, dead bolts, barred windows or other devices where they will improve borderline risks. The validity of these requirements is demonstrated by their inclusion in the federal crime program.

Underwriters should consider the actual occupancy of each applicant and the problems associated with that commercial occupancy. Inspections may be needed to secure all of the necessary information, although detailed information may already be available from local insurance services, offices which staff inspectors and engineers for that purpose.

Recommendations for improvements should be made, but only where needed and never on an indiscriminate basis. The conditions and hazards of each risk should be analyzed, and the insurance should be written if a means could be found to do so. Only in this way will underwriters discharge their duties to the public and to their companies.

NEIGHBORHOOD

Insurance practices based on risk location must change. If revisions are not made voluntarily, they will be mandated by government decree. Both risk selection and rating will be affected.

One possible response of insurance companies is to deny that redlining exists. At hearings by the NAIC Subcommittee, an analyst for the House of Representatives in the state of Washington defined redlining to be "a practice which results in significant fair or unfair geographic discrimination in terms of rates, extent of coverage or availability of coverage."

Whatever reasons, underwriters use to explain subjective selection based on geographic location, the public and the regulators simply will not tolerate the practice. Selection must be based on the characteristics of the risk itself, not the neighborhood.

This approach must extend to the evaluation of producers. A company should not refuse to appoint a producer because of the latter's office location or the location of his or her customers. Existing producers should not be terminated or restricted because of those factors of location either.

AGE OF THE INSURED

Underwriters have long felt that since accident frequency of youthful drivers, as a class, is considerably above the average, special attention should be given to all members of that class. Young people have been driving only a relatively short time; too brief a period to have established their own patterns. Individuals may have good driving records, but this may stem from their limited access to an automobile and to careful driving because they know they are being watched. The only safe approach is to limit acceptability of the class members and to charge higher rates to all of them until they have reached enough maturity to establish their own driving patterns.

Elderly drivers have been viewed in much the same fashion as youthful operators. They are mature and have demonstrated their method of driving, but some loss of ability is common as a person ages.

Again, the uncertainty concerning the class is present. Knowing that some persons lose some of their driving ability above age 68 or 70, underwriters tend to reject all such applicants. This practice has continued even while actuaries have determined that elderly drivers are better than the average, and reduced rates have replaced the former surcharges.

Individuals in both of the aforementioned groups complain that they should be evaluated on their own performance. They resent being grouped with other drivers of similar ages, some of who have poor driving records.

There are solid reasons for abandoning the old practices. Young people are becoming more concerned about social and economic conditions than formerly and are becoming active in opposition to practices which they perceive to be unfair. The ranks of the elderly are increasing at an astonishing rate. For example, the American Council of Life Insurance, in a press article, stated:

"Each day approximately 1,300 persons join the ranks of the older population, the Council notes, which add up to nearly 500,000 more retired people annually.

There were approximately 22.9 million persons, age 65 and older in the U.S. in 1976, the Council says. By the year 2000 the figure is expected to reach 31.8 million. And by the year 2030, the number of persons age 65 and older is expected to reach 55 million."

SEX AND SEXUAL PREFERENCE

Underwriters have been having difficulty in adjusting to the concept of ignoring sex and sexual preference in both selection and rating. The current prohibitions seem to do harm to the established practices that conformity is hard to accept.

Statistics have seemed to support different rates and selection patterns by sex, particularly in youths. Even though some later statistics appear to erase many of the differences, these statistics are not yet concrete enough to convince underwriters to change voluntarily.

Where statistics are credible and irrefutable, insurers may be able to use different classifications for a time, although this may disappear in the near future. Where data is not so certain, underwriters should immediately drop all consideration of these factors; any continuation under these circumstances will only lead to further laws and regulations.

MARITAL STATUS

Using marital status in insurance rating may soon disappear, unless statistical proof of the validity of the classifications is established beyond question.

SINGLES

The practice of single people living together has grown during the past few years and shows no sign of abating. As long as this continues, underwriters will be attacked strenuously if they use this practice as a reason for rejecting an applicant for insurance.

Many of the young people who adopt this living arrangement are in a temporary or transitional situation, which serves as a prelude to entering into more conventional family living.

In automobile insurance, it may be necessary to rate for the other partner in the arrangement. If this is resisted, an exclusion of that driver might be needed if permitted in the state. These steps assume that the underwriter has determined that the applicant is acceptable but that the other party is not acceptable, at least not at the rate level established.

In homeowners insurance, the problem is to establish values and ownership. If these are difficult to determine, an inventory of the property owned by the applicant may be required. Another possibility is to write a separate policy, in the same company, for the other mingling partner.

Both at inception and at renewal, the ownership of major items should be established in order to avoid confusion after a loss. In this way the underwriter will be able to determine if proper insurance to value is written.

The first step, in any line, is to get the facts. Where a singles situation is present or suspected, investigation must be made to find out if there is another person who might drive the car or own some of the property in the residence. If so, the driving record of that person should be evaluated if automobile insurance is written. Then the underwriter will know what steps to take regarding that driver.

Negotiation might be necessary because the first reaction of the applicant often will be that "the other person will never drive my car." Under these circumstances, the other driver should be excluded, but a request by the underwriter for approval of the exclusion endorsement usually results in protests, thus indicating that the person may, indeed, occasionally drive the car. Rates must then be based on that potential exposure.

Rejection of the risk because of another driver or another owner of some of the property may lead to criticism or lawsuits. Enough cases of this type have occurred to indicate this possible result. The only way to avoid such unpleasantness is to not reject a risk solely because of a singles situation. Where laws or regulations prohibit consideration of the marital status, naturally this factor cannot be used. The only consideration, then, is to secure a proper premium for the exposures.

One problem still remains, however: the possibility that the mingling partners will separate and a new partner will enter the scene. There is no way to avoid this situation. The exposures must be underwritten, as they exist at the moment.

A good underwriter, recognizing a situation, which appears to be unstable, will make arrangements to check the facts at the time of renewal. A "mingles" arrangement is generally temporary, by its very nature, so periodic monitoring of the risk is important.

SINGLE, SEPARATED, WIDOWED AND DIVORCED PERSONS

Single, separated, widowed, divorced—these types of marital status should be ignored in the selection of risks. They may be rated differently, if this can be shown to be valid, at least in most states at the present time.

One important reason for disregarding the marital status is that such a practice is prohibited in many states. In others, it is frowned upon and will soon be prohibited if a pattern of selection against these people is found to exist.

Even if regulatory restraints were not imposed, the marketing practices of insurers might soon require an adjustment in thinking. Unmarried persons no longer live only in small rented rooms, owning very little property worth insuring. Today, increasing numbers of singles are becoming owners of homes. This is partly due to increased incomes, partly due to a realization that a house can be a good investment in an inflationary period and partly because living alone has become an acceptable life style.

In summary, marital status should be ignored in the selection risks. This factor is prohibited in many states and will be prohibited in others if selection standards continue to consider the marital status of the applicant. Furthermore, SSWD's represent such a large share of the market that they cannot be rejected without a serious reduction in potential sales.

The conclusion is obvious: marital status should be removed from the list of selection criteria and completely disregarded.

OCCUPATION

The occupation of the applicant is not considered by to be a valid selection factor. Its use is prohibited in some states. In other states, the trend is the same, and a reasonable approach to underwriting requires that occupation not be used as a selection device.

This is not to say that occupation must be completely ignored.

It might be a clue to other factors, which should lead to rejection of the application. The occupation may indicate a risk, which needs to be investigated in certain respects in order to determine acceptability. The characteristics of the individual applicant should be the guide, not the occupational group in which the applicant falls. If some occupations are marked by certain undesirable traits in many cases, the individuals who bear those traits may need to be rejected.

On the other hand, those who do not show those traits should not be rejected simply because they work in that occupation. Specific examples, using traditional groups, illustrate the practices, which should be used.

TRAVEL

There is no doubt, that some people, who travel extensively, are more exposed to theft and loss than normal. This increased exposure can be caused by the merchandise carried, the type of transportation used, the geographic area traveled, the type of living quarters used while traveling and the attitude of the applicant toward protecting property.

If an applicant has a history of losses because of these characteristics, the application may need to be rejected, or limited in perils or by deductibles, because of those losses. In such cases, the underwriting action is taken because of loss history, not occupation itself.

An applicant who travels in the course of work but who has not had any such losses is apparently not subject to these adverse traits exhibited by others. A good loss history can be due to many factors. If such is the case, an individual should not be rejected on the basis of the occupational hazards.

Each individual applicant should be underwritten on other aspects of loss exposures, not just the fact that travel is an inherent part of the occupation.

TRANSIENTS

Exactly the same type of approach should be used during the underwriting of applicants whose occupations' are historically considered to be held by transients. Many of these people are in the restaurant, hotel and other such service bases industries and tend to drift from job to job, but many others are just as steady as office workers.

Most of the potential underwriting problems of people in these occupations can be specifically identified. Excessive usages of alcohol or drugs, high incomes that attract lawsuits and poor premium payment records are major concerns. Each of these may be justification for taking underwriting action.

When a person in one of these transient-type occupations is found to present a specific problem, action should be taken on that basis. On the other hand, if an individual applicant does not present these problems, action should not be taken solely because of occupation. The emphasis should be on the individual characteristics of the applicant, not on the general characteristics of the group in that occupation.

OTHER TYPES

The same type of handling is desirable on applicants in other occupations. Military, students, ministers and other groups, which concern some underwriters, can include both acceptable and unacceptable risks. The underwriter should get the facts about the specific qualities of each applicant and make a decision on that basis, not on the occupation itself.

Illegal activities are the exception. No government agency would require the writing of insurance on known illegal activities. Where the facts show that the applicant is engaged in such activities as smuggling or maintaining a house of ill repute, rejection is the only reasonable course.

STABILITY

The applicant's stability should not be a factor in selection, without further definition. It is too imprecise for effective administration. Factors, which indicate stability or instability, must be used carefully. Some of these are discussed in other sections, such as marital status and occupation.

Others, which are sometimes applied, are the period of time on the job or in the area, the number of jobs or addresses during recent years (such as five years) and transient types of living quarters (hotels or motels, for example).

Underwriters can use such factors if they can prove that the chance of loss is increased in such cases. Some companies may have statistics on policyholders with hotel or post office box addresses. With adequate proof, such rules can be used.

Without statistical proof, underwriters should not use these stability factors as primary selection rules. However, information on these items can be gathered because they might point to other types of problems.

These stability factors should ordinarily be used only to indicate possibility of other problems. More facts may be needed, when instability is indicated, in order to underwrite the application in a thorough manner.

Tenants may offer particular problems. The loss ratio on tenants' homeowner policies may be worse than for policies, which insure the dwelling as well as contents and personal liability. If certain groups of tenants can be identified as being worse than the average, such as those who have lived in four or more locations during the past five years, this could be used as a selection factor. In the absence of such specific statistics, rate adjustments are a more logical solution than merely assuming that all tenants are unstable.

Commercial underwriters could justify the use of a years-in-business rule for acceptability, based on statistics showing failures and bankruptcies. Such an arbitrary rule, particularly if it is longer than one year, will restrict sales and may be considered unreasonable. It would be preferable to use this as a guide, but to look at the work history and experience of the applicant in making the final decision.

SOCIAL MALADJUSTMENT

The involvement of applicants with such social agencies as welfare and public health clinics may be statistically proven to increase loss frequencies. However, this factor should never be used as a sole reason for taking underwriting action. As with other factors, this type of involvement may indicate other problems.

When such is the case, action may be required because of these other factors. Underwriters should disregard any apparent social maladjustment in applicants, especially if this is indicated by contacts with social agencies, unless other adverse factors are present.

ATTITUDE

Underwriters are interested in every factor that may affect the chances of loss involving applicants and policyholders. Thus, underwriters could be expected to use study results, which show that certain "attitudinal characteristics" have been present in a large number of fatal accidents. The use of these characteristics has not been prohibited. At the same time, underwriters should be aware that abuses of a factor such as this could lead to restrictions.

Underwriters wanting to use the attitude of the applicant as a selection tool will have difficulty in securing accurate information. An investigation report is virtually the only source, which can be used on prospective new clients. With these reports, there is always the danger of a personality clash between the investigator and the applicant or a set of circumstances, which the investigator might read incorrectly.

A neighbor may bear a grudge toward a person and will accuse that person of belligerence or argumentativeness. Caution must be exercised in using information secured from a single source when it involves a factor of this type.

Information on existing policyholders may be secured from claims reports. This may be the best source to learn about attitude because it is at the time of a loss that verbal accusations, negativism, belligerence and similar traits are most likely to be revealed. The potential problem of a personality clash is present here, so care must be taken in using this information.

When adverse attitudes have been verified, underwriters may take action on that basis. They must realize that such a decision is subject to challenge and perhaps reversal by a regulator. On a case basis, this factor may be very relevant and defensible.

Too much use of this factor can lead to problems. Taking action on borderline cases, or without proper verification, could cause regulations to be imposed. Therefore, this characteristic should be employed only in serious cases, and then only with other types of problems, which indicate the desirability of underwriting actions.

CRIMINAL RECORD

Underwriters who become aware of an applicant's criminal record must give serious consideration to this factor. Certain types of past criminal activity, combined with the temptations and opportunities of many lines of insurance, could substantially increase the chances of loss. On the other hand, other types of past criminal activity may have no relationship to the exposures of a particular line of insurance. Where this is the case, no underwriting action is justified.

The individual circumstances of each case are extremely important. The date of the crime may govern; a conviction for car theft by a youth may not be relevant to the exposures when that person has grown to middle age.

The type of crime may be important; assault and battery may be no problem for fire insurance but critical to automobile insurance. A record of petty theft or shoplifting may not concern an automobile underwriter but may be very important to a commercial underwriter.

In every case, the underwriter must secure all of the relevant factors when a criminal record is discovered. This factor may justify a rejection. Many cases, however, will not be affected by this factor, and no action is warranted. Where circumstances do not call for underwriting attention, a setting aside of this information will both help sales and assist in keeping outside restrictions to a minimum.

MENTAL INCOMPETENCE

Underwriters cannot ignore evidence of mental incompetence of applicants. This condition can be very serious, particularly while driving a car. The pressures of driving, or even of living under many conditions, are great enough for normal people without adding the extra factor of mental instability.

This condition is difficult to measure. There are many degrees of incompetence. Some people can respond to treatment, resulting in complete recovery. A blanket approach is not valid.

The facts of each case must be obtained. When they indicate a non-harmful degree of incompetence, or a full recovery, the factor should be ignored. When the facts indicate potential problems, careful consideration must be given. Some of these people should not be driving cars, and underwriters should not encourage their driving by furnishing insurance.

All of the available facts about each such case must be analyzed. The decision must be based on these facts, whether to accept or reject. When care is taken, and the decision is based on a careful weighing of the facts, underwriters can expect support in their actions, not criticism.

PHYSICAL IMPAIRMENTS

Studies have shown that physically handicapped drivers are generally no worse than average drivers. In many cases, they are better.

In the face of these indications, underwriters must abandon their long-held impressions of driving problems expected when insuring applicants with physical impairments. Where laws prohibit the use of these factors in the selection of risks, naturally these laws must be followed. In other states, judgment must be used, but with consideration of each individual case, not a blanket refusal to write such applicants.

The only line of property/liability insurance in which, the physical condition of the applicant has been used by underwriters is automobile insurance, both personal and commercial. The problem, then, is to determine those characteristics, which affect the driving ability. Different types of handicaps can offer different types of problems.

ORTHOPEDICS

The orthopedic group includes those physically handicapped persons who do not have use of one or more extremities because of loss, paralysis or serious deformity.

As a group, these drivers perform about as well as the average of all drivers, according to studies, which have been made. Some drivers within this group may be more susceptible to losses, so underwriters need to know the types of characteristics, which can be expected.

License restrictions in many states can give a clue to the problem. One type of restriction is to require hand controls on a vehicle; these drivers often are paraplegics, having little or no use of their legs. Most of these people can handle a car well, providing it is properly equipped. An inspection report usually will reveal if the proper equipment has been installed.

Another license restriction is to require the wearing of an artificial leg (or two) when operating a vehicle. Again, when the correct prosthesis is used, these persons can operate a car in a normal manner. Still another restriction used on drivers' licenses in some states is to require that the vehicle be equipped with a knob attachment on the steering wheel.

Typically, these drivers have had one arm partially or fully amputated or disabled. Most of these drivers demonstrate an average ability to drive a car, if it is properly equipped.

The underwriter may need to secure additional information about these handicapped drivers. If circumstances sometimes seem to require that the person operate a car without the proper adaptation, driving problems can result. This needs to be verified as much as possible. If the applicable modification is always used, as far as can be determined, drivers with orthopedic problems can be expected to have a normal driving experience and should not be rejected on these grounds.

MEDICAL

Physical impairments, which might be called "medical" or "seizures" include heart ailments, diabetes, epilepsy and spastics. Although studies have not been detailed on each of these, indications are that these persons generally have better driving records than the average. This means that underwriters are not justified in automatically rejecting applicants having these handicaps. At the same time, underwriting is concerned with individual applicants, and some persons having these impairments may be subject to driving problems. The difficulty is in finding those individuals who may be expected to have accidents.

Heart problems are difficult to handle by underwriting. Doctors may know about the last seizure, but they are not able to predict future occurrences with much accuracy. Most patients who have had heart attacks are able to live normal lives with some care in diet and with medicine. The only ones in this category who would concern underwriters are those who refuse to follow the prescribed course. These individuals are difficult to identify. If they are identified through medical reports or other information, underwriters are justified in refusing insurance on such lines as automobile. Otherwise, this factor should be disregarded.

Diabetes mellitus shows a mixed record of driving experience. Drivers with epilepsy or diabetes appear to have higher than average accident rates. Persons who suffer from fainting spells also compare poorly to other drivers, but persons with heart disease or vision defects have average accident rates.

The study was made on the state's medically restricted drivers computed by age, sex and disease. These accident rates were then compared to average rates for all Washington drivers in the same age and sex groups.

The study showed that subjects with epilepsy had 33 percent more accidents than other drivers of the same ages, and diabetics had 19 percent more. Persons who, for various reasons, were subject to fainting spells had 83 percent higher rates than normal.

The type of diabetes can be important. Juvenile-onset diabetes is the most serious, usually being controlled only by insulin. Such a person is subject to a sudden seizure and coma. Adult-onset diabetes can usually be controlled by diet and oral agents and is much less likely to result in a coma.

An underwriter should attempt to find out the type of diabetes involved and get as much information as possible about the chances of a coma. Where there is little or no indication of a problem, this impairment can be disregarded. Otherwise, extreme care should be taken, and limitations or even rejection might be justified.

Other types of seizures, such as fainting spells, must also be underwritten carefully. Each case must be investigated to determine if there appears to be a potential driving problem. Where indications of possible difficulties appear, automobile insurance might not be written.

HEARING IMPAIRMENTS

There are many types and degrees of hearing impairments. One authority explains them this way:

"The term deafness is used loosely to refer to any amount of hearing loss, but in planning the rehabilitative program for adults, or an educational program for children, it is necessary to make a distinction between the 'deaf' and the 'hard of hearing.' In the mind of the layperson, 'deaf' means 'completely without hearing.' Actually, there are very few individuals whose auditory mechanism is completely dead. Most persons educationally classified as deaf have some shreds of hearing remaining; that is, they have some level of hearing which is demonstrable on an audiometric test. It is the usefulness of this residual hearing which determines whether a person is deaf or hard-of-hearing."

Most people with hearing impairments can hear traffic noises, often with the use of hearing aids, even though many of them cannot distinguish words. It is this ability to hear traffic sources that is crucial to automobile underwriters.

Many "deaf" individuals drive cars. They can identify the presence of emergency vehicles by observing the traffic patterns. They tend to drive more carefully and to observe the traffic around them, which helps to compensate for their inability to hear noises, which could warn of problems.

Studies conducted in some states have indicated that people with impaired hearing are better drivers than the average. Other studies have arrived at the opposite conclusion. There is only one-way to for the underwriter to reconcile these conflicting reports; underwrite on an individual basis. Undoubtedly, some deaf people are excellent drivers while others have poor driving records.

This is the same as for any other group. A blanket rule for all members of a group simply does not fit. Where hearing impairments are present, underwriters should be cautious—the same as they are when any potential difficulty is discovered. Additional information may be needed.

The applicant should be judged on the actual circumstances, not on a preconceived notion. If the driving record is good, and no other unusual factors are present, the application should be accepted. Otherwise, limitations or rejection are justified.

IMPAIRED SIGHT

Different degrees of impaired sight also are found in the population. Many drivers wear glasses and most of these drivers enjoy adequate correction to permit normal living.

Monocular (one-eyed) drivers were shown to have driving records, which are better than the average. Totally blind persons offer somewhat more of a problem. One state (Utah) has adopted a regulation, the violation of which could result in revocation of a company's license. It reads, in part:

"The following are hereby identified as acts or practices which constitute unfair discrimination between individuals of the same class: refusing to insure, or refusing to continue to insure, or limiting the amount, extent or kind of coverage available to an individual, or charging an individual a different rate for the same coverage solely because of blindness or partial blindness, except where the refusal, limitation or rate differential is based on sound actuarial principles or is related to actual or reasonably anticipated experience as may be accepted by the Insurance Commissioner."

The foregoing regulation applies to all lines of insurance, but presumably automobile insurance could be refused to a totally blind person under the "sound actuarial principles" exception of the law.

Fire insurance, health insurance and other lines probably could not apply underwriting selection because of total or partial blindness, unless actual experience indicated that such action is justified. Other states have adopted laws or regulations, which refer to the "physically handicapped" or the "partially sighted." These terms would apply to impaired sight unless specifically excluded.

Where these controls are in effect, underwriters must not use these factors in the selection process, of course. In other states, each individual applicant should be considered on the merits of the case. Serious impairment of sight could be justification for refusing to write automobile insurance, but it seldom would be justified on other lines.

If the impairments are not serious, the applicant should be accepted.

ALCOHOL AND DRUGS

Underwriters are justified in being concerned about the use of alcohol and drugs by drivers. Studies have indicated that usage is increasing and is a contributing factor in accidents. Alcohol is estimated to be involved in roughly one-half of all highway fatalities, according to various surveys conducted by the National Safety Council and others.

Drugs are being identified as a factor in an ever-increasing number of accidents. The picture is not yet clear as to the volume of cases involving only drugs or those involving both alcohol and drugs. One study was reported in this way: "Marijuana was found in the blood of nearly one in five suspected drunken drivers whose blood contained intoxicating levels of alcohol or less, according to a state Justice Department study nearing completion.

Some law enforcement officials have suspected motorists stopped for drunken or erratic driving but who easily passed blood alcohol, breath or urine tests were using marijuana or a combination of marijuana and alcohol...the study also found marijuana in the blood of 15 percent of the heavier drinkers, those with more than 0.10 percent of alcohol in their blood."

FOREIGN BORN

The national origin or ancestry of an applicant should not be a cause for rejection. Both laws and the present climate prohibit taking underwriting action because of this factor.

Most applications for insurance no longer request information on national origin or ancestry. Seldom do they request answers concerning the ability of the applicant to read, speak or understand English. In spite of suspected underwriting problems because of these deficiencies, the information simply is not available on most new submissions. However, these facts will come to the attention of underwriters in some cases.

Producers concerning a language deficiency might add comments to applications. Often, a claim will reveal the problem, and the adjuster may point this out to the underwriter. Where language or comprehension difficulty is discovered, the underwriter should not take action solely on that fact. This is prohibited in many states and would be criticized in others.

At the same time, this information does not need to be ignored. Further investigation might be conducted to determine if there are other potential problems. Some persons with language difficulties may be found to have poor driving records, whether related to this factor or not. Other problems may also be found and the combination of borderline items may be enough to justify declination or cancellation.

Underwriting action should never be taken solely because of the national origin or ancestry of an individual. This factor can be used as one item in the total picture, and may point to other deficiencies, which would require action.

RELATED BUSINESS

Underwriters should no longer require the purchase of other policies with the same company before a requested coverage is written. The economies in investigation and claims adjusting expenses, and the desire for a more profitable coverage to offset an unprofitable one, simply cannot be justified. Each line should be priced so that it can stand on its own.

Most importantly, practices are forbidden which smack of coercion or compulsion by insurers. The present feeling is that potential buyers have a right to purchase the coverage's they desire, from the companies they desire, without any requirements of related business by one insurer. The requirement may be aimed only at efficiency, but it comes across as compulsion to buyers.

PRIOR INSURANCE

Underwriters are taught to secure as much information as possible in order to select applicants intelligently. One item of information, which was used regularly, was the name of the prior insurer, if any. This practice could continue if its only purpose was to verify the accident record from the prior insurer.

While some insinuations have been made about "exchanges of privileged information" and some underwriters feel that the Fair Credit Reporting Act (including related state laws) may prohibit this practice, this is probably a valid source of reliable information.

Unfortunately, underwriters cannot ignore other facts, which reach them. If the prior insurer is a substandard writer, an underwriter cannot overlook this. If no insurance is reported to have been carried, it is a natural tendency to wonder if something is being hidden. It is this related use of the information that arouses suspicions among regulators. It is difficult to deliberately set aside information, which may be helpful. However, this must be done if some of the facts are desired.

Underwriters have only two possible paths of action in such cases. Use the name of the prior insurer only as a means of securing facts about the losses, which have occurred or, disregard all other possible uses of the information. If such courses are not practical, do not even request data about the prior insurer. Drop the question from all applications.

PRIOR CANCELLATION

In the previous section, it was indicated that underwriters might want to continue to secure specific information concerning a prior insurer. Regardless of most information, it is obvious that no action should be taken solely because of a previous rejection or cancellation.

Severe criticism will result from underwriting decisions based solely on the actions of others. Underwriting rules are different by company. One of the quickest ways to arouse antagonism is to reject or cancel coverage solely because another underwriter took similar action.

This does not mean, however, that an underwriter should ignore the actions of prior insurers. In fact, this may be the most valuable item of information, which is secured by finding out about the previous insurer. This factor is one of the best examples of how "balanced underwriting" can be practiced. The secret is how underwriters use the information that a prior insurer had obtained to reject or cancel the coverage.

The wrong course is to automatically reject the applicant. Not only will this bring down the wrath of regulators, it may also cause the rejection of some business, which would be perfectly acceptable since insurers aim at different sectors of the market.

The right course is to use the fact of a prior cancellation as another warning flag. A smart underwriter will immediately start to secure more information about the applicant. Such investigation may reveal a poor driving record or other such factors, which would be adequate cause for rejection.

This last factor to be discussed, the rejection or cancellation by a prior insurer, is a good illustration of how underwriters can continue to select risks under the watchful eye of government regulators. Factors, which have caused concern to underwriters in the past, need not be ignored. However, they should not lead to a blind reaction based on past practices.

Rather, these factors can point out the need for the securing of more facts before accepting an applicant. Then, based on complete information, a decision can be made which complies with the laws and regulations and still senses the needs of the company and the public.

Focus Points

- o The first goal of underwriting is to help to achieve underwriting gains.
- o Underwriters select applicants who fit the parameters of the rates developed by the company.
- o Insurance benefits society by reducing the uncertainty of certain types of risks.
- o Underwriters are the focal point from which the benefits of insurance are supplied.
- o The greatest contribution underwriters can make is to maintain a strong and solvent insurance industry.
- o Better underwriting is a product of securing all relevant information.
- o Objective information is the most reliable data received from outside sources.
- o Subjective information is personal information obtained by the applicant.
- o Right to privacy laws restrict the information, which can be secured.
- o Applications can be looked at by class or by individual risk.
- o Class usually underwrites personal lines.
- o Commercial lines usually underwritten by individual risk.
- o Location, sex, age, and marital status cannot be used as the primary reason for rejection.
- o Any reasons for rejection of application must be given and should be specific.
- o Many states prohibit cancellation of new policies after a discovery period.
- o Desk underwriters use statements of principle to make decisions on individual risk.
- o Loss history is the record of past losses.
- o Automobile underwriters use accident records as their primary tool.
- o Information on existing policyholders may be secured from claims reports.
- o If fault does not appear to fall on the applicant, the underwriter should ignore it.
- o Underwriters should consider type of loss rather than just the number of losses.
- o No legislation exists controlling the number or type of accident that can be considered in underwriting.
- o The degree of fault should be considered in property and automobile claims.
- o Patterns of losses can be used in the prediction of future losses.
- o Property and liability losses often are the result of unsafe conditions.
- o Underwriters wishing to serve the public will do more than accept or reject applications.
- o Underwriters use traffic violations in selection and rating where allowed.

- o Motor vehicle reports are the most reliable source of information in determining records of traffic violations.
- o The most important factor in underwriting and rating an applicant is the driving record.
- o A risk should not be accepted if a driver's license is suspended or revoked.
- o Automobile and property lines can be underwriting on the basis of property condition.
- o The age of a building is not a reliable indication of an insurance risk.
- o Underwriters should determine the approximate value of buildings before writing insurance.
- o Securing proper insurance-to-value is the key to the profitable writing of property insurance.
- o Underwriters should not write a policy for less than 80 percent of replacement cost.
- o If the amount of insurance exceeds the value of property, an incentive for arson may be created.
- o Commercial risks must be written on the basis of occupancy.
- o Insurance based on risk location is a common practice.
- o Using marital status in insurance rating may soon disappear.
- o Using marital status in selection of risk is prohibited in many states.
- o Occupation of the applicant is not a valid risk selection factor.
- o Using occupation in selection of risk is prohibited in some states.
- o The applicant's stability should not be a factor in selection, without further definition.
- o The underwriter must secure all of the relevant factors if a criminal record is discovered.
- o Underwriters cannot ignore evidence of mental incompetence of applicants.
- o Studies show that physically handicapped drivers are generally no worse than average drivers.
- o The orthopedic group includes handicapped persons who do not have use of one or more extremities.
- o As a group, orthopedic drivers perform about as well as the average of all drivers.
- o Monocular drivers have driving records, which are better than the average.
- o The national origin of an applicant cannot be a cause for rejection.
- o Most insurance applications do not request information on national origin or ancestry.

CHAPTER 11: THE ROLE OF THE NAIC

A BRIEF HISTORY

Benjamin Franklin helped found the insurance industry in the United States in 1752 with the Philadelphia Contribution ship for the Insurance of Houses from Loss by Fire. The current state insurance regulatory framework has its roots in the 19th century with New Hampshire appointing the first insurance commissioner in 1851. Insurance regulators' responsibilities grew in scope and complexity as the industry evolved. Congress adopted the McCarran-Ferguson Act in 1945 to declare that states should regulate the business of insurance and to affirm that the continued regulation of the insurance industry by the states was in the public's best interest.

The Financial Modernization Act of 1999—also called Gramm-Leach-Bliley—established a comprehensive framework to permit affiliations among banks, securities firms and insurance companies. Gramm-Leach-Bliley once again acknowledged that states should regulate the business of insurance. However, Congress also called for state reform to allow insurance companies to compete more effectively in the newly integrated financial service marketplace and to respond with

innovation and flexibility to evermore demanding consumer needs—all while continuing to protect consumers, which is the hallmark of state regulation.

THE ROLE OF THE STATE LEGISLATURES

State legislatures set broad policy for the regulation of insurance. They establish and oversee state insurance departments, regularly review and revise state insurance laws, and approve regulatory budgets. State insurance departments employ 12,500 regulatory personnel. Increases in staff and enhanced automation have allowed regulators to substantially boost the quality and intensity of their financial oversight of insurers and expand consumer protection activities.

State regulation of insurance provides a major source of state revenue. In 2000, states collected more than \$10.4 billion in revenues from insurance sources. Of this amount, \$880 million—roughly 8.4 percent—went to regulate the business of insurance while the remaining \$9.6 billion went to state general funds for other purposes.

NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS (NAIC)

The NAIC serves as a vehicle for individual state regulators to coordinate their activities and share resources. Established in 1871, the NAIC functions as an advisory body and service provider for state insurance departments. Commissioners use the NAIC to pool scarce resources, to discuss issues of common concern and to align their oversight of the industry. Each state, however, ultimately determines what actions it will take.

THE PURPOSE AND STRUCTURE OF INSURANCE REGULATION

The fundamental reason for government regulation of insurance is to protect American consumers. State systems are accessible and accountable to the public and sensitive to local social and economic conditions. State regulation has proven that it effectively protects consumers and ensures that promises made by insurers are kept. Insurance regulation is structured around several key functions, including company licensing, producer licensing, product regulation, market conduct, and financial regulation and consumer services.

COMPANY LICENSING

State laws require insurers and insurance-related businesses to be licensed before selling their products or services. Currently, there are approximately 7,200 insurers in the United States. All U.S. insurers are subject to regulation in their state of domicile and in the other states where they are licensed to sell insurance.

Insurers who fail to comply with regulatory requirements are subject to license suspension or revocation, and states may exact fines for regulatory violations. In 2000, nearly 300 companies had their licenses suspended or revoked.

The NAIC's Uniform Certificate of Authority Application (UCAA)—a company licensing system—helps states expedite the review process of a new company license. In addition, an NAIC database has been developed to facilitate information sharing on acquisition and merger filings. These databases assist insurance regulators by creating a streamlined and more cost-efficient regulatory process.

PRODUCER LICENSING

Insurance agents and brokers, also known as producers, must be licensed to sell insurance and must comply with various state laws and regulations governing their activities. Currently, more than 3.2 million individuals are licensed to provide insurance services in the United States. State insurance departments oversee producer activities in order to protect insurance consumer interests in insurance transactions.

The states administer continuing education programs to ensure that agents meet high professional standards. Producers who fail to comply with regulatory requirements are subject to fines and license suspension or revocation. In 2000, nearly 16,000 insurance producers had their licenses suspended or revoked.

When producers operate in multiple jurisdictions, states must coordinate their efforts to track producers and prevent violations. Special databases are maintained by the NAIC to assist the states in this effort. The National Insurance Producer Registry (NIPR)—a non-profit affiliate of the NAIC—was established to develop and operate a national repository for producer licensing information.

PRODUCT REGULATION

State regulators protect consumers by ensuring that insurance policy provisions comply with state law, are reasonable and fair, and do not contain major gaps in coverage that might be misunderstood by consumers and leave them unprotected. The nature of the rate review, rating rules and forms varies somewhat among the states depending on their laws and regulations.

For personal property-casualty lines, about half of the states require insurers to file rates and to receive prior approval before they go into effect. With the exception of workers' compensation and medical malpractice, commercial property-casualty lines in many states are subject to a competitive rating approach. Under such a system, regulators typically retain authority to disapprove rates if they find that competition is not working.

Premiums for life insurance and annuity products generally are not subject to regulatory approval, although regulators may seek to ensure that policy benefits are commensurate with the premiums charged. Many states subject health insurance rates to prior approval—with all other lines using a “file and use” system or no provisions for review.

PRODUCT REGULATION FORUM

NAIC members discussed options for achieving true uniform product filing standards. They recognized that the financial services marketplace has changed in recent years and continues to evolve with increased competition in certain product lines from entities such as banks and securities firms.

They also recognized that there is increased mobility of the population and greater need for uniformity of some product lines. A working group was established to identify and analyze possible options to modernize this regulatory process and make a formal recommendation. In March 2002, the working group proposed the development of an interstate compact whereby state insurance regulators would jointly set uniform product standards and establish a single point of filing for designated insurance products. If properly structured, an interstate compact would allow the states to address the issue of state variations affecting product standards.

Throughout 2002, the Interstate Compact Working Group and interested regulators worked to develop draft language for an interstate compact and received comments from representatives of the insurance industry and consumer groups. Eleven draft versions of the model language were developed and four public hearings were held.

Interested parties submitted over 20 written comments. During the NAIC's national meeting in December 2002, the members adopted model legislation for the creation of the Interstate Insurance Product Regulation Compact “for presentation to interested state lawmakers and policy makers for their review, input, and approval”.

On July 17, 2003, the NAIC adopted amendments to the interstate compact that provided clarification of certain provisions. Specifically, the amendments addressed such items as publishing bylaws, conducting open meetings, making information regarding the operations of the interstate commission available to the public, and preserving the authority of state attorneys general.

During their respective annual meetings during 2003, both the National Conference of State Legislatures (NCSL) and the National Conference of Insurance Legislators (NCOIL) adopted resolutions in support of the proposed interstate compact. During 2003 a working group was appointed to begin drafting standards for policy filings. These are intended as sample products that may be adopted by the Interstate Compact Commission when it is formed.

After a draft of standards for a particular product is prepared, it is released for public comment. These draft standards will provide helpful evidence to legislators as to the types of standards that might be adopted by the Compact Commission.

The NAIC's Regulatory Modernization Action Plan, adopted by the NAIC membership in September 2003, is a commitment by state regulators to continue modernizing the state-based system of insurance regulation. One facet of the plan is implementation of an interstate compact.

State regulators are urged to work with state policymakers with the intent of having the Compact operational in at least thirty states or states representing 60% of the premium volume for life insurance, annuities, disability income insurance and long-term care insurance products entered into the Compact by year-end 2008.

FINANCIAL REGULATION

Financial regulation provides crucial safeguards for America's insurance consumers. The states maintain at the NAIC the world's largest insurance financial database, which provides a 15-year history of annual and quarterly filings on 5,200 insurance companies.

Periodic financial examinations occur on a scheduled basis. State financial examiners investigate a company's accounting methods, procedures and financial statement presentation. These exams verify and validate what is presented in the company's annual statement to ascertain whether the company is in good financial standing.

When an examination of financial records shows the company to be financially impaired, the state insurance department takes control of the company. Aggressively working with financially troubled companies is a critical part of the regulator's role. In the event the company must be liquidated or becomes insolvent, the states maintain a system of financial guaranty funds that cover consumers' personal losses.

MARKET REGULATION

Market regulation attempts to ensure fair and reasonable insurance prices, products and trade practices in order to protect consumers. With improved cooperation among states and uniform market conduct examinations, regulators hope to ensure continued consumer protections at the state level.

Market conduct examinations occur on a routine basis, but also can be triggered by complaints against an insurer. These exams review agent-licensing issues, complaints, types of products sold by the company and agents, agent sales practices, proper rating, claims handling and other market-related aspects of an insurer's operation.

When violations are found, the insurance department makes recommendations to improve the company's operations and to bring the company into compliance with state law. In addition, a company may be subject to civil penalties or license suspension or revocation.

CONSUMER SERVICES

The states' single most significant challenge is to be vigilant in the protection of consumers, especially in light of the changes taking place in the financial services marketplace. States have established toll-free hotlines, Internet Web sites and special consumer services units to receive and handle complaints against insurers and agents. The states also have launched an interactive tool to allow consumers to research company complaint and financial data using the NAIC Web site.

During 2000, state insurance departments handled 4.5 million consumer inquiries and complaints. As needed, state insurance departments worked together with policyholders and insurers to resolve disputes. In addition, many states sponsor educational seminars and provide consumer brochures on a variety of insurance topics. Some states publish rate comparison guides to help consumers get the best value when they purchase insurance.

WHY STATE INSURANCE REGULATIONS

WHY INSURANCE IS REGULATED

Government regulation of insurance companies and agents began in the states more than 100 years ago for one overriding reason—to protect consumers. State regulators' most important consumer protection is to assure that insurers remain solvent so they can meet their obligations to pay claims. States also supervise insurance sales and marketing practices and policy terms and conditions to ensure that consumers are treated fairly when they purchase insurance products and file claims.

THE FIRST PRIORITY OF INSURANCE REGULATORS

The fundamental purpose for government regulation of insurers and agents is to protect American consumers. Effective consumer protection that focuses on local needs is the hallmark of state insurance regulation. State regulators understand local and regional markets and the needs of consumers in these markets. State policymakers recognize that consumer protection as their highest job priority. Meaningful evaluation of the existing state regulatory system or any federal alternative must begin with a hard look at its impact on current protections that the public expects.

HOW IS INSURANCE DIFFERENT FROM BANKING

Insurance is a commercial product based upon subjective business decisions:

- ✓ Will an insurance policy be offered to a consumer and at what price
- ✓ What are the policy terms and conditions
- ✓ Does a policyholder file a claim valid? If so,
- ✓ How much should the customer be paid under the policy's terms

Unlike most products, the purchaser of an insurance policy will not be able to fully determine the value of the product purchased until after a claim is presented—when it is too late to decide that a different insurer or a different product might make a better choice. All of these subjective aspects add up to one big certainty—insurance products can generate consumer backlash and dissatisfaction that require a high level of regulatory resources and responsiveness.

THE COST OF STATE INSURANCE REGULATION

In 2000, state insurance departments employed 12,500 regulatory personnel nationwide and spent \$880 million to be the watchful eyes and helping hands on consumer insurance problems. States also maintain a system of financial guarantee funds that cover personal losses of consumers in the event of insurer insolvency. The entire state insurance system is authorized, funded and operated at no cost to the federal government.

WHAT IS GRAMM-LEACH-BLILEY?

The Financial Modernization Act of 1999—also called Gramm-Leach-Bliley—established a comprehensive framework to permit affiliations among banks, securities firms and insurance companies. Gramm-Leach-Bliley once again acknowledged that states should regulate the business of insurance. However, Congress also called for state reforms to allow insurance companies to compete more effectively in the newly integrated financial service marketplace and to respond with innovation and flexibility to evermore demanding consumer needs.

States already have taken action to meet the specific requirements of Gramm-Leach-Bliley. Forty-six states have enacted a model law to establish a system of reciprocity to license out-of-state insurance agents and brokers. This already exceeds the

29 states required by federal law to prevent establishment of the National Association of Registered Agents and Brokers—a quasi-governmental entity that would preempt state laws. In response to another provision that requires states to set minimum standards to keep insurance information private, the NAIC drafted model privacy regulations, and 49 states and the District of Columbia now meet or exceed the federal privacy requirement.

WHAT STATES ARE DOING TO MODERNIZE INSURANCE REGULATION

States are committed to streamline and simplify state insurance regulation while continuing to protect consumers. The nation's insurance commissioners announced their commitment to modernize the state system in specific areas by endorsing an action plan, the *Statement of Intent—The Future of Insurance Regulation*, which was adopted in March 2000.

Working in their individual states and collectively through the NAIC, the commissioners have made tremendous progress on their goal of creating an efficient, market-oriented regulatory system for the business of insurance. The *Statement of Intent* set forth goals for improvement in producer licensing, product speed to market, privacy of consumer information and company licensing.

State legislatures working through the National Conference of State Legislatures (NCSL) and the National Conference of Insurance Legislators (NCOIL) also are committed to reform state insurance regulation. In September 2001, the NCSL Executive Committee established the *Task Force to Streamline and Simplify Insurance Regulation*—co-chaired by Senator Kemp Hannon of New York and Representative David Counts of Texas—to lead state legislative efforts to modernize state insurance regulation.

The Task Force is charged by the NCSL Executive Committee to explore the issues that confront state insurance regulation in the integrated financial marketplace and, if necessary, to recommend specific measures to the states for legislative consideration. Moreover, for many years, NCOIL has served as a forum for legislators to discuss the many issues confronting state insurance regulation and has recommended to states model laws to promote market-based regulatory structures.

HOW DO REGULATORS PROMOTE COMPETITIVE MARKETS?

The purpose of government supervision is to make sure the critical personal interests of consumers are not lost in the arena of commercial competition. Once the consumer protection responsibilities of government insurance regulators are satisfied, it is fair to ask how the system of regulation can be made most compatible with the demands of commercial competition without sacrificing the needs of consumers. Regulators continue to give this matter our highest attention, as evidenced by our speed to market initiatives.

KEEPING INSURANCE MARKETS COMPETITIVE

Insurers, especially in the life insurance and annuities market, increasingly face direct competition from products offered by other financial services entities. State insurance regulators have worked diligently over the past two years to identify the issues in this area and come up with possible solutions to reflect the new market realities.

Regulators now believe that a more efficient review process for these products is possible and could help insurers better compete in the marketplace while maintaining a high level of protection for insurance consumers. To accomplish this goal, regulators have endorsed the idea of an interstate insurance compact. The NAIC has drafted an interstate compact proposal and is discussing it with state legislators and interested parties for legislative consideration.

WHY ARE THE STATES' MODERNIZATION EFFORTS TAKING SO LONG?

Insurance regulation is a complex matter and any change to the process should not be undertaken without thorough review and analysis of the impact of change to the business, companies and agents, and also to the consumers and policyholders the industry serves.

However, the states have established aggressive timelines in order to meet their modernization objectives. They have come to a point where a number of the goals set out in the *Statement of Intent* have worked their way through the state legislative process. From the Producer Licensing Model Act to privacy regulations, the states have proven a commitment to modernizing insurance regulation and protecting consumers—as states have done for the past 130 years.

ISN'T THIS REALLY JUST ABOUT STATES PROTECTING THEIR TURF?

Modernization efforts are not just about the survival of the state system. It is about responding to change and, in turn, making the best insurance regulatory system in the world even better. State policymakers believe consumers are—and will continue to be—best served by the states. Regulators and legislators have accepted the challenge to make the state system of insurance regulation better, and they will continue to make progress in implementing this vision.

A NEED FOR MORE UNIFORMITY

Having similar processes with local control and application is really the best of both worlds. Consumers need to have the confidence that the people regulating their policies understand the area market. For example, Iowa consumers do not buy much hurricane insurance, and there is little need for crop insurance in New York City. However these types of insurance are very important in the regions in which they are sold.

WOULD A FEDERAL AGENCY LIKE THE SEC OVERSEE REGULATION?

Clearly—since the Gramm-Leach-Bliley Act passed—conglomerates are being formed and banks and insurance and securities firms that are converging. But there are still fundamental differences between banking, securities and insurance. Insurance is a product with which consumers have many issues and questions. State insurance regulators need to be there on a local basis to deal with them. The state system has the expertise and has demonstrated that it can be responsive to these situations.

When consumers have a problem with their insurance, it is often at a time of tragedy—when a child needs an operation and the insurance company won't pay for it, or a house just burned down and the insurance company is not coming through. So, insurance is very different from banking and securities products. Insurance also involves extremely complex contracts—so there is greater potential for consumer abuse.

FOCUS POINTS

- o Benjamin Franklin helped found the insurance industry in the United States in 1752 with the Philadelphia Contribution ship for the Insurance of Houses from Loss by Fire.
- o The current state insurance regulatory framework has its roots in the 19th century with New Hampshire appointing the first insurance commissioner in 1851.
- o Congress adopted the McCarran-Ferguson Act in 1945 to declare that states should regulate the business of insurance and to affirm that the continued regulation of the insurance industry by the states was in the public's best interest.
- o The Financial Modernization Act of 1999—also called Gramm-Leach-Bliley—established a comprehensive framework to permit affiliations among banks, securities firms and insurance companies.
- o Gramm-Leach-Bliley once again acknowledged that states should regulate the business of insurance.
- o State legislatures establish and oversee state insurance departments, regularly review and revise state insurance laws, and approve regulatory budgets.
- o State insurance departments employ 12,500 regulatory personnel.
- o State regulation of insurance provides a major source of state revenue.
- o The NAIC serves as a vehicle for individual state regulators to coordinate their activities and share resources.
- o Established in 1871, the NAIC functions as an advisory body and service provider for state insurance departments.
- o Commissioners use the NAIC to pool scarce resources, to discuss issues of common concern and to align their oversight of the industry.
- o The fundamental reason for government regulation of insurance is to protect American consumers.
- o Insurance regulation is structured around several key functions, including company licensing, producer licensing, product regulation, market conduct, and financial regulation and consumer services.
- o State laws require insurers and insurance-related businesses to be licensed before selling their products or services.
- o Insurers who fail to comply with regulatory requirements are subject to license suspension or revocation, and states may exact fines for regulatory violations.
- o The NAIC's Uniform Certificate of Authority Application (UCAA)—a company licensing system—helps states expedite the review process of a new company license.
- o An NAIC database has been developed to facilitate information sharing on acquisition and merger filings.
- o Insurance agents and brokers, also known as producers, must be licensed to sell insurance and must comply with various state laws and regulations governing their activities.
- o More than 3.2 million individuals are licensed to provide insurance services in the United States.
- o The states administer continuing education programs to ensure that agents meet high professional standards.

- The National Insurance Producer Registry (NIPR)—a non-profit affiliate of the NAIC—was established to develop and operate a national repository for producer licensing information.
- For personal property-casualty lines, about half of the states require insurers to file rates and to receive prior approval before they go into effect.
- With the exception of workers' compensation and medical malpractice, commercial property-casualty lines in many states are subject to a competitive rating approach. Under such a system, regulators typically retain authority to disapprove rates if they find that competition is not working.
- Premiums for life insurance and annuity products generally are not subject to regulatory approval, although regulators may seek to ensure that policy benefits are commensurate with the premiums charged.
- Many states subject health insurance rates to prior approval.
- In March 2002, the NAIC working group proposed the development of an interstate compact whereby state insurance regulators would jointly set uniform product standards and establish a single point of filing for designated insurance products.
- The NAIC's Regulatory Modernization Action Plan, adopted by the NAIC membership in September 2003, is a commitment by state regulators to continue modernizing the state-based system of insurance regulation.
- The intent is of having the Compact operational in at least thirty states or states representing 60% of the premium volume for life insurance, annuities, disability income insurance and long-term care insurance products entered into the Compact by year-end 2008.
- Financial regulation provides crucial safeguards for America's insurance consumers.
- The states maintain at the NAIC the world's largest insurance financial database, which provides a 15-year history of annual and quarterly filings on 5,200 insurance companies.
- Periodic financial examinations occur on a scheduled basis.
- State financial examiners investigate a company's accounting methods, procedures and financial statement presentation. These exams verify and validate what is presented in the company's annual statement to ascertain whether the company is in good financial standing.
- When an examination of financial records shows the company to be financially impaired, the state insurance department takes control of the company.
- Aggressively working with financially troubled companies is a critical part of the regulator's role.
- In the event the company must be liquidated or becomes insolvent, the states maintain a system of financial guaranty funds that cover consumers' personal losses.
- Market regulation attempts to ensure fair and reasonable insurance prices, products and trade practices in order to protect consumers.
- Market conduct examinations occur on a routine basis, but also can be triggered by complaints against an insurer.
- Market conduct examinations review agent-licensing issues, complaints, types of products sold by the company and agents, agent sales practices, proper rating, claims handling and other market-related aspects of an insurer's operation.
- When violations are found, the insurance department makes recommendations to improve the company's operations and to bring the company into compliance with state law.
- A company may be subject to civil penalties or license suspension or revocation.
- States have established toll-free hotlines, Internet Web sites and special consumer services units to receive and handle complaints against insurers and agents.

- o State insurance departments handle more than 4.5 million consumer inquiries and complaints each year.
- o As needed, state insurance departments worked together with policyholders and insurers to resolve disputes.
- o Many states sponsor educational seminars and provide consumer brochures on a variety of insurance topics.
- o Some states publish rate comparison guides to help consumers get the best value when they purchase insurance.
- o Government regulation of insurance companies and agents began in the states more than 100 years ago for one overriding reason—to protect consumers.
- o State regulators' most important consumer protection is to assure that insurers remain solvent so they can meet their obligations to pay claims.
- o States supervise insurance sales and marketing practices and policy terms and conditions to ensure that consumers are treated fairly when they purchase insurance products and file claims.
- o The fundamental purpose for government regulation of insurers and agents is to protect American consumers.
- o Effective consumer protection that focuses on local needs is the hallmark of state insurance regulation.
- o State regulators understand local and regional markets and the needs of consumers in these markets.
- o Unlike most products, the purchaser of an insurance policy will not be able to fully determine the value of the product purchased until after a claim is presented—when it is too late to decide that a different insurer or a different product might make a better choice.
- o State insurance departments spent \$880 million yearly to be the watchful eyes and helping hands on consumer insurance problems.
- o States also maintain a system of financial guarantee funds that cover personal losses of consumers in the event of insurer insolvency. The entire state insurance system is authorized, funded and operated at no cost to the federal government.
- o The Financial Modernization Act of 1999—also called Gramm-Leach-Bliley—established a comprehensive framework to permit affiliations among banks, securities firms and insurance companies.
- o Forty-six states have enacted a model law to establish a system of reciprocity to license out-of-state insurance agents and brokers.
- o This already exceeds the 29 states required by federal law to prevent establishment of the National Association of Registered Agents and Brokers—a quasi-governmental entity that would preempt state laws.
- o In response to another provision that requires states to set minimum standards to keep insurance information private, the NAIC drafted model privacy regulations, and 49 states and the District of Columbia now meet or exceed the federal privacy requirement.
- o States are committed to streamline and simplify state insurance regulation while continuing to protect consumers.
- o . The NAIC *Statement of Intent* set forth goals for improvement in producer licensing, product speed to market, privacy of consumer information and company licensing.
- o State legislatures working through the National Conference of State Legislatures (NCSL) and the National Conference of Insurance Legislators (NCOIL) also are committed to reform state insurance regulation.
- o The purpose of government supervision is to make sure the critical personal interests of consumers are not lost in the arena of commercial competition.
- o Insurers, especially in the life insurance and annuities market, increasingly face direct competition from products offered by other financial services entities.
- o Regulators believe that a more efficient review process for these products is possible and could help insurers better compete in the marketplace while maintaining a high level of protection for insurance consumers.

- o Insurance regulation is a complex matter and any change to the process should not be undertaken without thorough review and analysis of the impact of change to the business, companies and agents, and also to the consumers and policyholders the industry serves.
- o Modernization efforts are not just about the survival of the state system. It is about responding to change and, in turn, making the best insurance regulatory system in the world even better.
- o Consumers need to have the confidence that the people regulating their policies understand the area market. For example, Iowa consumers do not buy much hurricane insurance, and there is little need for crop insurance in New York City. However these types of insurance are very important in the regions in which they are sold.
- o Since the Gramm-Leach-Bliley Act passed—conglomerates are being formed and banks and insurance and securities firms that are converging.
- o There are still fundamental differences between banking, securities and insurance.
- o Insurance is a product with which consumers have many issues and questions. State insurance regulators need to be there on a local basis to deal with them. The state system has the expertise and has demonstrated that it can be responsive to these situations.
- o When consumers have a problem with their insurance, it is often at a time of tragedy. This makes insurance very different from banking and securities products.

CHAPTER 12: ETHICAL ISSUES

Whether you are a Life and Health Agent or a Property and Casualty Agent, the ethics you employ in your sales approach reflects not only on you but also the companies you represent.

Although some ethical issues are personal issues of conduct or level of integrity, other issues become violation of state laws.

In selling insurance it is critical that the highest standard of ethics be adhered to in making recommendations for products.

Are you properly outlining the risk factors involved in some choices the client may make?

Do you know enough about the products that you are marketing not to misrepresent to the consumer?

In this chapter we will be reviewing the ethical issues that face all agents in the conflict of earning a living versus serving the customer's needs.

At the core of ethical behavior are honesty, responsibility, care, integrity, and trustworthiness.

Codes of ethics developed by various professional associations serve as guides for the insurance professional who is committed to his/her responsibilities to both the insurance company he/she represents and the clients he/she serves.

STANDARDS AND PRACTICES

PERCEPTIONS OF ETHICS

Ethics is "the discipline that deals with what is good and bad or right and wrong or with moral duty and obligation."

Ethics can be approached from two levels:

- The philosophical level dealing with the possibilities
- The practical level - dealing with the reality of every day experiences

Society, through laws and accepted behavior patterns, imposes guidelines on how to deal with other people.

From the practical side most agents have been tempted from time to time to either "stretch the truth" or perhaps "color" their presentation in order to obtain the sale. Although this may appear to have no short-range harm, will this coloration or untruth affect the client's future benefit? This consideration is critical in ethical behavior because it can result in future liability and/or lost clients for both you and the insurer.

A strong sense of honesty and personal integrity will enable an individual to stay on the straight and narrow and avoid deceiving either the customer or the insurer.

Overstating a product can be injurious to the insured and a deceptive statement on the application could result in a higher hazard for the insurer.

If you have a high standard of honesty and personal integrity, you may be unable to compromise them, even if your agency or client asks you to do so.

Honesty is the basics of ethics and relates to a person's integrity and truthfulness.

Society measures success by financial gain and many businesses, including the insurance industry, motivate their employees or independent contractors by the same theory. When achieving success and financial gain becomes primary over the customer's, client or employer's needs then, ethical issues may begin to arise.

Ethic and the law are not always synonymous. What is legal is not always ethical. In many cases professional organizations preceded laws and their code of ethics served as guides to establishing some of the laws to which we adhere. In this transformation not all ethical standards were codified into law.

Thus it is possible to operate within the law and yet be unethical. Selling someone a casualty policy they do not need might be legal, but not necessarily ethical.

Often times, things that are unethical but legal today, may become illegal tomorrow due to public pressure to bring about reform. For this reason ethical behavior should supersede the lack of a law of statute.

ETHICS FOR THE PROPERTY & CASUALTY AGENT

An insurance agent is anyone who solicits insurance or who aids in the placing of risks, delivery of policies or collection of premiums on behalf of an insurance company.

In most states agents are considered representatives of the insurance company and not of the insured. An agent is regarded as a fiduciary, a position of special trust in handling the affairs or funds of another

There are four areas of ethical responsibility for an insurance agent:

RESPONSIBILITIES TO THE AGENT'S INSURER

These responsibilities are covered under the concept of agency. The agent owes his or her insurer the duties of good faith, honesty and loyalty. The agent's day-to-day activities are a direct reflection of the insurer's "image" within the community.

RESPONSIBILITIES TO POLICY OWNERS

Responsibilities to the policy owners require the agent to meet the needs of the client, provide quality service, and maintain loyalty, confidentiality, timely submission of applications and prompt policy delivery.

RESPONSIBILITIES TO THE PUBLIC

The responsibilities the agent has to the public require the agent to maintain the highest level of professional conduct and integrity in all public contact in order to maintain a strong positive image of the industry.

RESPONSIBILITIES TO THE STATE

State responsibilities the agent holds require the agent to adhere to the ethical standards mandated by his or her state.

Under the ethical responsibilities owed to the insurer the agent has an obligation to reveal all material facts concerning the insured or any other matter relating to the agency relationship.

ETHICS AS IT APPLIES TO INSURANCE BROKERS

A broker's primary responsibility is to his or her client, meaning that, the broker is charged with the responsibility of finding the appropriate insurance coverage and markets to meet a client's needs. A broker legally represents the insured.

Many brokers provide sources of specialized insurance products and with this provide their clients with their expertise and knowledge of such products. It is critical that an insurance broker realize that their fiduciary responsibility to the insured dictates that they work in the best interest of the insured. Their ethical standards should reflect this obligation and put the client's needs ahead of any financial gain they might realize by selling one product over another.

An individual who is strictly a broker does not have binding power and coverage is not effective until the insurance company receives the application and accepts the risk.

Dual Agency exists when a broker is both a broker and an agent in which case he is functioning both on behalf of the insured and the insurer.

Some states today do not issue a broker and separate agent license, but simply issue an insurance producer license.

Brokers are held to the same standards of care as agents in terms of their responsibilities to the general public and the state. Brokers primary responsibilities are to their clients by finding the appropriate insurance coverage to meet their client's needs.

CHARACTERISTICS OF A PROFESSIONAL

The word "profession" means an open or public declaration, but has come to mean any calling requiring academic training and specialized knowledge.

Insurance agents and real estate agents are considered professionals because their business meets the following six commonly accepted characteristics of a profession:

- Commitment to high ethical standards
- Concern for the welfare of others
- Mandatory licensing and training
- Formal participation in an association or society
- Acting with integrity and objectivity
- Public acknowledgement as a profession

High ethical standards must be maintained at all times in order to serve the general public, our clients and principal.

Commitment to high professional standards often comes in conjunction with membership to professional associations that demand these high standards from their membership. Concern for the welfare of others is a personal ethics issue that often times is inbred in ones upbringing and is then later required as part of ones profession. The fiduciary responsibility entrusted to every insurance producer demands that the welfare of the client is put ahead of his or her own need.

Mandatory licensing is required by virtually all states and continuing education has become a core requirement to update the producer on changes occurring within the law and the industry. Membership in formal associations further enhances professionalism and ethical behavior by providing a forum for additional exchange of information and knowledge.

FOCUS POINTS:

- The ethics the agent employs reflect him and the company he represents.
- The core of ethical behavior is honesty, responsibility, care, integrity, and trustworthiness.
- Ethics is the discipline that deals with good and bad or right and wrong or with moral duty and obligation.
- Ethics can be approached from a philosophical or practical level.
- It is possible to operate within the law and also be unethical.
- Ethical behavior should supersede the current lack of a law of statute.
- Agents hold a position of special trust in handling the affairs or funds of another
- The agent owes his or her insurer the duties of good faith, honesty and loyalty.
- A broker's primary responsibility is to his or her client.
- Dual Agency exists when a broker is both a broker and an agent.
- Some states do not issue licenses to brokers and agents but issue a producer license.

FIDUCIARY RESPONSIBILITY

Fiduciary responsibility in many professions is harnessed under a concept called agency.

Many times both insurance agents and brokers and real estate agents and brokers do not realize that even though they are involved in the sale of a product, they are not merely sales representatives working to fulfill their own needs, but are fiduciaries of their "principals".

This high level of performance makes them ethically and legally accountable to their principals and legally accountable to the state and federal licensing bodies.

This accountability is outlined under a concept called agency.

The two fundamental principals of an agency relationship are power and authority.

THE CONCEPT OF AGENCY

Agency is a legal term used to describe the relationship between two parties, in which the principal authorizes the agent to perform certain legally binding acts on the principal's behalf.

The main components of an agency relationship are:

- An agent is an agent of the principal (the insurance company) not the third party with whom the agent deals (the insured).
- An agent has the power to bind the principal to a legal contract and its terms.
- The acts of the agent, within the scope of authority, are the acts of the principal.

Legally, the acts of the agent are the acts of the principal, it is critical that the agent does not misrepresent the principal in any manner or fashion, and that the third party understands that the agent is working to the best interest of his or her principal.

While serving the principal, the agent also has a responsibility to the third party to be honest and forthright in presenting the products up for discussion.

Because agency can be created in several ways, it is important that an agent does not create an agency relationship that becomes a conflict of interest without proper disclosures.

The methods an Agency can be created are:

- Appointment or Explicit contract
- Estoppel
- Ratification

APPOINTMENT OR EXPLICIT CONTRACT

Appointment is an agreement between the principal (insurer) and the agent that specifically outlines the duties the agent may perform on behalf of his or her principal.

ESTOPPEL

Estoppel is the principal wherein the insurer allows someone (an agent) to act in a way that would cause an innocent third party to believe that the individual was an agent of the principal, than that agent actually becomes an agent of the principal and the principal is held accountable for his or her actions. In order for estoppel to occur three elements must come into play:

- The principal must act in some way that gives the appearance that an agency relationship exists
- An innocent third party must be misled
- An innocent third party must be harmed

AGENCY BY RATIFICATION

Agency by ratification is the last method in which an agency relationship can exist. In this format agency is initially created by misrepresenting that an agency relationship exists, but later on, the "authority" is legitimized by the principal through acceptance of the representation and its actions.

Before an individual can act as an agent he or she must have the power and authority to take action. There are three types of agency authority:

Expressed authority is the authority the principal intentionally and expressly gives the agent.

Implied authority is the authority that the principal intends for the agent to have, but does not expressly give.

Apparent authority arises when a principal permits an agent to perform acts neither expressly nor implicitly authorized.

In the case of Expressed Authority the limits to an insurance agent's authority are usually defined in his or her agency agreement and the agent must work within those perimeters.

Implied Authority permits an agent to perform incidental actions that go along with the authority vested by virtue of the Expressed Authority.

Apparent Authority is created when a third party relies on the acts of an agent, which have not been authorized, but through negligence are permitted by the principal. Apparent Authority holds the principal responsible for the agent's acts.

The ethical significance of these limits to an insurance agent's authority is that an agent must serve the needs of the insurer, live up to the contract and operate within the scope of his or her authority. By entering into this contractual relationship with the insurer, the agent becomes a fiduciary of the insurer.

THE AGENT AS A FIDUCIARY

An individual whose position and responsibilities involve a high degree of trust and confidence is known as a fiduciary. An insurance producer has a fiduciary relationship with his or her insurer with regard to the following:

- **Loyalty to insurer**-A producer must at all times act in the insurer's best interest, not his or her interests of personal gain.
- **Skill and performance**-An agent has the duty to carry out his or her actions with care and skill. Because an agent represents the company to the public and the agent must act in such a manner as not to create a tarnished image for the company.
- **Full disclosure**- An agent is obligated to fully disclose all information he or she has that may affect the insurer and the ability to do business. Full disclosure is critical during the application and claims handling processes.
- **Follow up**- An agent has the obligation to act promptly in all matters regarding the insurer's business, including the duties to forward completed applications as quickly as possible.
- **Handling of premiums** - By law, payment to an agent is payment to the insurer. The agent has a fiduciary duty to turn over all funds given to him or her as specified in the agency agreement.
- **Avoiding conflicts of interest** - An insurance agent cannot serve two principals at the same time. An agent has the ethical duty to make full disclosure to an insurer in regard to any other related service he or she provides and receives compensation.
- **Responsible solicitation** -An agent has the duty to solicit only business that appears to be good and profitable to his employer.
- **Competitive integrity** -An agent cannot misrepresent or in any way defame a competitive agent or insurer. An agent must compete only on the basis of products and services he or she can provide.

CAPTIVE AGENT VS INDEPENDENT AGENT

CAPTIVE AGENTS

Captive Agents have different ethical responsibilities than Independent Agents. Captive Agents are agents for the insurer and by virtue of an exclusive contract owe all of their allegiances exclusively to the individual insurer or group of insurers.

All accounts belong to the insurer. Should an agent terminate their contractual employment agreement with the insurer, such accounts would remain under the control and ownership of the insurer. A captive agent owes all of her or his allegiances to the insurer and must notify the insurer of any other sources of contractual or employment revenue the agent may have. Such sources would be reviewed for potential conflict of interest to the insurer.

The legal and ethical responsibility lie entirely with loyalty to the insurer and any attempt to sell a competitor's product would be a violation of both ethics and possibly the law.

INDEPENDENT AGENTS

Independent Agents are independent businessmen who typically represent a number of companies and are compensated on a commission basis. The insurance client belongs to the agent and is controlled by the agent upon an agent's termination of a business relationship with an insurer.

An independent agent can switch a client to another insurer with the client's permission, as long as; the switch does not harm the client.

Ethical issues arise when the agent does not "shop" the policy for the client in order to obtain the best price or terms for the client.

Because an independent agent is "quota" and "commission" driven much temptation in the area of ethics confront him and her on an everyday basis. Although the agent represents the insurer, every attempt must be made to serve the client in an ethical manner.

The agent must comply with the guidelines of Dual Agency to avoid possible conflict.

The rules of Dual Agency require, that an independent agent represent the client during the process of helping the client select the insurance plan best suited the client's needs, and represent the insurer in the application process, underwriting, record- keeping, and claims settlement processes.

- Payment of compensation in the form of commissions or fees
- Employment in return for meeting production responsibilities.
- Indemnification or reimbursement for damages or expenses incurred in defending claims for which the agent may be liable.

Legally, a broker acts as an agent and representative of the applicant. However, when an insurer gives a policy for delivery to an insured, the broker becomes the agent for the insurer. Should payment of a premium be involved, payment to the broker is considered payment to the insurer.

Although, the broker technically represents the client, the ethical and fiduciary standards that apply to an agent, also apply to a broker.

Employing sound ethics principles permits producers to serve both the insurer and client without creating a conflict of interest.

RESPONSIBILITIES TO CONSUMERS & CLIENTS

PROVIDING APPROPRIATE PRODUCTS

Agents fulfill their ethical responsibilities to their insurers' by providing the appropriate Products to meet their consumers' needs, as well as, quality service. Making sure that the consumer understands both the products and underwriting process is a critical responsibility of the agent.

The area of property casualty insurance covers fire insurance, marine insurance, casualty insurance, and multiple-line insurance. Fidelity and surety bonds also come under this category.

The umbrella insurance policy is used in this line of insurance to extend limits or expand coverage over the basic insurance policy. Agents in the property casualty field are usually limited agents or general agents.

A general agent can usually bind for the companies they represent, whereas a limited agent has reduced authority and usually cannot bind policies. Selling to the needs of the client is critical in maintaining integrity and ethical behavior.

The insurance agent can serve the needs of the prospect by providing the prospect with the types of policies that best fit his or her needs, in the amounts he or she can afford. In order to accomplish these goals, the agent should:

- Obtain the required knowledge and skills to accomplish the needed objectives.
- Constantly update this knowledge and skill through continuing education.
- Educate the prospect or policy owner about the products and plans being recommended by the agent.

In servicing the client, the agent should make the client aware of possible shortcomings of the basic policy and let the client know of the possible need for umbrella insurance.

Additionally, the agent should be committed to, not only selling the product, but to quality service both before, during and after the sale.

This means:

- Educating the prospect about insurance products and the underwriting process
- Treating all information obtained with confidentiality
- Disclosing all necessary information so that both the insurer and the prospect can make an informed decision
- Keeping the prospect informed through out his application
- Showing loyalty to prospects, clients and insurer

SERVICE BEGINS WITH THE APPLICATION.

It is the agent's duty to:

- See to it that the application is completed both accurately and completely
- To properly explain why required information is necessary
- How the information will be evaluated by the underwriter
- A prospect should be informed that failure to disclose information could result in denial of claims or policy cancellation
- It should be explained that a binder provides temporary protection while the policy is being underwritten and is not a guarantee that the policy will be issued

The agent or broker is responsible for service before and after the sale, which includes:

- Maintaining accurate client records
- Maintaining complete and accurate records of all business transactions
- Knowledge of new coverage and products
- Availability and changes in products offered in the marketplace
- Assistance with claims processing
- Reviewing clients' existing policies
- Suggestions on updating coverage on existing policies

Ethically an agent or broker must respect the confidential information provided by the client and must assist the client in the following areas:

- ✓ Selecting the most appropriate policy
- ✓ Understanding the basic features of the policy
- ✓ Evaluating the costs and features of similar plans

Ethical standards must be used in evaluating risk management. Risk management is the process of decision making that protects assets and income against accidental or unintended loss by identifying, measuring, controlling and treating the elements that contribute to the risk.

RISK MANAGEMENT

Two basic risk management rules are:

- The size of the potential loss must be within the scope of the resources available to the insurer.
- The possible benefit must exceed the costs of the potential loss.

The risk manager, agent or broker should:

- Identify and measure the loss exposures and hazard.
- Determine the amount of money available to pay for the potential loss; and
- Identify various risk management techniques to deal with potential losses.

RISK MANAGEMENT TECHNIQUES

Risk management techniques include:

Avoidance-averting a loss by refusing to take part in something that could cause a loss

Transfer- shifting risk to another entity through a contract or hold-harmless agreement

Loss control - reducing the frequency or probability of loss through loss prevention or lowering the severity of loss through loss reduction

Retention - holding part of the risk through deductibles or all of the risk through self-insurance

Insurance – transferring risk to an insurance company

RESPONSIBILITIES TO THE GENERAL PUBLIC

FAIR AND HONEST INFORMATION

Because unethical behavior by agents and brokers can affect the whole industry, the integrity and professionalism of their conduct is of utmost concern to all.

The public's perception of the insurance industry is gagged by the behavior of both insurance agents and brokers and their commitment to professionalism is the key to the public's trust of the industry.

Insurance is something that is used by many, but yet, many are unaware of how insurance works and benefits them.

The ethical agent has a duty to provide the consumer with fair and honest information of the policies and services he or she has to offer.

STATE AND FEDERAL REGULATIONS

The Insurance Industry is regulated by both the state and federal governments with the state departments of insurance issuing rules and regulations, licensing insurers, agents and brokers, suggesting laws to legislators, examining insurers' financial operations, approving policy forms and overseeing marketing practices.

The federal government is responsible for programs to cover things that commercial insurers are unable or unwilling to provide insurance. Such programs include flood insurance, Fair plans, federal crime insurance and crop insurance.

Each state has its own Department of Insurance or regulatory authority. This authority normally oversees the licensing of insurers, brokers and agents; issues rules and regulations; examines insurance company and educational providers records; approves forms and rates; and oversees the marketing of insurance products.

ORGANIZATIONAL CODES OF ETHICS

So that agents and brokers can provide accurate and knowledgeable information to the consumer, many industry organizations exist that provide guidelines and information to their memberships.

Such organizations include the Insurance Institute of America, and the American Institute for Property and Liability Underwriters.

A code of ethics is employed by the industry to guide corporations, agents and brokers. These Codes emphasize a high level of professional competence and service to the general public. One of the most prominent of these codes is the Independent Insurance Agent's Code of Ethics.

Insurance producers continuously face complex issues dealing with skill, competence, and levels of knowledge required of professionals.

RATINGS

Ethical pressures have brought down a review of ratings by sex and have fostered a unisex rating system for both casualty and life and health products.

REBATING

Much controversy exists around the subject of rebating to the consumer by the agent, broker, or insurer. Both ethical and legal issues surround this very controversial topic. Some states strictly prohibit rebating, while others have set up guidelines that must be followed if rebates are to occur. Where it is permitted some of the following guidelines serve as perimeters:

- ✓ The rebate has to be available to all insured's in the same actuarial class
- ✓ The rebate must be in accordance with a rebating schedule filed by the agent with the insurer issuing the policy
- ✓ The rebating schedule **MUST** be uniformly applied so that all insured's that purchase the same policy through that agent for the same amount of insurance receive the same rebate percentage
- ✓ Rebates shall not be given to an insured that purchases a policy from an insurer that prohibits its agents from rebating commissions

- ✓ The rebate schedule is prominently displayed in public view at the agent's place of business and a free copy is available to insured's on request
- ✓ The age, sex, place of residence, race, nationality, ethnic origin, marital status, occupation or the location of the risk is not used in determining the percentage of the rebate or whether a rebate will be available

Although these guidelines are not universal, they are presented here as examples of what might be expected in a rebating situation and are currently being used in some parts of the country in states that permit rebating.

REDLINING

Ethical standards and law forbid the practice of redlining. Redlining is the process of excluding certain geographic areas from insurance coverage strictly on the basis of location. The Fair Housing Act forbids this practice in any form.

Professional conduct often dictates that the client's needs be put ahead of the agent's needs, be dedicated to the insurance industry and offer quality plans from quality insurance companies. The agent should develop high ethical standards, adhere to integrity and serve the interests of the client.

The public's perception of the activities of an individual agent or broker shapes the perception of the industry as a whole. Skill, competence, professionalism and moral integrity shape public perceptions.

THE ENFORCEMENT OF ETHICS & THE LAW

MC CARRON FERGUSON ACT

Each state regulates the ethical conduct of insurance producers by creating rules, regulations and legislation to protect the consumer.

In 1945 the U.S. Congress enacted Public Law 15, better known as the McCarran-Ferguson Act, which clarified the roles of state and federal government in the regulation of the insurance industry.

The "Act" gave the federal government the authority to regulate insurance in the area of fair labor practices and antitrust. The states were left with the power of all other regulatory matters.

States through an Insurance Commissioner or Director oversee the marketing activities of agents and regulate the Insurance industry.

State insurance Commissioners or Directors are voluntary members of the NAIC. A national organization created to bring uniformity and communication amongst states on important insurance issues and regulations.

NAIC

The National Association of Insurance Commissioners (NAIC) proposes model legislation to encourage uniformity in state insurance laws and regulations, assist officials in administering laws and regulations, help protect the interest of policy owners, and preserve state regulation of insurance. The NAIC has created guidelines that serve as a model in most states in regulating advertising of products and services.

Most states have laws that protect consumers against unfair trade practices such as: misrepresentation and/or false advertising, coercion, improper placement, or rebating. All insurance advertisement must be truthful and not misleading in fact or implication. Words or phrases that are clear only through familiarity with insurance terminology cannot be used.

All information is required to be disclosed (exceptions, limitations of benefits and exclusions from coverage) and must be printed conspicuously next to the statements to which the information relates and displayed in such prominence that it is not minimized, confusing or misleading. Deceptive words, phrases or illustrations may not be used to describe a policy, its benefits, the losses to be covered or premiums payable.

Testimonials must be genuine, represent the current opinion of the author, be applicable to the policy advertised and be accurately reproduced. Disparaging remarks or statements about another insurer, agency or agent of another insure their products and services may not be used in any advertisement. The identity of the insurer must be clear in all advertisements, as well as the name, address and phone number of the agent placing the advertisement. Violations can result in fines, license suspension and revocation.

Because both agents and brokers are fiduciaries, client funds handled by these individuals must be segregated and held in PFTA (Premium Trust Fund Accounts) until properly delivered to the insurer.

The deposit into this account must be made with direction from the insurer and although a separate account is not required for each insurer, proper bookkeeping segregating one transaction from another must be maintained for audit. An agent or

broker cannot mix trust funds from the PFTA account with business or personal funds. The violation of this rule is termed as "commingling" and is subject to punitive action.

Much like FDIC for banks, a State Guaranty Fund has been established which provides a means for paying part of an insured's losses if his or her property casualty insurer becomes insolvent.

Unfair marketing practices are both unethical, a violation of state law and punishable by suspension, revocation, and fines.

COMMON MISREPRESENTATIONS

The most common violations in the area of misrepresentations are:

Defamation - spreading rumors or falsehoods about a competitor

Coercion or Intimidation - leading an individual to believe that a policy must be purchased from a certain agent, broker, or insurer

Misrepresentations - making false or inaccurate comparisons or statements

Twisting - persuading a policy owner to change policies without regard to the harm that would come to the policy owner

Replacement - the switching of a policy without proper disclosures and a full understanding by the policy owner

Rebating - the payment of part of the agent's commission to the buyer of the policy, either in violation of state law or without proper procedure in states where rebating is permitted

States also prohibit unfair claims methods and practices such as:

- Misrepresenting policy provisions to claimants or insured's.
- Failing to deliver a determination on a claim within a reasonable time.
- Failing to settle claims promptly and fairly.
- Attempting to settle a claim for less than could be reasonably expected.
- Engaging in activities that result in a disproportionate number of complaints.
- Failing to provide necessary claims forms.
- Compelling policyholders to go to court to recover amounts due them by attempting to make unreasonable settlement claims.
- Insurers are prohibited from engaging in underwriting or rating that is based on race, religion, and national origin or redlined areas.

In most states the punishment for unethical practices ranges from fines to license suspension and revocation. Once a license is revoked, normally a one-year waiting period is required for re-application. And in most states a bond will also be required.

People who set high personal and professional goals of honesty, integrity, loyalty, fairness and truthfulness will never have to deal with the penalties set by state governing bodies.

PROFESSIONAL CODE OF ETHICS

Independent Insurance Agents of America believe in the insurance business and its future, and that the independent insurance agent is the instrument through which insurance reaches its maximum benefit to society and attains its most effective distribution.

I will do my part to uphold and build the Independent Agency System, which has developed insurance to its present fundamental place in the economic fabric of our nation. To my fellow members of the Independent Insurance Agents of America, I pledge myself always to support right principles and oppose bad practices in the business.

I believe that these three have their distinct rights in our business: first, the Public second, the Insurance Companies, and third the Independent Insurance Agents, and that the rights of the Public are paramount.

To the public

I regard the insurance business as an honorable occupation and believe that it affords me a distinct opportunity to serve society.

I will strive to render the full measure of service that would be expected from an Independent Insurance Agent.

I will analyze the insurance needs of my clients, and to the best of my ability, recommend the coverage to suit those needs.

I will endeavor to provide the public with a better understanding of insurance.

I will work with the national, state, and local authorities to heighten safety and reduce loss in my community.

I will take an active part in the recognized civic, charitable, and philanthropic movements, which contribute, to the public good of my community.

To the companies

I will respect the authority vested in me to act on their behalf.

I will use care in the selection of risky, and do my utmost to merit the confidence of my companies by providing them with the fullest creditable information for effective underwriting, nor will withhold information that may be detrimental to my companies' sound risk taking.

I will expect my companies to give to me the same fair treatment that I give to them.

To fellow members

I pledge myself to maintain friendly relations with other agencies in my community. I will compete with them on an honorable and fair basis; make no false statements, or any misrepresentation or emission of facts.

I will adhere to a strict observance of all insurance laws relative to the conduct of my business.

I will work with my fellow Independent Insurance Agents for the betterment of the insurance business.

Realizing that only by unselfish service can the insurance industry have the public confidence it merits, I will at all times seek to elevate the standards of my occupation by governing all my business and community relations in accordance with the provisions of this Code and by inspiring others to do likewise.

American Institute for Chartered Property and Casualty Underwriters

Code of Professional Ethics Canons and Rules

Canon 1

CPCU's Should Endeavor at All Times to Place the Public Interest Above Their Own.

Rules of Professional Conduct

R1.1 A CPCU has a duty to understand and abide by all Rules of conduct, which are prescribed in the Code of Professional Ethics of the American Institute.

R 1.2 A CPCU shall not advocate, sanction, participate in, cause to be accomplished, otherwise carry out through another, or condone any act, which the CPCU is prohibited from performing by the Rules of this Code.

Canon 2

CPCU's Should Seek Continually to Maintain and Improve Their Professional Knowledge, Skills, and Competence.

Rules of Professional Conduct

R2.1 A CPCU shall keep informed on those technical matters that are essential to the maintenance of the CPCU's professional competence in insurance, risk management, or related fields.

Canon 3

CPCU's Should Obey All Laws and Regulations, and Should Avoid Any Conduct or Activity Which Would Cause Unjust Harm to Others.

Rules of Professional Conduct

- R3.1 In the conduct of business or professional activities, a CPCU shall not engage in any act or omission of a dishonest, deceitful, or fraudulent nature.
- R3.2 A CPCU shall not allow the pursuit of financial gain or other personal benefit to interfere with the exercise of sound professional judgment and skills.
- R3.3 A CPCU will be subject to disciplinary action for the violation of any law or regulation, to the extent that such violation suggests the likelihood of professional misconduct in the future.

Canon 4

CPCU's Should Be Diligent in the Performance of Their Occupational Duties and Should Continually Strive to Improve the Functioning of the Insurance Mechanism.

Rules of Professional Conduct

- R4.1 A CPCU shall competently and consistently discharge his or her occupational duties.
- R4.2 A CPCU shall support efforts to effect such improvements in claims settlement, contract design, investment, marketing, pricing, reinsurance, safety engineering, underwriting, and other insurance operations as will both inure to the benefit of the public and improve the overall efficiency with which the insurance mechanism functions.

Canon 5

CPCU's Should Assist in Maintaining and Raising Professional Standards in the Insurance Business.

Rules of Professional Conduct

- R5.1 A CPCU shall support personnel policies and practices which will attract qualified individuals to the insurance business, provide them with ample and equal opportunities for advancement, and encourage them to aspire to the highest levels of professional competence and achievement.
- R5.2 A CPCU shall encourage and assist qualified individuals who wish to pursue CPCU or other studies, which will enhance their professional competence.
- R5.3 A CPCU shall support the development, improvement, and enforcement of such laws, regulations, and codes as will foster competence and ethical conduct on the part of all insurance practitioners and inure to the benefit of the public.
- R5.4 A CPCU shall not withhold information or assistance officially requested by appropriate regulatory authorities that are investigating or prosecuting any alleged violation of the laws or regulations governing the qualifications or conduct of insurance practitioners.

Canon 6

CPCU's Should Strive to Establish and Maintain Dignified and Honorable Relationships with Those Whom They Serve, with Fellow Insurance Practitioners, and with Members of Other Professions.

Rules of Professional Conduct

- R6.1 A CPCU shall keep informed on the legal limitations imposed upon the scope of his or her professional activities.
- R6.2 A CPCU shall not disclose to another persona any confidential information entrusted to, or obtained by, the CPCU in the course of the CPCU's business or professional activities, unless a disclosure of such information is required by

law or is made to a person who necessarily must have the information in order to discharge legitimate occupational or professional duties.

R6.3 In rendering or proposing to render professional services for others, a CPCU shall not knowingly misrepresent or conceal any limitations on the CPCU's ability to provide the quantity or quality of professional services required by the circumstances.

Canon 7

CPCU's Should Assist in Improving the Public Understanding of Insurance and Risk Management.

Rules of Professional Conduct

R7.1 A CPCU shall support efforts to provide members of the public with objective information concerning their risk management and insurance needs, and the products, services, and techniques, which are available to meet their needs.

R7.2 A CPCU shall not misrepresent the benefits, costs, or limitations of any risk management technique or any product or service of an insurer.

Canon 8

CPCU's Should Honor the Integrity and Respect the Limitations Placed upon the Use of the CPCU Designation.

Rules of Professional Conduct

R8.1 A CPCU shall use the CPCU designation and the CPCU key only in accordance with the relevant GUIDELINES promulgated by the American Institute. R8.2 A CPCU shall not attribute to the mere possession of the designation depth or scope of knowledge, skills, and professional capabilities greater than those demonstrated by successful completion of the CPCU program.

R8.3 A CPCU shall not make unfair comparisons between a person who holds the CPCU designation and one who does not.

R8.4 A CPCU shall not write, speak, or act in such a way as to lead another reasonably to believe the CPCU is officially representing the American Institute, unless the CPCU has been duly authorized to do so by the American Institute.

Canon 9

CPCU's Should Assist in Maintaining the Integrity of the Code of Professional Ethics.

Rules of Professional Conduct

R9.1 A CPCU shall not initiate or support the CPCU candidacy of any individual known by the CPCU to engage in business practices, which violate the ethical standards, prescribed by this Code.

R9.2 A CPCU possessing unprivileged information concerning an alleged violation of this Code shall, upon request, reveal such information to the tribunal or other authority empowered by the American Institute to investigate or act upon the alleged violation.

R9.3 A CPCU shall report promptly to the American Institute any information concerning the use of the CPCU designation by an unauthorized person.

Focus Points

- o Agency is the relationship between two parties where one gives authority to another to perform legal acts on his/her behalf.
- o Under agency, the acts of the agent are the acts of the principal.
- o Individuals whose responsibilities involve a high degree of trust are known as fiduciaries.

- o Fiduciary responsibility is harnessed under agency.
- o The two fundamental principals of an agency relationship are power and authority.
- o Appointment is an agreement between the insurer and the agent outlining duties the agent may perform on behalf of the principal.
- o The three types of agency authority are expressed, implied and apparent.
- o Expressed authority limits agent's authority to the definitions in his agency agreement.
- o Implied Authority allows an agent to perform incidental actions that go along with the authority vested by virtue of the Expressed Authority.
- o Insurance agents have a fiduciary relationship with the insurer.
- o Captive Agents have different ethical responsibilities than Independent Agents.
- o Captive Agents work solely for one insurer through an exclusive contract.
- o When a captive agent leaves a company all accounts remain with the insurer.
- o A captive agent owes all of their allegiances to the insurer.
- o Independent Agents are independent agents who typically represent a number of companies.
- o Independent Agents work on a commission basis.
- o When an Independent Agent leaves a company, his/her clients go with him/her.
- o Although the agent represents the insurer, every attempt must be made to serve the client first.
- o The agent must comply with the guidelines of Dual Agency to avoid possible conflict.
- o Sound ethical principles permit producers to serve both the insurer and client.
- o Agents fulfill their ethical responsibilities by providing the appropriate products their consumers' need.
- o Ensuring the consumer understands the products and underwriting process is the responsibility of the agent.
- o The agent's responsibility to the client begins with the application.
- o The agent or broker is responsible for service before and after the sale.
- o Avoidance, transfer, loss control, retention and insurance are Risk Management techniques.
- o Public perception of the insurance industry is gagged by the behavior of agents and brokers.
- o Both the state and federal government regulate the Insurance Industry.
- o Each state has it's own Department of Insurance or regulatory authority.
- o Ethical standards and law forbid the practice of redlining.
- o Excluding certain geographic areas from insurance coverage is called "Redlining".
- o The Fair Housing Act makes "redlining" illegal.
- o The McCarran-Ferguson act clarifies the roles of federal and state government in regulating the insurance industry.
- o The federal government only regulates insurance in the area of fair labor and anti-trust.
- o Unfair marketing practices are unethical and a violation of state law.