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TABLE OF CONTENTS

PART ONE

WATERCRAFT INSURANCE

CHAPTER ONE

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.

An example 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:

1. Direct loss to,

    A. Watercraft.

    B. Trailers.

    C. Furnishings.

    D. Equipment.
    E. Outboard motors

……from windstorm or hail is covered ONLY if the property is inside a fully enclosed building.

2. Theft of,

   A. Watercraft.

   B. Trailers.

   C. Furnishings.

   D. Equipment.

   E. Outboard motors

…away from the resident premises is specifically excluded.

3. Watercraft and other boating property are covered only for a limited number of named perils.

4. Coverage on,

   A. Watercraft.

   B. Trailers.

   C. Furnishings.

   D. Equipment.

   E. 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 loss exposures such as:

1. A water-skier is injured because of excessive speed.
2. Speedboat swamps another boat causing it to turn.

3. A boat runs into swimmers and seriously injures them.

4. A boat collides with a dock causing property damage.

5. Two boats collide injuring the occupants.

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

1. Owned watercraft regardless of size with inboard or inboard/outboard motor power.

2. Rented watercraft with an inboard or inboard/outboard motor power with more than 50 horsepower.

3. An owned or rented sailing vessel that is more than 26 feet in length.

4. Watercraft powered by one or more outboard motors with more than 25 horsepower if the motor's 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.

CHAPTER TWO

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:

  A. Hull.

  B. Motor or Motors.

  C. Boat Equipment.

  D. Boat Accessories.

  E. Boat Carrier.

  F. Boat Trailer.

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

  A. $25.00.

  B. $50.00.

  C. $100.00.

  D. Or more.

COVERED PERILS

The floater can be written on a named peril 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:

A. Bodily injury.

B. Loss of life.

C. 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 common exclusions are as follows:

1. Business pursuits. No coverage will be afforded if the boat is used as a public conveyance for carrying passengers for compensation.

2. No coverage will be provided if the boat is rented to others.

3. Coverage is excluded for race boats or speed contests.

4. Repair or service. Loss or damage from:

   A. Refinishing.

   B. Renovating.

   C. 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.

CHAPTER THREE

WATERCRAFT PACKAGE POLICIES

Many insurance companies have developed a special boat owner's policy that combines the following:

1. Liability.
2. Physical Damage.
3. Medical Payments.

Boat owner policies contain certain common characteristics, which are:

Physical Damage Coverage.

Currently most boat owner 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.
- Trailer.

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.
- 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.
- Watersports' 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).
- Loss Covered under Worker's Compensation.
- Losses by a Nuclear Energy Liability Policy.
- Contractual Liability.
- Injury to an Employee if the Employee's Work involves Operation or Maintenance of the Watercraft.

CHAPTER FOUR

PERSONAL YACHT INSURANCE

This type of policy is for larger boats such as inboard motorboats and cabin cruisers. Personal Yacht insurance provides the following coverage:

- Hull Insurance.
- Protection and Indemnity Insurance.
- Optional Coverage.
- Warranties.

HULL INSURANCE

This protection refers to physical damage on the boat. This coverage also applies to:

- Sails.
- Tackle.
- Machinery.
- Furniture.
- The Boat.

This insurance provides "all-risks" protection. For example if the boat is damaged by:

- High winds.
- Heavy seas.
- Collision.

- Flood.
- 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.
- Liability of the insured to maritime workers injured in the course of employment.
- Boat trailer insurance.
- Land transportation insurance.
- 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.

CHAPTER FIVE

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.

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.*

PART TWO

UMBRELLA INSURANCE

CHAPTER ONE

SOME BASIC QUESTIONS AND THEIR ANSWERS

Why would I need an umbrella policy?

There are many situations where a standard liability policy is simply not enough coverage. An umbrella policy allows you to protect yourself against major lawsuits in two ways. First, the umbrella provides excess liability over underlying coverage. Second, the umbrella provides liability coverage that may be excluded by homeowners or auto policies.

Just what is a personal umbrella policy?

Often times referred to as a personal catastrophe policy, a personal umbrella policy, supplements the basic personal liability coverage provided under homeowners and auto policies. The umbrella was created to protect people from large losses.

What special protection is afforded by an umbrella policy?

Personal injury losses that may be limited or excluded under most homeowner's policies will receive broader coverage under an umbrella policy. As a rule, personal injury does not have a uniform definition; however, just about all umbrellas will refer to personal injury to include bodily injury. Most policies also include in their definition of personal injury:

> *Mental anguish, false arrests, wrongful eviction, wrongful detention, malicious prosecution, invasion of privacy, assault and battery, slander, libel and defamation of character.*

Are there differences in personal umbrella policies?

There is no standard personal umbrella policy. The insurance coverage, as well as the exclusions, will vary by company. It is important that you compare the costs against the coverage the policy provides. In some cases, it is more important to know what is excluded from coverage. Additionally, you need to know what coverage and limits are required on the underlying homeowners and auto policies.

Explain how the policy works.

Generally, an umbrella policy pays all of the covered loss that exceeds the limits of the base or underlying policy. If, for example, the basic policy paid $200,000 on a slip and fall injury and the claim was for $250,000, the umbrella would cover the $50,000 over the basic policy's $200,000 limit.

Is there a deductible?

Usually umbrella liability policies have two types of deductibles. These are also referred to as retained limits. Depending on the loss, one of them pays first before the umbrella pays. If the loss is covered by the underlying policy, that policy pays first up to its maximum limit and then the umbrella policy kicks in. Another consideration is that a loss may occur and is covered by the personal umbrella but not by an underlying policy. In this case, the insured must meet a deductible that is referred as the SIR, which stands for Self-Insured Retention. For example, a $1 million umbrella usually has a $250 SIR that the insured must pay before the umbrella kicks in.

Other exclusions in an umbrella policy.

- Typically, the umbrella policy will exclude losses that are better covered under other policies. Although there are differences, most umbrellas will not cover the following: Obligations under workers' compensation or similar laws.

- If a domestic employee is injured, coverage is afforded under workers' compensation and will not be duplicated under the umbrella policy.

- Damage to property owned by you. This precludes any coverage for property damage best insured under some form of property (homeowners) or inland marine (jewelry floater) insurance.

- Damage to property on which you have agreed to provide insurance. The intent is to prevent the insurance company from paying for a loss that should be insured under some form of property insurance, especially since the insured has agreed to provide coverage.

- Liability arising out of a business pursuit - unless it is covered by your homeowners or auto insurance. If your homeowners' policy covers some business pursuits (i.e., an office at home), the umbrella will also extend coverage. Some policies also provide coverage to persons who are involved in civic activities, other than a person's regular employment, that may prompt lawsuits.

- Liability arising from your rendering (or failing to render) professional services. This typically excludes malpractice, which is better covered by malpractice insurance.

- Liability arising from the ownership, maintenance or use of any aircraft. Such potentially catastrophic losses are excluded.

- Liability arising from the ownership, maintenance or use of watercraft not covered under the homeowners policy (subject to certain restrictions). The umbrella covers small boats that are typically afforded coverage under the homeowner's policy; however, large watercrafts are excluded because of the increased liability risk.

- Liability covered by a nuclear energy policy. Nuclear energy policies contain a person's insured or "omnibus" clause that encompasses virtually everyone who may be responsible for a nuclear accident, barring only the U.S. government. If a person should become involved in a nuclear incident covered by a nuclear energy policy, such a person would be covered by that policy and would not need protection under the umbrella. Therefore, coverage is excluded under the personal umbrella policy.

CHAPTER TWO

RISK MANAGEMENT

THE PROCESS OF RISK MANAGEMENT

Unfortunately, an unavoidable part of everyday life is risk. Different people handle risk in different ways. Usually your past experience or personal experiences determine how you will respond to uncertainty. Before you can determine the best way to handle a risk, you must be able to identify risk probability and severity. This is referred to as risk management. It is the process of:

1. Determining what exposures to loss exist
2. Determining the seriousness of exposures
3. Developing a way of minimizing the effect of the loss exposure.

The goal of risk management is to make the best possible arrangements ahead of time so that one will not be seriously financially affected when a loss occurs. Risk management is intended to protect income and assets against unforeseen, unintended or accidental loss. A risk manager follows five basic steps in the risk management process:

1. Identifying the loss
2. Evaluating the exposure and eliminating the severity and frequency
3. Selecting the most economical way of handling the risk
4. Formulating a risk management plan
5. Revising and monitoring the risk management plan.

Let us discuss these five steps in more detail.

IDENTIFYING LOSS EXPOSURES

Before a person can "manage" risk, he or she must first *identify* all the possibilities of loss or the loss exposures to which he or she is subject and that can be guarded against in some way. The term *loss exposure* is used to describe the property or person facing a condition in which loss is possible and unpredictable. Potential property losses include direct and indirect losses; potential liability losses are those associated with torts or, to a much lesser extent, breach of contract.

Property Loss Exposures

The individual risk manager begins the risk management process by compiling an inventory of all real and personal property that indicates the amount of property owned and its present value. *Real property* consists of land and, generally, whatever is erected or growing upon or affixed to it. The definition of real property included the earth's surface, the air above and the ground below, as well as all appurtenances to the land, including buildings, structures, fixtures, fences and improvements erected upon the land. Excluded are growing crops. The term also includes the interests, benefits and rights inherent in the ownership of real estate. *Personal property* consists of tangible, movable possessions and includes things such as furniture, jewelry, automobiles and recreational vehicles.

After the inventory is complete, the risk manager can identify the possible property loss exposures that should be addressed. The possible causes of property losses that should concern property owners are too numerous to list; however, two basic types of risk that may cause financial loss may classify these losses. These risks include:

- *direct physical damage* to property caused by perils such as fire, wind, water and other perils that may damage or destroy the property; and

- *indirect loss* that occurs following a direct loss to property by an insured peril and that included additional loss expenses for the extra cost of food, transportation and housing incurred by the insured.

Property may be damaged or destroyed by *physical perils*, such as fire, smoke, explosion, hail, etc. Deviations from expected individual conduct, such as theft, vandalism, or arson, may be termed *social perils* that cause property loss. Finally, certain *economic perils*, which occur less frequently, may result in property loss. For example, people protesting a factory layoff may cause damage to nearby property. Two or more perils, such as fire and vandalism, may be involved in a loss.

Liability Loss Exposures

The term *liability* may be used in a number of ways. Generally, the term is synonymous with moral or legal *responsibility* and involves the concept of facing a penalty when a particular responsibility is not met. In this text, we are primarily concerned with the term *legal liability*, which is defined as the condition of being bound in law to do (or not to do) something that may be enforced in the courts. The law does not recognize moral responsibility alone as legally enforceable, but people who do not meet their moral responsibility may also become legally obligated to pay for another's injuries.

Under our legal system, a person may be held responsible for causing injury to another person or damage to another's property. People are faced with the possibility of having to defend themselves against a lawsuit, even if the suit is groundless. The risk of being held financially responsible for judgments and legal defense and court costs, as well as the indirect expenditures of time, energy and money, is the greatest risk that most people face. Therefore, in addition to property loss exposures, risk managers must identify two basic types of *liability loss exposures*:

- *casualty loss* that results from perils such as robbery, burglary, vandalism or arson; and

- *liability risk* where the law of negligence is used as the basis to determine whether an individual may be held responsible for the financial cost of other people's bodily injuries or for damage to their property.

People may incur liability loss exposures in a number of ways. A person may be held legally responsible for injuries or damages that result from his or her ownership of an auto, recreational vehicle, watercraft or residence premises; from personal or business activities; from obligations assumed under a contract; from the employment of domestic workers; from libel, slander and other personal injury offenses; and from a number of other events.

Individuals may be held criminally or civilly liable, depending on the nature and form of their actions. *Criminal liability* is clearly established by statute or administrative rules. In a criminal action, a district attorney or attorney general of either the state or federal government initiates the criminal action against the accused wrongdoer. For example, a district attorney will file charges against an accused murderer. If the accused is convicted, the state or federal government imposes penalties.

On the other hand, *statutes, administrative rules and prior court decisions that outline the rights of the parties as opposed to each other establish civil liability*. One party normally brings a civil liability action against another party for the wrongs alleged. The litigants at their own expense bring these legal actions (with the court costs usually imposed on the losing party). The sources of civil liability are classified as those arising from:

- contractual or similar agreements;

- *torts*, which are acts or omissions other than breach of contract;

- *equitable actions* such as fraud, errors or mistakes;

- actions that do not fall into the first three categories.

Remedies based on contractual agreements and tort actions seek monetary damages; those based on equitable actions usually seek some other remedy, such as performance of a contract.

EVALUATING LOSS EXPOSURES

In the second step of the risk management process, the risk manager must evaluate the loss exposures and decide which risks are intolerable, which are difficult to tolerate and which are tolerable. *Intolerable risks* are those that are so large that a loss from one might cause a person's bankruptcy. These risks typically include liability risk and the risk of the destruction of a home because of a natural disaster. *Difficult to tolerate risks* is those that would cause the individual a significant financial loss but that would not lead to bankruptcy.

An example would be the destruction of an automobile. Finally, *tolerable risks* include loss or damage to personal property that might be large but are not intolerable in terms of the individual's finances. An example would be replacement of a broken windshield.

Having identified the risks, the risk manager then estimates both the maximum possible loss and the maximum probable loss the property owner faces. These two estimates are useful in determining the best way or ways to handle a loss exposure. The *maximum possible loss* is the worst loss that could *possibly* happen, while the *maximum probable loss* is the worst loss that is *likely* to happen. For example, it is possible for a house located in Arizona to be completely destroyed by flood; however, it is unlikely that such a loss will occur. Therefore, if a house is not located in a flood area, it is usually unnecessary (and sometimes impossible) for the insured to purchase flood insurance.

After the risks have been classified in this way, the risk manager then evaluates the frequency and severity of each loss. *Frequency* is a measure of how often a particular event has occurred; *severity* is a measure of the damage caused by each incident. For example, counting the number of times a person's dog has bitten a neighbor is a frequency measurement, but calculating the medical and legal costs of those bites is a severity measurement. After this step has been completed, the risk manager can decide how to effectively deal with his or her property and liability loss exposures.

SELECTING THE BEST WAY TO HANDLE RISK

The risk manager may select one or more risk management techniques to handle the risks he or she has identified. These techniques include avoidance, retention, loss control, non-insurance transfer and insurance. When considering which of the risk management techniques to implement, the risk manager should remember three general, practical rules of risk management:

- The size of the potential loss must relate favorably to the resources of the one who must bear the loss.

- The possible benefits of taking a risk must be reasonably related to the possible costs.

- The amount of potential loss can usually be reduced or prevented through effective loss control programs.

The risk manager must determine whether it is best to reduce, eliminate or transfer the risk. Let us look at how these general rules of risk management apply when selecting a risk management technique.

First, selecting a technique begins by using information gathered in the second step of the risk management process. The risk manager has approximated the total loss from one event, or *occurrence*, and has estimated how often a particular loss is likely to occur (*loss frequency*) and how much could be lost if a certain event should occur (*loss severity*). For example, if a homeowner is estimating the potential loss frequency and severity of a fire, the following losses are possible:

1. direct fire and smoke damage to the house and its contents;

2. indirect damage in the form of burn injuries to a visitor in the house;

3. damage to neighboring property if the fire spreads; and

4. Loss of use of the property because the fire damage makes it necessary for the homeowner to move to another location, at least temporarily.

The risk manager should determine the probability and possibility of each type of loss, as well as the loss frequency and severity of those losses.

Second, the risk manager must determine the amount of money that will be available to meet the potential loss. Obviously, this amount will vary widely by individual. To find out how much a person is worth in dollars and cents, he or she should complete a personal balance sheet. This is a financial inventory of all personal *assets* (that which is owned) and liabilities (that which is owed). The difference between assets and liabilities is a person's *net worth*.

The balance sheet provides people with a record of their financial progress and can help them with a future savings and investment program. By determining net worth on an annual or semiannual basis, people can see whether their net worth is increasing, decreasing or remaining the same, and if they are keeping pace with the rate of inflation. They can also determine what portion of their assets could easily be converted into cash if they experienced a property or liability loss and needed cash to pay for the loss.

Finally, the benefits and costs of any available alternative method of handling the risk in certain situations must be considered. In many cases, insurance is the answer; however, other risk management techniques, such as loss prevention or self-insurance, may also be viable options under various circumstances.

IMPLEMENTING A RISK MANAGEMENT PLAN

The fourth step of the risk management process is executing the plan that the risk manager has devised. Insurance coverage, which is the focal point of most individual plans, is usually purchased. The risk manager's objective is to purchase policies that will provide the most comprehensive coverage at the most reasonable cost. Insurance contracts will be one of three types:

- *primary* insurance required by law (e.g., automobile liability insurance) or by contract (e.g., homeowners insurance required under a mortgage contract);

- *desirable* insurance that provides protection against losses that could financially harm an individual but that would not completely destroy his or her savings (e.g., physical damage insurance protects against damage to the insured's auto); and

- *catastrophic* insurance that provides protection against losses that could financially destroy an individual (e.g., flood, earthquake and personal umbrella liability insurance provide protection against devastating losses).

The risk manager selects limits of liability that adequately cover the risk's probable maximum loss, as well as reasonable deductibles that help to reduce the annual premium for insurance coverage. Because some of the risks faced by the individual may not be insurable, these risks must be handled in some other way. For example, war risk is not covered by insurance so individuals must retain that risk. In other words, if property is damaged or destroyed by an act of war, property owners must pay for the loss themselves.

MONITORING THE PLAN

The final step in the risk management process involves a well-planned program for monitoring and updating the original plan. This consists of regularly identifying any changes in the risk manager's loss exposures, net worth, ability to personally bear financial losses and so forth. All of these are very important considerations for individuals. Risk management as a process grew out of businesses' insurance management, but insurance is hardly the sole method of treating risk. As noted earlier, there are various alternative methods available. For example, as a person's net worth increases, he or she needs more insurance to protect the possible financial costs of losses to that property, the loss of use of that property and additional expenses that could arise from such losses. Or, on the other hand, increased wealth might mean that a person would feel comfortable retaining more losses and may, therefore, take a larger deductible to reduce the cost of his or her insurance premiums.

When an insurance agent participates in the risk management process with a client, he or she assumes important responsibilities. The client looks to the agent as a professional who can provide sound advice and, when necessary, can work with other experts in applying the principles of risk management. When insurance protection is necessary for transferring a risk, the agent will be expected to propose a practical and effective insurance plan that provides proper coverage in the correct amounts to offer adequate protection at the most reasonable cost.

PRIMARY INSURANCE POLICIES

The average person selects insurance, with some retention in the form of a deductible, as his or her primary risk management technique. Most people will purchase homeowners and/or a personal auto policy to cover their loss exposures. The policies are referred to as *primary, basic* or *underlying* insurance policies. Although various homeowners and personal automobile forms are in use, most follow a format similar to the programs developed by the Insurance Services Office (ISO). When we refer to any personal insurance coverage in this text, we will be referring to the standard ISO forms.

Handling Liability Loss Exposures

We will primarily be concerned with liability losses in this text. Most people handle the risk of legal liability arising out of their personal acts with *personal liability insurance*. Because liability losses involve a third party, the insurance company or the courts must make a determination of fault. In the event of a lawsuit involving bodily injury or property damage to another person, the insurance company will provide a legal defense and will pay those sums the insured is legally obligated to pay, up to the limits of the policy. *Bodily injury* refers to bodily harm, sickness or disease, including injury that results in death. Coverage also applies for any required care or loss of services of anyone whose bodily injury is negligently caused by the insured. For example, at common law, a husband may be entitled to monetary compensation if his wife is injured in an accident and unable to provide certain duties owed her husband under the marriage contract. These duties are collectively call *consortium* and the spouse may be compensated for *lack of consortium*. Additional coverage called *property damage* coverage applies to damage to or destruction of tangible property, including the loss of such property.

Personal liability insurance may be purchased as a separate policy or, more commonly, it is provided as part of a package policy, either an auto or a homeowner's package. Because this liability coverage is quite similar, we will primarily discuss the homeowner's liability coverage. The liability section of the homeowner's policy protects the insured in at least two ways:

1. If a claim is made or a lawsuit is brought against an insured, the policy will pay for damages for which the insured is found legally liable, up to the

policy's limit of liability, typically $100,000 per occurrence. Higher limits may be obtained for an additional premium. Typically, coverage will apply for claims arising out of the ownership or use of the insured location; personal activities, such as sports or social activities on or away from the insured premises; and actions of a residence employee, such as a cook, maid, nanny or baby sitter, in the course of employment.

2. In addition to the limits of liability, the insurance company must defend any claim or lawsuit that is brought against the insured for bodily injury or property damage - even if the claim is false, baseless or groundless. In come cases, the policy specifies that the insurer's obligation to settle or defend claims ends when the amount the insurer pays for legal defense equals the policy's limits of liability. As a practical matter and to avoid expensive litigation, most personal liability lawsuits are settled out of court.

As mentioned earlier, individuals who own or operate automobiles may purchase liability protection in the form of an automobile policy. The Personal Auto Policy, for example, includes Part A - Liability Coverage, which provides protection against economic loss to an insured for "bodily injury" or "property damage" that arises out of the operation, maintenance or use of an insured automobile. Under this policy section, the insurance company makes two promises to the insured:

1. to pay damages on behalf of the insured for which he or she becomes legally responsible because of an accident; and

2. to settle or defend any claims under the policy, up to the policy's limit of liability.

It is important to note that the insurer has no duty to defend lawsuits or to settle any claims that are not covered under a particular insurance policy. For example, an insurer who provides automobile or homeowners insurance is not required to defend an insured who is sued by a neighbor for intentionally using a motor vehicle to damage the neighbor's lawn because intentional damage is not covered.

Handling Personal Injury Liability

The personal liability provided that under the ISO homeowner's policy specifically covers two types of liability:

- bodily injury, meaning bodily harm, sickness or disease, including required care, loss of services and death that results; and

- property damage, meaning physical injury to, destruction of or loss of use of tangible property.

The policy does not mention coverage for personal injury losses meaning any injury to another's person, rights or reputation, including torts such as libel, slander or invasion of privacy. Many insurers contend that they did not intend to provide coverage for personal injury liability under a standard homeowner's policy and coverage is often denied on that basis.

When coverage is not provided by the homeowners policy itself, a personal injury endorsement may be added to the policy to provide coverage for certain offenses committed during the policy period. The ISO personal injury endorsement does not provide coverage for liability:

1. arising out of disputes between insured;
2. from contracts not related to the premises;
3. from the injured person's employment by the insured;
4. involving a violation of a penal law;
5. arising out of business pursuits; or
6. arising out of civic or public activities performed for pay. Personal injury liability protection may also be extended by a personal umbrella liability policy.

THE STRUCTURE OF PRIMARY POLICIES

Property-casualty policies usually contain the same policy elements, regardless of what type of property or liability coverage they provide. Each policy begins with a Declarations page that contains information found on the client's application for insurance and any information that is unique to that particular policy. A Declarations page usually contains the name and mailing address of the insured(s), the name of the insurance company providing coverage, the policy number, the inception date and expiration date of the policy, the dollar amount of the applicable policy limits and deductibles, the numbers and edition dates of any forms and endorsements and the premium.

Policies usually contain a separate Definitions section that explains the meaning of certain words that are used in the insurance contract. The defined words may appear in boldface type, italics or within quotation marks. For instance, this section often explains that throughout the policy the named insured is referred to as "you," "your" and "yours" and the insurance company is referred to as "we," "us" and "our." If a word is not defined in the Definitions section or in the body of the policy, rules of contract interpretation are used to determine the meaning. For example, technical words are interpreted according to their ordinary technical meaning and legal words are assigned their usual legal meaning.

The policy's Insuring Agreements provision sets forth the insurance company's promise to pay the insured (or to pay on behalf of the insured) for a covered loss. In return for the insurer's promise the insured must pay a premium and comply with certain policy requirements, which are spelled out in a section call Conditions. The Conditions section states that the insured must, in addition to paying a specified premium, report losses promptly, cooperate with the insurer in settling a loss and avoid anything that might harm an insurer's right to recover damages from a responsible third party. If the insured fails to comply with these conditions, the insurer may be relieved of its obligation to pay for the loss or defend a lawsuit.

Policies also contain a number of coverage exclusions that restrict or eliminate insurance coverage for specified loss exposures. These exclusions appear throughout the policy as well as in a separate section call Exclusions. Finally, some policies may contain various amendments or Endorsements to the basic policy provisions. The insurance company or its duly appointed agent must issue these endorsements.

CHAPTER THREE

THE NEED AND PURPOSE OF UMBRELLAS

WHAT IS THE NEED?

People can be held legally liable to pay damages for the bodily injury or property damage caused by their negligence. The need for liability can arise as a result of a person's personal or recreational activities as well as a person's business. Some of the higher liability claims arise when insured are entertaining guests or permitting people to use their property.

Consider how a jury's desire to punish a negligent person could result in a judgment for damages in the following situations:

- A practical joke misfires and results in a lawsuit for defamation of character.
- A neighbor or guest falls on a person's property, resulting in permanent disability.
- A protective watchdog proves that his bite is even worse than his bark.
- A person's child accidentally breaks an expensive vase while at another person's house.
- A moment's inattention while driving results in a multi-car accident.
- A spark from burning leaves starts a fire that inadvertently burns a neighbor's roof.
- A letter to the editor triggers a libel suit.

At this point, it is important to make a distinction between two terms frequently used in liability suits: coverage and liability.

The word coverage refers to the contractual obligation imposed on the insurance company that agrees to indemnify the insured for sums he or she becomes legally responsible to pay as damages. Liability refers to the legal responsibility of the policyholder to other persons arising out of an occurrence. In some cases, a particular peril will not be covered by the policy and the insurance company is under no contractual obligation to indemnify the insured. For example, assume the insurer issued homeowners policy covering an insured's liability arising out of the ownership of a certain property. The insurer is under no obligation to provide coverage under that homeowner's policy for an automobile accident that occurred away from the residence premises even if the insured was at fault. In this case, there may be liability on the part of the insured, but there is no coverage provided under the policy.

On the other hand, there may be coverage under the policy but no liability on the part of the insured. For example, the Personal Auto Policy provides coverage for property damage up to the policy limits. However, if the insured vehicle is stolen and the thief uses the car to damage several lawns in the area, the insured has no liability for the damage. Even if the insured feels sorry for the neighbors and perceives some moral obligation to repair their lawns, he or she has no legal liability to do so. Likewise, the insurance company has no responsibility, either by way of settlement or as a gift, to make any payment to the neighbors. In this case, while three may be coverage under the policy, but there is no liability on the part of the insured.

Insureds should be cautioned to remember that even when there is no apparent liability on the part of the insured or available insurance coverage, the insured may still be sued and found legally responsible. In a civil case, it is possible that the plaintiff, who must establish his or her claim by a preponderance of evidence, may produce evidence that is more credible and convincing than that of the defendant's. And, if the plaintiff's case is more believable, the plaintiff will win. The settlement the plaintiff receives might be quite substantial because of three factors:

1. the public's attitude toward claims;
2. the application of the law of negligence; and
3. the jury's opinion about damage awards.

IDENTIFYING GAPS IN LIABILITY COVERAGE

Insureds routinely believe that their policies cover every possible loss exposure, but this is simply not the case. When a liability loss occurs, insured may be surprised to learn that there are serious holes, or gaps, in their insurance coverage. As stated earlier, an insurance policy covers the insured only up to its liability limits; beyond these limits, a liability insurance policy does not protect the insured.

The majority of policies covering liability for bodily injury have two limits, a limit of liability for one person and another limit (usually higher) for any single occurrence, where more than one person is involved. For example, assume an insured has a Personal Auto Policy that covers him or her up to a $300,000 liability limit for bodily injury for each accident or occurrence. If the insured is involved in an accident and is held liable for $200,000 in bodily injury damages, the auto policy will pay for those damages. However, if the insured is held liable for damages in excess of $300,000, he or she will be held personally liable for the additional damages.

The underlying personal liability insurance, in addition to paying only up to certain limits of liability, excludes certain loss exposures. For example, the liability portion of the homeowner's policy does not cover the following:

1. damage from the intentional acts of the insured;

2. damage caused by the rendering or failure to render professional services;

3. damage from acts of war;

4. damage from communicable diseases; and

5. damage arising out of business activities.

In addition, not all individuals on the insured's property or in the insured's auto are afforded coverage by the insured's primary liability insurance. Residence employees, defined as an employees of the insured whose duties are related to the maintenance or use of the residence premises, including household or domestic services, may not be covered under the liability section of the homeowners policy if the insured is required to have workers' compensation coverage in force for such employees.

The basic Personal Auto Policy excludes liability coverage for:

1. damage caused by intentional acts of an insured;

2. damage to property owned by, rented to, used by or in the care of an insured;

3. bodily injuries to employees covered under workers' compensation;

4. damages resulting from the ownership or operation of a vehicle while it is being used as a public or livery conveyance; and

5. damages incurred while a party is employed or engaged in the business of selling, repairing, servicing, storing or parking vehicles.

Finally, underlying policies generally do not provide liability coverage for unusual loss exposures or for losses that occur outside the United States. For example, the Personal Auto Policy limits coverage to accidents and losses that occur within the policy territory, meaning the United States of America, its territories or possessions; Puerto Rico; Canada; or while the auto is being transported between their ports.

PURPOSE OF UMBRELLA POLICIES

The Personal Umbrella Liability Policy was created to expand the insured's liability coverage by filling gaps in the basic liability coverage provided by underlying policies and to reduce the insured's worry, trouble and burden of facing personal litigation on his or her own. Personal umbrella liability coverage is usually sold in units of $1 million or more and may be added to a basic homeowners or auto policy that is already written by the insurance company. Many companies also write stand alone, or separate, personal umbrella policies without writing the underlying coverage. To qualify for stand-alone coverage, however, the applicant is usually required to show proof of certain underlying insurance coverage with other insurance companies. Umbrella policies provide insurance for accidents and other situations not ordinarily covered under primary insurance, subject to a deductible of between $250 and $1,000.

There is no standard personal umbrella liability policy. The policy's forms, format and coverage vary by insurer. This does not necessarily mean that because one company's policy looks more extensive that it is superior to another policy. Rather, each contract should be reviewed to determine which offers the best coverage for a particular policyholder. Regardless of which company is providing the policy, all personal umbrella policies are designed to give insured and their families two types of extra liability protection:

- They add to the liability of any homeowners, automobile or other liability policies currently in force. Most homeowner's policies provide a basic personal liability coverage of $100,000; auto policies typically contain a combined single limit of $300,000 per occurrence. An umbrella policy supplements these basic personal liability coverage. If, for example, the insured has a standard auto policy with liability limits of $300,000 and a personal umbrella policy with limits of $1 million, the insured is protected up to $1,300,000, if a covered auto accident occurs and the insured is found legally responsible.

- They are designed to cover liability exposures that other policies do not cover. The personal umbrella policy is designed to cover some of the more unusual exposures, such as personal injury claims, that an insured might face but that are typically not covered under most standard liability policies. A personal umbrella is the liability counterpart of

Difference in Conditions (DIC) insurance, a property coverage that expands insurance written on a named perils basis to an open perils basis and protects the insured against risks of direct physical loss to the insured property, subject to certain exclusions and deductibles. An umbrella contract provides (subject to a deductible) liability coverage where no other liability insurance exists, and in addition provides coverage for liability when the limit of the primary or underlying insurance has been exhausted.

SPECIAL CHARACTERISTICS OF UMBRELLA POLICIES

The insurance company that issues the umbrella policy provides additional liability coverage over the primary policies, up to the limits listed on the Declarations page of the umbrella policy, even if the same insurer does not provide the underlying insurance. The personal umbrella policy covers any number of accidents or occurrences that occur during the policy term, regardless of how many claims are presented. However, the policy restricts payment for any one accident to the limit listed in the policy (usually up to $1 million per occurrence). In other words, even though the insurer may pay for ten claims totaling $10 million during a one-year period, it will not pay more than $1 million for any one occurrence.

To limit the insurer's liability, however, many umbrella policies are beginning to offer aggregate limits, meaning a maximum dollar amount that may be paid during the policy period or during the insured's lifetime, as specified in the policy. A policy with a $10 million aggregate limit, for example, may pay several claims for $1 million each, but it will only pay out a maximum of $10 million during a given policy period.

It is important to remember that the personal umbrella is a third-party liability policy that covers only another person's claim against the insured. It does not cover damage to the insured's own property, motor vehicles, home or other valuables.

CHAPTER FOUR

THE BASIC POLICY AND COMPONENTS

PERSONAL UMBRELLA LIABILITY POLICIES

The insurance industry has developed a number of liability contracts over the years to meet the basic liability exposures of individuals and businesses. It was not until 1960, however, that a personal catastrophe liability contract (or as it is more commonly called a personal umbrella liability policy) was developed. The contract was originally aimed at insurance buyers with the idea of providing broader insurance protection for individuals, especially professionals and wealthy members of society, who were excellent targets for liability lawsuits that could result in significant claims. Today, however, it is not unusual for liability claims to exceed the basic limits of liability afforded by an average insured's homeowners or auto policy. These claims, which may result from personal activities or professional or business pursuits, are usually covered by a personal umbrella liability policy.

As we have said, there is no standard personal umbrella liability policy form or format. Each insurer develops its own policy based on its own preferences and/or the needs of its clients. Because coverage varies by insurer, it is important for the insurance producer and his or her client to examine each personal umbrella policy to make sure that it is not merely an ordinary excess liability contract. An excess policy provides only additional layers of coverage to the coverage already furnished by the underlying policy. The terms and conditions of an excess policy should be precisely the same as those of the underlying policy. A true umbrella policy, on the other hand, provides not only excess liability but also responds to claims that may be excluded in the underlying policy but are not excluded under its own form.

Personal umbrella liability insurance is intended for catastrophe-type claims; an umbrella insurer is simply not interested in covering small claims. To support this intent, personal umbrella policies that cover loss exposures that are not covered by the underlying policies are subject to deductibles commonly referred to as a retention or self-insured retention. Most insurers offer minimum deductibles of $250 but offer higher ones for additional reductions in premium. In some cases, an insurance underwriter will require a substantial deductible when a particular risk is not otherwise insurable because of some unusual exposure to loss.

In general, the purpose of a personal umbrella policy is not only to provide million dollar-plus excess limits but also to broaden basic liability protection in several ways. In most cases, the personal umbrella liability policy is intended to:

- coverage for liability assumed by the insured under certain oral or written agreements;
- cover a broad range of personal injury hazards such as libel, slander, false arrest, humiliation, defamation of character, false apply worldwide coverage (where permitted by law), without territorial restriction as is the case with most primary insurance coverage;
- provide liability coverage for the insured who uses certain non-owned automobiles, watercraft and aircraft when this coverage is excluded under Section II of the homeowners policy;
- include imprisonment, wrongful eviction, wrongful detention, malicious prosecution or invasion of privacy; and
- provide payment of defense costs when primary insurance does not apply.

To adequately protect the insured, a personal umbrella liability policy should serve three purposes:

- It should add an additional amount of liability coverage above the limits provided by the insured's homeowners, personal auto or other underlying policies.
- It should provide insurance coverage for some exposures that are not covered (or only minimally covered) by the insured's underlying policies.
- It should provide protection for the insured against certain catastrophic liability losses that might otherwise cripple the insured financially.

BASIC POLICY COMPONENT PARTS

Depending on the preferences of the insurance company, the actual format of the personal umbrella liability policy will vary among companies. In addition, the amounts and types of coverage may also vary. Regardless of how it looks or exactly what it covers, however, a personal umbrella policy will usually contain six basic components or policy provisions that outline the details of the contract between the insurer and the insured.

Declarations –

This part identifies the parties to the contract and defines who and what the policy insures and for what period of time. The premium and amount of insurance are also stated in the Declarations.

Definitions –

The contract's commonly used words and phrases are defined in this section to reduce any misunderstandings between the parties about what the insurer intends to cover.

Insuring Agreements –

An umbrella policy contains a number of promises and specific obligations assumed by the insurance company, including its duty to pay certain losses on behalf of the insured. In addition to an introductory insuring clause, there may be several additional statements within the body of the policy that must be referenced when a loss occurs to determine both the insured's and the insurer's responsibilities.

Conditions –

This policy provision describes the policy requirements with which the insured must comply before the insurer is obligated to pay.

Exclusions –

This provision specifically lists causes of loss for which the insurer does not intend to provide coverage.

Miscellaneous Provisions –

Some policy provisions, such as the insured's duties when a loss occurs, do not neatly fit into the Declarations, Definitions, Insuring Agreement, Conditions or Exclusions headings. These provisions may be grouped together as Miscellaneous Provisions.

In the following sections, we will briefly describe each of these policy components.

Declarations Page

The preliminary section of each umbrella liability policy contains a Declarations page (also called a dec page or the dec) that contains pertinent information about the insurance risk, on the basis of which the policy was issued. The insurer, which draws up the insurance contract, is expected to represent clearly the intent and terms of the policy. Therefore, the purpose of the Declarations page is to provide information about who is covered (the named insured), what is covered (the property and perils listed in the policy), when it is covered (the effective dates of coverage), where it is covered (the described location) and why it is covered (a premium has been paid) so that there is no ambiguity.

The entire policy, including any endorsements or changes to the policy, is inserted into a policy jacket that serves the same function as the covers of a book. The policy jacket keeps the Declarations page and all the policy forms in one place, thereby allowing the insured to easily find, read and review his or her insurance policy.

INSURING AGREEMENTS

Every umbrella liability policy contains an insuring clause that is a general statement of the promises the insurance company makes to the insured. In addition to this general clause, the policy often contains a number of other guarantees referred to as Insuring Agreements. These Agreements state what the company promises to do, such as agreeing to defend the insured in a liability lawsuit.

Definitions

In response to complaints from insured and the courts that the terms used in insurance policies were not clearly defined, the insurance industry developed a section called Definitions that is now contained in every insurance policy, including a personal umbrella policy. Personal umbrella liability policy definitions are not standardized. An insurer develops its own definitions and policy wording, which may later be modified by the underwriter to meet the requirements of the applicant or to adapt to unique situations presented by different underlying forms of coverage. For example, an insurance company's definition of an insured may include the person named in the Declarations page (the "named insured"), the named insured's spouse, any relatives and persons under a specified age and in the care of any of the persons previously named - if they live in the insured residence. However, another company's definition might specifically remove coverage for any person, other than the named insured, using automobiles or watercraft while engaged in an automobile or boat-related business.

Conditions

Like other insurance contracts, the umbrella policy is a conditional contract. The insured must pay the premium indicated in the Declarations and abide with certain requirements specified in the policy. The personal umbrella policy's Conditions component describes the rights and duties of both parties to the insurance contract - the insurer and insured. Conditions are provisions inserted in the contract that qualify or place limitations on the insurer's promise to pay for losses. In addition to being contained in a separate section, a policy's conditions may also be found anywhere in the contract where the insurer intends to limit coverage.

Exclusions

A personal umbrella policy does not cover every risk that the insured faces. For example, many insurers will not provide coverage for perils that they consider being uninsurable, such as war or some other potentially catastrophic event. They also intend to deny coverage under the umbrella if coverage could be better provided by another type of insurance policy or if there are extraordinarily hazardous conditions present. Finally, insurers exclude coverage for losses that are difficult to measure or for perils that are not needed by the typical insured. Therefore, the personal umbrella policy also contains an Exclusions component that specifically lists causes of loss for which there will be no coverage. The policy may place limitations on coverage or exclude certain perils or types of losses.

Typically, personal umbrella policies exclude the following types of losses:

- obligations under workers' compensation, unemployment compensation, disability benefits or similar laws;
- business pursuits, professional services and liability resulting from owned or rented aircraft and watercraft excluded under the homeowners policy;
- property damage to any property owned by the insured or in the care, custody or control of the insured;
- any act committed by or at the direction of the insured with the intent to cause personal injury or property damage; and
- personal injury or property damage for which the insured is covered under a nuclear energy liability policy.

Although these exclusions are fairly standard, additional exclusions may be listed in the policy. In some cases, the insurer allows the insured to "buy back" certain coverage, such as workers' compensation, for an additional premium. The agent should be familiar with each insurer's exclusions and be careful to point them out to his or her clients so that there will be fewer surprises if a loss occurs that is not covered under the umbrella liability policy.

MISCELLANEOUS PROVISIONS

Some umbrella policies contain provisions that cannot be strictly classified within one of the previous five policy components. These Miscellaneous Provisions might include a discussion of the insurer's production and underwriting rules, its required underlying limits or any other special company guidelines. In addition, any endorsements that add to, delete or modify the provisions in the original contract may be included in this section.

An endorsement is an attachment to an insurance policy that is used to clarify, extend or restrict coverage with regard to perils, coverage periods or premiums. It can be a standard endorsement that is used to fit a general situation or it may be worded to fit a particular situation. These special endorsements are called manuscript forms. When an endorsement is attached to a policy, the endorsement's terms normally take precedence over any conflicting wording in the policy. However, if state law requires any provisions in the policy, an endorsement cannot be used to subvert the intention of the required legislation.

For example, the law may hold a person liable for damages if he or she is found guilty of negligently operating a motor vehicle. The personal umbrella and underlying auto policies cannot be endorsed to delete liability for negligence. If endorsements are in conflict with a state regulation or law, the laws take precedent and the policy is read and interpreted as if the conflicting endorsements had not been added. In other words, the original intent and coverage are preserved.

REQUIREMENTS OF A LEGAL CONTRACT

A **contract** is an agreement entered into by two or more parties under the terms of which one or more of the parties, for a consideration, undertakes to do or to refrain from doing some specified act or acts., In order to be binding on the parties involved, a contract must meet five basic requirements:

- offer and acceptance;
- consideration;
- competent parties;
- legal purpose; and

- legal form (in some cases).

Let's briefly review each of these requirements.

OFFER AND ACCEPTANCE

A contract is in essence an enforceable promise. In order for a valid contract to exist, there must be a valid offer and an unqualified acceptance of that offer, so that the seller understands the buyer's offer and the buyer understands to what the seller has agreed. In other words, a contract begins with a **meeting of the minds.**

The general rule is that it is the applicant for insurance who makes the offer, and it is the insurance company that accepts or rejects the offer. For example, the potential insured requests insurance and fills out an application for personal umbrella insurance; the application constitutes the **offer**. The agent then **accepts** the offer on behalf of his or her company. Assuming that the other requirements for a valid contract is met, the property-casualty agent can usually bind coverage and make it effective immediately.

However, the insurer retains the right to investigate, underwrite and cancel the coverage (as described in the policy and in accordance with state law) if the risk does not meet the company's underwriting guidelines. For example, the applicant may not have disclosed several large liability losses that would have made him or her ineligible for umbrella coverage with some insurance companies. In this case, the insurance company may decline to offer coverage. In most cases, the agent cannot bind personal umbrella liability insurance.

CONSIDERATION

The second requirement of a valid contract is **consideration**, which is the value that each party gives to the other. In the case of an umbrella policy, the insured's consideration is the payment of the first premium (or the promise to pay) and his or her agreement to abide by the conditions specified in the policy. The insurance company's consideration is the promise to do certain things that are specified in the policy. This includes indemnifying the insured for covered losses and defending the insured in a liability lawsuit.

It should be noted that the values of the considerations exchanged are not always equal. When the insured purchases a policy, he or she usually pays a relatively small premium in exchange for a comparably large amount of insurance protection. For example, the annual premium for a $1 million umbrella policy might be less than $200, a decidedly unequal exchange of values if a large loss occurs. In fact, for the benefits the insured receives, a personal umbrella policy may be the best buy in insurance. This relatively inexpensive policy raises the insured's liability coverage to a million dollars or more, and protects him or her from personal responsibility for damages.

COMPETENT PARTIES

In order to be legally enforceable, a contract must be between at least two bona fide parties. A person cannot make a legally enforceable promise to himself or herself. Thus, John Doe cannot agree to sell a piece of property to himself; however, he could agree to deed the property to himself and his wife as tenants in common.

The parties involved must be legally competent in order top enter into a valid contract. Generally speaking, **competent parties** are adults (usually age 18 or 21, depending on the state) who are able to understand the terms and conditions of the contract into which they are entering. In some states, however, minors as young as 14 may enter into some contracts. For example, minors have limited ability to contract, which means that the contract of a minor is valid only if the minor does not disavow a contract entered into during his or her minority or shortly after reaching majority (usually age 18 or 21). For example, a minor possesses the limited capacity to enter into a valid contract to purchase property from an adult. Such a contract would be enforceable by the minor against the adult, but would be voidable by the minor. A **voidable contract** is an agreement that for a reason satisfactory to the courts may be set aside by one of the parties to the contract. Contracts made by minors to obtain such necessities as food, clothing or shelter, however, are not voidable by the minor and will be enforced against him or her.

Some entities are excluded parties to legally binding contracts. When a person has been adjudicated insane or is an officer of a corporation who is not authorized to execute a contract on behalf of the corporation, he or she has no capacity to contract. Lack of a capacity would also cover acts of a corporation beyond its powers as defined in the articles of incorporation.
Also considered incompetent is any person who is impaired by reason physical or mental disability, drugs, alcohol, age or any other cause to the extent that he or she lacks sufficient understanding or capacity to make or communicate responsible decisions concerning himself or herself. Therefore, insane and, in certain, intoxicated people are incapable of entering into valid contracts. An illiterate person, however, is not incompetent as long as he or she understands the nature of his or her acts.

LEGAL PURPOSE

In order to be enforceable, contracts must be made for some **legal purpose**. If the contract does not have a legitimate purpose, it would be contrary to public policy to enforce such a contract. For example, Robert may contract with another person to paint his house for a fee. Such a contract is considered legal and binding. However, Robert cannot legally contract with another person to kill his wife. Because murder-for-hire is not legal, it is not considered a valid contract and would not be enforceable in a court of law.

LEGAL FORM

Unless otherwise required by laws, oral contracts can be just as valid as written contracts. Generally, however, an insurance contract must follow a specific **legal form** and must be in writing to be enforceable. All essential terms of the contract must be complete and certain so that the entire agreement is set forth in writing and nothing material to the contract is left to be agreed upon in the future. Once the policy is issued, changes may be made by endorsement, but only if the insurer agrees to the requested changes.

CHAPTER FIVE

COMMON UMBRELLA CONDITIONS

KNOWING POLICY CONDITIONS

Insurance policies are conditional contracts that create a continuing relationship between the insured and the insurance company. In the policy's Insuring Agreement, the insurance company promises to pay on behalf of the insured those sums for which the insured is found legally responsible, to provide a defense for the insured or to furnish other services as stated in the policy. However, the insurer's promises are enforceable only if an insured peril occurs and if the insured has complied with certain conditions contained in the policy. Insureds understand that they must pay premiums in order to keep their insurance policies in force, but that is not the only thing they have to do. Additional duties are spelled out in the Conditions section of the policy.

As an insurance professional, you should review insurance policies before they are forwarded to your clients to assure that the policies have been issued as you requested. You should also discuss the policy with your client to assure that they understand what is covered and excluded. You should also be certain they are aware of their rights and obligations under their contracts so they will have fewer problems should a loss occur. We will discuss the important conditions that apply to most personal umbrella liability policies and explain how you can help your insured to understand this important part of their insurance coverage.

UNDERSTANDING POLICY CONDITIONS

All property-casualty insurance contracts are written subject to certain conditions or prerequisites. The duties of the insured are primarily listed in the Conditions section of the policy; however, other provisions that qualify the otherwise enforceable promise of the insurer may also be found elsewhere in policy forms or endorsements. As explained previously, insured should fully understand their obligations under their policies because they cannot expect the insurance company to fulfill its part of the contract unless the insured fulfills all of the required policy conditions. Failure to do so may release the insurer from its obligations.

Most of the policy's conditions have to do with such matters as loss settlements, actions required at the time of a loss, cancellation of coverage and suits against the insurer. Under most umbrella contracts, insured are obligated to report losses in a timely manner; provide any required documentation of losses to the insurer; cooperate with the insurer in investigating, negotiating and settling claims; and avoid any action that would risk the insurer's rights to recover from a responsible third party.

COMMON PERSONAL UMBRELLA CONDITIONS

Personal umbrella liability policies contain a number of conditions that describe the circumstances under which the contract is to operate. Insureds should be certain that they understand how these conditions modify, suspend or rescind the original obligations. In the Conditions section of most policies, the insurer explains that the insured must meet a number of obligations before insurance coverage will apply. For instance, the policy might state:

> *There are certain responsibilities, which you must fulfill (in addition to paying the premium) as a condition for us to provide coverage.*

Policy conditions may be classified in one of two ways:

- a condition precedent or
- a condition subsequent.

A condition precedent is a requirement or qualification that must take place before the contract exists. For example, in a contract of insurance, the insured agrees to pay the premium and the insurer agrees to provide certain insurance coverage in return. The principal duty of the insurer is to provide this coverage, but this obligation is conditioned on the insured's payment of the premium. The failure of the insured to pay the premium (condition precedent) relieves the insurance company of its principal obligation and, in fact, nullifies or voids the contract.

A condition subsequent is a requirement that must be met after the contract is in force. For example, the insured must report all accidents and potential claims to the insurer as soon as possible. A typical clause might read:

> *In case of a claim or "occurrence" that may be covered by this policy or if a "covered person" is sued in connection with an "injury" or "damage" which may be covered under this policy, the "covered person" must do the following:*
>
> 1. *Promptly notify us or our agent in writing;*
> 2. *Promptly send us copies of any notices, legal documents and any other documents that will help us with your defense;*

3. *Cooperate with us in the investigation, settlement or defense of any claim.*

Assume the insured is involved in an auto accident. The insured feels he or she was not at fault, so the insurance company is not notified of the accident until a year later when the other driver files a lawsuit. Because the insured breached the contract by not notifying the insurance company "promptly," the insurer may be relieved of its obligation to defend and indemnify the insured for that particular loss. The insured's failure to comply with this policy condition does not void the entire contract. The insurer will still respond to other losses during the policy term with the same obligation to defend and indemnify the insured provided that the insured complies with the policy's terms and conditions.

The things that an insured or other covered person must do as a condition before the insurance company will provide coverage will vary by company. Generally speaking, umbrella insurers will include conditions relating to claims notification, assignment of the policy, cancellation of coverage and legal action against the insurer.

UNDERSTANDING INSURING AGREEMENTS

You'll recall that an insurance contract is an agreement entered into by two parties, the insurance company and the insured. The contract usually begins with an insuring clause (or clauses) called **Insuring Agreements** that outlines the insurance coverage that the company promises to provide in return for the insured's promise to pay a premium and compliance with the terms of the contract. Technically, complying with these conditions is also a part of the consideration.

If a covered loss occurs but the conditions are not met by the insured, the insurer has no obligation to pay. A rather broad Insuring Agreement might read:

> *"We will provide the insurance described in this policy if you pay the premium and comply with all the terms of the policy."*

With this statement, the insurance company (one competent party) enters into a legally binding **contract** with the insured (a second competent party). Based on the insured's application for insurance (offer) and payment of a specified premium (consideration), the umbrella insurer agrees to provide coverage (acceptance) and issues a personal umbrella liability policy (legal form). In return for the insured's premium and promise to abide with the terms of the policy, the insurer agrees to assume many of the insured's liability loss exposures. The exact terms of the agreement are specified in the various policy provisions.

COVERAGE RESTRICTIONS

At first glance, Insuring Agreements like the one above might appear to cover every loss exposure. However, because it is unlikely that a company intends to provide unlimited coverage, the insurance producer should look for words or phrases in a policy's Insuring Agreements that might restrict or limit coverage. In our first example, the words **insurance described in this policy** are included to warn the reader to look for additional definitions, conditions, exclusions and miscellaneous provisions throughout the policy that will clarify exactly what the insurer intends to cover under the policy. The policy is not intended to cover every hazard an insured faces. Coverage applies **only** as described throughout the policy.

Insurance companies may include words or phrases in their Insuring Agreements that have a special meaning as used in its personal umbrella policy. This interpretation may be quite different from that normally used by the average person. As explained previously, many insurers use boldface type, italics or quotation marks throughout the policy to identify words or phrases that may be used in a special way by the insurer. An insurance producer or insured who is uncertain about what the insurer intends to cover when a loss occurs will usually find that the intended meaning of a term is explained in the Definitions section of the policy. The definitions are included to reduce confusion about what the insurer expects to cover.

For example, the following Insuring Agreements contain a number of accented words.

> *The company agrees to indemnity the "insured" for "ultimate net loss" in excess of the "retained limit" which the "insured" shall become legally obligated to pay as damages because of "personal liability."*

In this case, the insurer wishes to alert the insured that certain words, including "insured, " ultimate net loss, " " retained limit" and "personal liability," are used in a way that may be unique to this particular company. The insurance producer and the insured should use the policy's Definitions section to determine whether these terms are used in a way that is familiar to them. Let's review how most insurance companies define these highlighted terms.

INSURED

An **Insured (or covered person)** is defined under most personal umbrella policies as the person named in the Declarations, his or her spouse and any relatives living in the named insured's household. As mentioned earlier, some companies will limit coverage to relatives under a specified age or require that the named insured have custody of child or stepchild in order for coverage to apply. In many cases, any person insured under the named insured's basic or underlying policies is also covered under the personal umbrella.

ULTIMATE NET LOSS AND RETAINED LIMIT

The intent of an **ultimate net loss** provision is to limit the insurer's liability to the amount specified in the Declarations less any required retained limits, either specified underlying limits or a retained limit or self-insured retention (a form of deductible). The policy wording will usually go on to explain exactly how and when the insurer intends to make payments under the policy.

A **Retained limit** provision requires the insured to pay some portion of a covered loss before the umbrella policy pays. A retained limit is the larger of: The total of the applicable limit(s) of all required underlying insurance required by the insurer and described in the Declarations or elsewhere in the policy and any other insurance available to a covered person; or Any deductible required by the insurer or by the state in which the insurer does business.

The insured bears the risk to the extent of the uninsured amount. The retained limit or retention applies on a per loss basis to any loss covered under the umbrella policy but excluded in primary underlying policies. The retained limit does **NOT** apply when the umbrella is simply supplementing a primary policy that has exhausted its limits in the payment of a covered claim.

In other words, before the umbrella insurer makes any payment, the primary coverage must pay first or the insured must meet a specified deductible, such as $250 per occurrence. There is a common misunderstanding that there is a **GAP** or space between the primary and the umbrella coverage. No such corridor exists. In those cases where the insured has purchased the required underlying primary coverage, the protection applies right up to the top collar of the umbrella. In other words, if the insured has the required primary coverage, only that coverage and the umbrella coverage come into play. The insured is not out of pocket for any deductible.

PERSONAL LIABILITY

In most umbrella policies, the term **personal liability** means:

1. bodily injury, sickness, disease, disability, shock, mental anguish and mental injury;

2. false arrest, false imprisonment, wrongful entry or eviction, wrongful detention, malicious prosecution or humiliation; and

3. assault and battery, including death resulting therefrom. Many policies also include injury to or destruction of tangible property, including its loss of use.

To illustrate how an umbrella policy would indemnify an insured for a loss, assume an insured's umbrella policy specifies that its retained limits are the larger of either the minimum underlying comprehensive personal liability limits of $300,000 or $250. The insured's homeowner's policy has a $300,000 limit of liability. The insured is found legally responsible for covered damages of $500,000 when someone is injured. In this case, the primary coverage (the liability section of the homeowners policy) pays the first $300,000 (the retained limit) and the umbrella policy pays the remaining $200,000. There is no corridor or gap between the primary and excess coverage, and the insured pays no deductible himself or herself.

Now, assume that the insured is found legally responsible for slander in the amount of $500,000. Coverage for personal injury damages is not provided under the homeowner's policy. However, coverage is provided under the personal umbrella, up to its policy limits of $1 million. In this case, there is no underlying coverage so the insured must pay the first $250 (retained limit) before the umbrella insurer is obligated to pay the remaining balance of $499.750.

Now, assume that the insured in these examples allows the required homeowners policy to lapse and is subsequently found legally responsible for covered damages of $500,000 when someone is injured on his or her property. In this case, there is no primary liability coverage available; however, the personal umbrella insurer is NOT relieved of its obligation to pay even though the insured has failed to maintain the basic liability limits required as a condition of obtaining and maintaining personal umbrella liability coverage. Before the insurer pays, however, the insured, in essence, must take the place of the primary insurer and pay the amount that the primary insurer would have paid if the homeowner's coverage had been in force. The umbrella insurer then responds in the same way that it would of had the primary liability insurance been in force to act as the retained limit. In this case, the insured pays the first $300,000 (the retained limit before the personal umbrella insurer pays the remaining $200,000. The insured does **NOT** pay an additional $250 deductible.

EXCESS VERSUS PERSONAL UMBRELLA LIABILITY INSURANCE

Many insurance producers use the term **excess personal liability insurance** and **umbrella insurance** interchangeably. These two insurance coverages are actually quite different and should not be confused. Unlike excess liability that provides additional coverage **ONLY** if the underlying policy provides coverage for a loss exposure, a typical personal umbrella policy will respond in two ways;

- If the listed underlying insurance coverages, such as the homeowners policy or personal auto policy, are exhausted in the payment of a loss, the umbrella picks up the protection and continues payment on behalf of the insured until the personal umbrella's limit of liability is also exhausted.

- If a loss occurs that is NOT insured under the underlying policies, because of policy exclusions or for any other reason, the personal umbrella policy will often cover a loss subject to a deductible, RETAINED LIMIT or SELF-INSURED RETENTION payable by the insured.

However, the umbrella policy does NOT cover every loss, and it should be analyzed to determine any coverage exclusions.

REQUIRED UNDERLYING LIMITS

The insurer will include policy language that clearly states the types and minimum limits of liability that the insured must carry. In some policies, this provision is called MAINTENANCE OF INSURANCE OR REQUIRED UNDERLYING LIMITS. A typical provision might read:

> *The named insured agrees that as of the inception and for the duration of this policy (1) the following underlying insurance shall be maintained in force for at least the minimum primary limits stated hereafter, and (2) that such underlying insurance insures all residences occupied by the insured and all farms, watercraft and land motor vehicles owned, rented, hired or controlled by the named insured.*

As explained earlier, an umbrella insurer does not intend to provide first-dollar coverage; therefore, the insurer requires that certain primary insurance be in place to provide the first layer of liability coverage if a loss occurs. To illustrate how a claim involving and umbrella policy should be settled, assume the umbrella insurer requires underlying automobile liability insurance with split limits of 250/500/50 (or a combined single limit of $500,000) and homeowners liability coverage in the amount of $300,000 before it will insure a personal umbrella policy for $2 million. The insured purchases the required policies in the required amounts and an umbrella policy is issued. The insured is involved in an auto accident and found legally liable for the other driver's bodily injuries. Damages of $1.3 million are awarded. The insured's auto policy pays up to $500,000 for the covered accident and the umbrella policy pays the remaining $800,000.

To guarantee that the applicant is aware of its underlying insurance requirements, insurers include questions about underlying limits on their umbrella applications. In addition, when the umbrella policy is issued, the Declarations page typically includes information about the insured's primary insurance coverage. The types of loss exposures, names(s) of the insurance carrier(s), policy numbers, effective dates of coverage and limits of liability are shown. Finally, the policy will include some explanation of how a loss will be handled when the primary insurance required by the umbrella policy is in place.

FAILURE TO PROVIDE UNDERLYING LIMITS

Although the insured is expected to supply certain underlying limits, these basic policies may be unavailable at the time of a loss for a number of reasons. For example, the insured may have allowed the primary policy to lapse or it may have been canceled for nonpayment of premium. The limits of coverage may be less than required by the umbrella insurer or may have been reduced by payments of losses. The primary insurance company may have become insolvent or it may refuse to pay a claim because a covered person has not complied with the terms of the primary policy.

As stated earlier, umbrella insurers intend to pay only for damages that exceed a retained limit. Therefore, insurers, safeguard themselves by having certain coverage exclusions, which will apply if the underlying insurance is missing. For example, a policy might state:

> *If your "primary insurance" has terminated, is uncollectable, or reduced, this will not void coverages. In these cases, we will pay the same manner as though your "primary insurance" was in force, collectable and with required limits, and you had fully complied with all conditions or agreements.*

This provision explains the insurer's intention for provide defense, investigation, legal fees, court costs or any similar fees or costs. However, the insured becomes PERSONALLY RESPONSIBLE for the amounts of coverage that would have been in effect if the policies had remained in force. For example, if the underlying insurance would have provided the first $300,000 of liability coverage, the insured must pay that amount BEFORE the umbrella insurer steps in. The insurer has no legal obligation until the retained limit has been met. It should be noted, however, that the umbrella insurer retains the right to enter the matter sooner and provide a defense. This could occur when the insurer sees the opportunity to quickly settle a lawsuit that could escalate if left uninvestigated or undefended.

SUMMARY

The Insuring Agreements contain the promises the insurer makes to the insured. Some umbrella policies have relatively simple Insuring Agreements. While others include a number of definitions, exclusions and conditions within their Insuring Agreements. Regardless of the policy wording, however, the Insuring Agreements provide a general description of the circumstances under which the policy becomes applicable.

In addition to Insuring Agreements, umbrella policies contain a separate section called CONDITIONS, which enumerates the duties of the parties to the contract, and in some cases, defines the terms being used. Many conditions found in an umbrella policy, such as notice of occurrence, assignment and the cooperation of the insured, are common to most property-casualty policies. Other conditions, such as maintenance of underlying insurance and appeals, are peculiar to umbrella policies.

CHAPTER SIX

RESTRICTIONS AND EXCLUSIONS

KNOWING POLICY EXCLUSIONS

The personal umbrella policy provides broader coverage than any underlying liability policy, but it is not intended to cover every risk that a person might face. Like other property and liability policies, the personal umbrella includes a number of provisions to clarify that certain perils are not to be covered. The wording of various provisions determines what is specifically excluded under the policy.

We will discuss a number of exclusions or coverage limitations that are commonly found in personal umbrella liability policies. Basically, policy exclusions are intended to prevent the insured from profiting from non-fortuitous losses, duplicate insurance coverage or unusual risks. To this end, a basic personal umbrella policy includes a number of exclusions that modify the policy's Insuring Agreements.

UNDERSTANDING POLICY RESTRICTIONS

Insurance policies contain a number of policy limitations or restrictions on specific perils, property, locations or losses for which the insurance company does not intend to provide coverage. The personal umbrella liability policy is no exception. Policy exclusions are usually listed and explained in a separate section of the policy called What Is Not Covered or Exclusions. An Exclusions section explains any exceptions to the policy's Insuring Agreements and clarifies the insurer's intentions by limiting or modifying certain aspects of coverage that the insurer plans to provide.

In theory, the policy language should clearly express an insurer's intentions as they might apply to a wide variety of loss situations. Unfortunately, the meaning of certain phrases may be debated and it is not uncommon for the courts to find that coverage applies to losses that the insurer never intended to cover when the policy was developed. In an attempt to be certain that an umbrella policy provides or limits certain coverages, an underwriter may issue an endorsement to amend, enlarge or completely eliminate coverages in the basic contract.

CHAPTER SEVEN

THE UNDERWRITING PROCESS

As part of their duties, underwriters identify and evaluate loss exposures, price the insurance product, determine policy terms and conditions, make the final risk selection and monitor and service the account. The series of steps that underwriters use to select, evaluate and approve (or reject) applicants for insurance is called the underwriting process. An underwriter who understands and observes each step in this process is likely to achieve a profitable book of business for the insurer.

IDENTIFYING AND SELECTING A RISK

The personal umbrella underwriting process begins with the identification and selection of a particular risk. In most cases, it is the property-casualty insurance producer who initially determines whether a risk will be acceptable to the company. In essence, the producer is a field underwriter for the company who often selects the umbrella risk from his or her existing book of business. The producer typically has had personal or business dealings with the applicant and may attest to his or her personal reputation, background and loss experience over a long period. In fact, the insured's long-term relationship with the insurance producer is often the primary reason that a personal umbrella policy is issued.

In many cases, the prospect for umbrella coverage will be an affluent client, although this is not a requirement for umbrella coverage. As we have stated, anyone who has loss exposures that could result in large liability claims is a candidate for personal umbrella coverage. However, the producer should be careful not to select applicants who present loss exposures greater than those assumed by the insurer in its rates or premiums. Risks should be in the good to above-average range to assure that they may be profitability underwritten.

GATHERING, ORGANIZING AND ANALYZING UNDERWRITING INFORMATION

The insured is usually asked to answer a series of questions on a detailed application for insurance. Although the producer may complete the application, the named insured is usually asked to verify the information and then sign the application. The application requests information about the risk being considered for insurance coverage, and in some cases, the completed application will be attached to and become part of the umbrella policy.

The questions on the application will vary by insurer, but most applications will ask for information in three specific categories:

- personal information about the named insured and other members of the household;
- information about real and personal property owned, leased or used by the insured that might present a liability exposure; and
- general insurance information that can be used to assist the underwriter in determining a premium to be charged for the umbrella coverage.

In the following sections, the information from these three categories will be used to show how to determine whether a risk is acceptable.

After the application has been completed and signed by the applicant, the insurance producer forwards the information to the line underwriter (usually located in the home office) who makes the final determination about whether the risk can be written and at what premium. The home office underwriter analyzes the information provided on the application and measures it against a theoretically ideal risk to judge whether the applicant is a good candidate for insurance.

Personal Information

The underwriter needs personal information about the insurance applicant to determine whether the risk presents any unwanted hazards for the company. The underwriter looks for specific warning signs of potential moral or morale hazard. For example, assume that during the ten years the insured has carried homeowners and auto insurance with a particular insurer he or she has maintained extremely low limits of liability. The applicant's sudden interest in increasing the underlying limits and obtaining an umbrella may indicate that this is a poor umbrella risk. The underwriter should question what has happened to make the applicant now interested in increased limits.
The application provides the underwriter with basic information about the individual applying for insurance (the named insured) and members of the named insured's

household. The information is used to give the underwriter a feeling for the loss exposures faced by the entire household. The application typically asks for the following details:

1. name, mailing address and residence address of the applicant;

2. marital status; age (or birth date) of the applicant and spouse, in states where such questions are permitted;

3. occupation and employer of applicant and spouse (if any);

4. information about stability factors, such as ownership of home, years at present address, previous residence address and length of time at that address; and

5. information about any liability claims made against the insured during a specified period (usually three to five years).

Such information is intended to assist the underwriter in deciding whether the applicant has any unusual exposures to loss. For example, many insurers will decline coverage for people, such as actors, professional athletes and politicians, whose professions or activities expose them to extraordinary publicity and potentially large lawsuits.

Property Loss Exposures

The personal umbrella liability application asks the applicant to describe any residence or other real property owned by the insured that could generate a liability claim. The underwriter is specifically looking for clues about the property, such as inferior construction or poor housekeeping, which might increase the chance of loss. Cause the personal umbrella typically provides coverage on a worldwide basis, the underwriter needs information about all the property at risk. The application seeks:

- information about all residences occupied by the applicant, type of interest (owned or rented), description of any other buildings on the residence premises, the number of swimming pools at each location;
- information about any farms owned or rented by the applicant, including the acreage and value of any leased property;

- information about all automobiles owned or leased by the applicant, including the type and principal operator of each, where it is garaged and the rate class used for each vehicle;

- information about watercraft owned or leased by the applicant, including manufacturer, model year, type, length, horsepower, location of operation and whether any underlying policy has restrictions on water-skiing;

- information about any aircraft owned or used by the applicant with descriptions of each aircraft and additional information about the pilot;

- a description of employer's liability or workers' compensation exposures, including number and type of domestic and/or farm employees;

- a description of all business pursuits and business properties of the applicant; and

- a description of any unusual hazards, such as dangerous animals on the premises, water-skiing activities by any member of the family, child care duties (such as baby-sitting) by any member of the family, plans to enter a race, contest or exhibition, etc.

General Insurance Information

An underwriter needs as much general information about the risk as possible to properly quote the risk. Rating is based in part on an underwriter's experience and judgment and without fairly complete knowledge of the risk, an underwriter cannot provide a competitive quotation. At the very least, an underwriter will request the following:

- The policy limits desired and the requested effective date;

- A schedule of all applicable underlying policies: automobile, homeowners, boat, recreational vehicles, aircraft, employer's liability or workers' compensation insurance (information typically includes the name of the insurer, policy number, effective dates, limits of liability and the premium per policy);

- Information about other insurance policies in force, such as those providing coverage for business pursuits or business properties (any exclusions or limitations of liability coverage must be noted on the application for the personal umbrella policy);

- Information about any previous personal umbrella insurer, including name of the insurer, policy number, effective dates and reason for changing insurers; and

- An explanation of the circumstances if any insurer has ever canceled, refused or denied renewal of a personal umbrella policy for the applicant.

ACCEPTING OR REJECTING THE RISK

Based on the personal, property and general information received on the application and an analysis of that information, the underwriter will make a decision about whether to accept or reject the risk. Many underwriters will not go to great lengths to secure information other than that on an application. They assume that if another insurer willingly provided underlying insurance, the risk should be acceptable for umbrella insurance. However, some insurance companies will write umbrella coverage only if they also write the required underlying coverage. Other insurers write stand-alone policies and do not require that they issue the underlying policies but only that the coverages are in place with some insurance company.

The underwriter determines the acceptability of a particular risk by checking it against a large number of factors known to be related to loss potential. Some underwriters feel that if a property is eligible for a homeowner’s policy under another insurer's underwriting guidelines, it is also eligible for umbrella coverage. Most underwriters would agree, however, that even though a risk is eligible for insurance coverage, it might be declined for any number of reasons. For example, the applicant may have an attractive nuisance, such as a swimming pool or a vicious dog that is not properly safeguarded. Although the primary insurer may consider this an acceptable risk, the umbrella underwriter may be concerned about the likelihood of a multimillion-dollar lawsuit if a child drowns in the insured's pool or is killed by the insured's dog. It is likely that an umbrella underwriter would decline such a risk or require additional safeguards before the umbrella policy is issued. The underwriter may also charge additional premium for certain hazardous exposures.

Most insurers refuse to issue coverage for persons who are engaged in illegal activities, who have unusual exposures to libel or slander suits, such as broadcasters and newspaper reporters, or whose activities cause them to face significant publicity, such as actors, professional athletes, public lecturers and politicians. The general feeling among insurers is that such persons offer substantial exposure to lawsuits and large liability settlements.

Pricing the Risk

One of the most important parts of a personal lines underwriter's job is to determine the proper pricing for various insurance products. The policy premium is determined by multiplying an insurance rate, the dollar amount charged per a particular amount of insurance coverage, by the amount of insurance needed. Actuaries who collect data and analyze the many factors that determine the relative hazards of different risks usually accomplish the highly technical procedure of establishing rates. The costs of establishing rates would be prohibitive if each insurance company were to maintain its own rating bureaus. A practical method of solving this problem is for groups of insurers to act together to set up a central body to promulgate proper rates. In addition, the pooling of various insurers' experience makes more accurate results possible.

Strictly speaking, no two personal umbrella risks present exactly the same hazards. Even if two applicants have identical dwellings, the structures will differ as to their contents, maintenance, and number of occupants and so forth. The applicants will have different types and numbers of automobiles, insurance requirements, loss histories, etc. Because these applicants have different loss exposures, an underwriter will use specific (or schedule) premium rates. The rate is determined by an analysis of the insured's application, which is compared in terms of the relative loss exposures against a theoretical average risk. Using a predetermined average price as a base, the risk being considered is given credit for superior elements, such as fire-resistive construction, loss control devices and high level maintenance. Risks with hazardous exposures, such as swimming pools, are often surcharged if the underwriter wishes to cover those types of risk.

ISSUING THE POLICY

After the underwriter has analyzed and priced the risk, he or she will usually forward a written premium quotation to the producer. The underwriter will note the general terms of the policy, such as the required underlying limits of liability, the amount of the self-insured retention, the proposed effective date of the policy and so forth. The producer then forwards the information to the insured that accepts or declines the quote. If the insured accepts, the underwriter proceeds with the issuance of the actual policy. In almost all cases, the producer cannot bind or issue personal umbrella liability coverage.

Although the basic coverages do not vary greatly, the policy appearance and format will be quite different. In addition, the underwriter may change the coverages and modify the basic policy by endorsement. The underwriter may wish to amend the general policy provisions to comply with the special needs of the applicant, to cover unique situations also covered by the underlying policies or to restrict certain risks that the underwriter does not wish to cover.

MONITORING THE RISK

The final step of the underwriting process is monitoring the risk throughout the policy term to confirm that the decision to write the risk was a good one. The underwriter often works with other departments, such as the accounting and claims departments, to be certain that the premiums are paid in a timely manner and that the insured's loss experience is not excessive. As part of the monitoring step, the underwriter will often follow up with the producer about three months before the umbrella's expiration date to offer a renewal policy. Although most umbrella policies are annual policies without a guaranteed renewal provision, some underwriters will send a notice of non-renewal if the company does not want to reissue the coverage. Sending a notice of non-renewal informs the producer and the insured that umbrella coverage will have to be placed with another insurer and also protects the insurer if there is some dispute about whether coverage should have been in force after a specific date. In some states, this notice may be required by statute.

PUBLISHER'S NOTE

IMPORTANT NOTICE

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