

# Property & Casualty Fundamentals (Utah)



## *Course Manual*

# Important Information

## **Course Intent**

Mountain CE, LLC does not render legal services or advice. This course is not intended as an authority on legal matters. The purpose of this course is to provide continuing education for insurance agents.

We have attempted to provide the most accurate information available. As rules, regulations, and industry practices change, some aspects of this course may become outdated. This course will be updated on a periodic basis as deemed necessary.

## **Terms of Use**

The content of this course is the sole property of Mountain CE, LLC. This course material can only be used for the purpose of obtaining continuing education credit—and cannot be duplicated, copied, or reproduced for any other purpose.

For correspondence (non-classroom) courses, you must read and study this course manual and then pass an exam to demonstrate what you have learned. For instructions on how to obtain CE credit, visit our web-site at [www.mountainCE.com](http://www.mountainCE.com).

# Table of Contents

1—Insurance Concepts & Terms.....	1
Loss.....	1
Exposure.....	1
Risk.....	1
Managing Risk with Insurance.....	1
Peril.....	2
Hazard.....	2
Legal Liability.....	2
Insurable Risk.....	3
Legal Contracts.....	4
Legal Insurance Contracts.....	4
Insurance Policies and Policy Components.....	6
2—Property & Casualty Insurance Industry.....	8
History of Insurance.....	8
Property & Casualty Insurance Defined & Compared.....	10
Types of Insurance Providers.....	10
Regulation.....	12
State Insurance Departments.....	12
National Association of Insurance Commissioners.....	13
Financial Ratings.....	14
3—Insurance Company Operations.....	15
General Operations.....	15
Marketing.....	15
Sales Management.....	16
Actuarial.....	16
Underwriting.....	17
Policy Processing.....	18
Claims.....	18
Legal.....	19
Accounting & Finance.....	19
Investments.....	19
Risk Management and Reinsurance.....	20
Brokerage.....	21
4—Agent Requirements & Responsibilities.....	22
Utah Licensing Requirements.....	22

<i>Table of Contents</i>	ii
Producer Licensing.....	22
Consultant Licensing .....	23
Adjuster Licensing .....	24
Continuing Education Requirement .....	24
Responsibilities to the Insurance Company .....	25
Authority.....	26
Conduct .....	27
5—Homeowners Insurance Policy .....	30
Organization and Terminology.....	30
Declarations .....	30
Definitions .....	31
Property Coverages .....	31
Property Perils Insured Against .....	34
Property Exclusions .....	35
Property Conditions .....	35
Liability Coverages .....	36
Liability Exclusions.....	38
Liability Conditions .....	38
General Conditions .....	38
Options and Endorsements .....	40
Homeowners Policy Forms .....	42
6—Personal Auto Insurance Policy.....	45
Organization and Terminology.....	45
Declarations .....	45
Motor Vehicle Insurance Cards .....	47
Definitions .....	47
Liability Coverage .....	48
Personal Injury Protection .....	50
Uninsured Motorist Bodily Injury .....	52
Underinsured Motorist Bodily Injury .....	53
Physical Damage Coverage.....	53
Policy Provisions.....	55
Other Optional Coverages.....	56
Personal Liability Umbrella Policy .....	57

# 1—Insurance Concepts & Terms

## Loss

A **loss** occurs when an event happens resulting in someone losing something. If lightning strikes a house and destroys it, that is a loss. If someone is involved in an auto accident but no damage is done to anyone or anything, there is no loss.

## Exposure

An **exposure** is a **condition** in which a loss may occur. Owning a home is an exposure, because it could burn down, or a guest might slip, fall, and get hurt. Owning a car is another example of an exposure, since the owner could be involved in an accident where someone could be injured or something could be damaged. Everyday activities such as participating in recreational events are also considered exposures, because someone could get injured.

## Risk

**Risk** is the **chance** that a loss will occur. As exposure increases, risk also increases. A risk must have the element of **uncertainty**. The chance of a driver having a loss due to an auto accident is a risk. If something is certain to happen, it is not a risk. For example, an event such as tires wearing out on a car after many miles of use is not a risk, because it was certain to happen.

Losses quite often result in financial consequences. People are generally aware of the **financial risk** involved in owning property. Therefore, they look for ways to **manage the risk** of financial loss. For example, a person can **eliminate risk** by selling their car. This, of course, is not a practical solution for most people. A person can **reduce risk** by driving their car less, but the remaining risk must still be managed. There are two other ways to manage risk. One way is to keep or **retain risk**. Since the risk of financial loss can be enormous when homes or cars are destroyed, many people choose to **transfer risk** to someone or something else. In many situations, the best method of transferring risk is with insurance.

## Managing Risk with Insurance

Although insurance does not eliminate or reduce risk of property or liability loss, people buy insurance to **reduce** their **risk of financial loss**. Insurance

transfers risk of property or liability loss from one party to another. With insurance, people pay premiums to an insurance company in exchange for a promise by the insurance company to pay for insurable losses they incur. It is often said that insurance insures property. From an academic point of view that is incorrect, because it's actually the property **owner** that is insured. More specifically, the property owner is insured for the **risk of financial loss**.

Insurance is based on statistics and predictions of how likely it is a particular event will happen. Insurance companies rely on the **law of large numbers** to make their predictions more reliable. Most insurance companies sell insurance to thousands—or even millions—of people. Therefore, insurance companies can predict—with reasonable accuracy—the chance of loss for a particular customer. This allows insurance companies to know how much premium must be collected to satisfy their promises.

## Peril

A **peril** is the **reason** a loss occurred. It is also known as the **cause of loss**. Risk and peril are not the same. For instance, **risk** is the **chance** a fire will destroy a house. If a house is destroyed by fire, then fire is the **peril** that caused the loss.

## Hazard

A **hazard** is something that increases the likelihood a loss will occur. The terms **hazard** and **exposure** are similar—but different. An **exposure** is a **condition** in which a loss could occur, while a **hazard increases the chance** a loss could occur. For instance, a sidewalk on a homeowner's property is an exposure. An icy sidewalk on that same property is a hazard, because it greatly increases the chance someone will slip, fall, and be injured. In other words, a hazard is something that causes an exposure to be much **greater** than it should be.

The icy sidewalk is an example of a **physical hazard**. There are two other types of hazards that are similar to each other—**moral** and **morale**. The difference between the two lies with the **intent** of the person(s) who created the hazard. A **moral hazard** is an increase in exposure resulting from intentional and corrupt action. If someone intentionally sets their car on fire so they can collect the insurance money, the loss is a result of a moral hazard. On the other hand, a **morale hazard** is the result of a careless action. For instance, smoking a cigarette in bed or driving a car with worn out tires are examples of morale hazards.

## Legal Liability

A person is **legally liable** when they commit a **tort**—which is also known as a **civil wrong**. Unlike crimes, torts are not prosecuted by the government, since they are considered private matters between two parties. Liability insurance provides protection only for **unintentional torts**—which is commonly called **negligence**. A person is negligent if all four of these conditions exist:

- **Legal duty**—humans have a duty to protect the well-being of other people and their property. There are varying degrees of legal duty. For example, a homeowner owes more duty to a person they invite to their property than a person who is trespassing.
- **Breach of duty**—this occurs when a person does not take measures to protect the well-being of other people and their property. Breach of duty could include action, as well as lack of action.
- **Proximate cause**—this means the **breach of duty** by one person directly caused damage to another person or that person's property.
- **Damage**—a person who claims to have been damaged must be able to prove he or she was damaged.

Liability insurance provides protection for insureds that are determined to be negligent, and therefore **legally liable** for causing damage to someone or something. In insurance terminology, the insured is known as the **first party**, the insurance company is the **second party**, and the claimant who suffered the damages is the **third party**. Therefore, liability insurance pays for **third party losses**.

## Insurable Risk

Insurance companies sell insurance only for risks that are **insurable**. Although the rules and regulations vary with each type of insurance, there are a set of standards that all insurable risks must meet.

Insurance can only be purchased by someone who has an **insurable interest** in the property being insured. A person has an insurable interest when they will suffer a financial loss as a result of a property or liability loss. For example, if Sam's house burns down, he will suffer a financial loss. Therefore, Sam is allowed to purchase insurance on his home, so in the event of a fire, the insurance company can reimburse him for the loss. Sam is also allowed to purchase insurance on his automobile. That's because he needs liability protection in the event he injures someone or damages someone's property while driving his car.

To be insurable, a risk must be for a **significant financial loss**. This means a loss that a reasonable person would consider a hardship. For example, the risk of losing a \$3.00 pen is not insurable. The significant financial loss must also be **calculable**. For example, it is possible to determine the value of a car. Therefore, if the car is destroyed in an accident, the loss can be calculated. Only risks that have **unexpected loss** can be insured. For example, normal wear of tires on a car is not insurable, since it is expected.

Insurance policies only cover **pure risks**. A pure risk is where the chance of loss exists, and the chance of gain does not exist. The chance that a house might be destroyed by fire is a **pure risk**. On the other hand, insurance does not cover **speculative risks**. Investments and gambling are **speculative risks**, since they involve a chance that both a gain or a loss will occur.

## Legal Contracts

Like all valid contracts, an insurance contract must have these characteristics:

- **Agreement**—one party makes an offer and the other party accepts the offer.
- **Competent parties**—both parties must be sane, cannot be under the influence of drugs or alcohol and cannot be under the age of 18.
- **Legal purpose**—it must not violate any federal, state, or local laws.
- **Consideration**—one party gives something of value to the other party who provides a promise to perform. In most insurance contracts, the insured pays money (premium) to the insurance company for an insurance contract. In return, the insurance company promises to pay the insured for losses that are covered by insurance.
- **Good faith**—the courts usually do not enforce contracts if one of parties has taken unfair advantage of another party. Both parties must be truthful and act with integrity. For instance, the courts look unkindly upon contracts that mislead or deceive people—even if no law is otherwise broken.

## Legal Insurance Contracts

For many generations our society has realized that insurance contracts need additional rules and regulations. That's primarily due to the fact that insurance is usually sold by insurance companies that have billions of dollars

in assets—and quite often purchased by individuals or organizations with comparatively few assets. Our culture recognizes that consumers would be at a huge disadvantage without the assistance of additional standards for the insurance industry. Therefore, in addition to the characteristics of legal contracts already listed, insurance contracts (policies) also have these characteristics:

- **One-sided**—the insurance company has a higher legal obligation to perform. For instance, a customer can choose to cancel their insurance policy for any reason at any time. However, an insurance company does not have the same latitude. Regarding contract cancellation, an insurance company must follow the rules imposed by the state department of insurance.
- **Contingent on unpredictable loss**—only events that cannot be predicted can be covered under an insurance contract. For example, lightning striking a house is unpredictable and is an insurable risk. On the other hand, it is predictable that asphalt shingles on a roof will need replacing after many years of use; therefore, that situation is not an insurable risk.
- **Prepared by insurance company**—the customer usually does not have a say in the provisions and wording of the insurance contract (although the customer can request and purchase optional coverages). Since the terms and conditions are determined by the insurance company, the courts usually favor the policyholder when there is any uncertainty about what the insurance contract says or does not say.
- **Indemnity**—an insured who suffers a loss that is insured by an insurance policy, should be made whole. For instance, if an insured's house is completely destroyed by fire, he or she should receive an amount that will allow a new house to be built of similar quality and value. In other words, indemnity means the insured should be put back to the same financial situation they were in before the loss occurred.
- **Conditional**—both parties must follow the conditions specified in the insurance policy. For instance, the customer must provide complete and accurate information when applying for insurance. An insured must also pay premiums to keep the policy in force. Also, if a loss occurs, the insured has an obligation to do their best to prevent further loss from occurring. On the other hand, the insurance company has obligations such as providing the policyholder with all the required legal insurance documents and notifications. The insurance company is also required to pay covered claims within a reasonable

period of time.

- **Written**—insurance contracts are in writing. According to business law, legal contracts can sometimes be oral—they do not have to be written. However, insurance contracts are written agreements to avoid any misunderstanding between the parties. Written contracts are important when settling claims: they are reviewed to determine what coverage was in place at the time of loss.

## Insurance Policies and Policy Components

An insurance contract is also known as an insurance policy. Insurance policies must follow strict standards regarding what information is included. Although there is more than one accepted method of **organizing** the policy information, most property and casualty insurance policies have five major components:

- **Declarations Page**—this component is often referred to as the **dec page** or simply the **dec**. It is prepared by the insurance company. Unlike the other policy components, it contains information specific to the insured and the risk being insured. For property and casualty policies, the declarations page usually contains the following information:
  - Policy number, policy type, and coverage types
  - Insured's name and address
  - Description and identification of the vehicle or home covered by the insurance policy along with the coverage limits; a home is usually identified by its address; an Auto policy is usually identified by its vehicle identification number (VIN) and its year, make, and model
  - Effective date and expiration date of the policy
  - Agent's name, address, and phone number
  - If the home is mortgaged, the name of the mortgagee
  - If the vehicle has a lien, the name of the lien holder
  - Optional coverages the insured has selected
  - Premium discounts the insured is receiving

- **Insuring Agreement**—this is one of the most important components of an insurance policy. It describes what losses will be covered and to what extent they will be covered. It indicates what is covered and what perils are covered. For instance, the insuring agreement of a homeowner’s policy is likely to indicate the home is insured against risk of direct physical loss—which may include perils such as wind, lightning, and fire. Likewise, the insuring agreement of an Automobile policy is likely to indicate under what conditions the policy will pay if the insured injures someone or damages something in an auto accident.
- **Definitions**—this component clarifies the meaning of the terms and jargon used in the policy. For example, it is likely to explain who is considered to be an insured and what is meant by bodily injury.
- **Exclusions**—this component spells out circumstances in which the insurance company will not pay a claim. For instance, most property and casualty insurance policies will not pay a claim if the damage or injury resulted from an intentional act by the insured.
- **Conditions**—the duties, responsibilities, and rights of both the **insured** and the **insurance company** are explained. For example, the insured has a responsibility to pay the premiums if they want to keep the policy in force. Also, in the event of a loss, insureds have a responsibility to do their best to keep further damage from occurring. In the event of a loss, the insurance company has a right to inspect the damaged property to properly assess the damages and determine the claim amount.

## 2—Property & Casualty Insurance Industry

### History of Insurance

The following article was written by Gareth Marples and is reprinted with permission from the [Zongoo.com](http://Zongoo.com) **Daily Press & Consumer Information** website:

#### **Shipping/transportation insurance—first guarantee against loss**

We look back in history at who first felt the need for a guarantee against loss, and who gave them that guarantee. Way back in Babylonian times, around 2100 B.C., the Code of Hammurabi was the first basic insurance policy. This policy was paid by the traders in the form of a loan to guarantee the safe arrival of their goods by caravan. Of course, caravans faced the same kind of perils our transportation industry faces today—like robbery, bad weather and breakdowns.

As history progressed, the needs for insurance increased. The Phoenicians and the Greeks wanted the same type of insurance with their seaborne commerce. The Romans were the first to have burial insurance—people joined burial clubs which paid funeral expenses to surviving family members. In medieval times, the guilds protected their members from loss by fire and shipwreck, paid ransoms to pirates, and provided respectable burials as well as support in times of sickness and poverty.

Then came the very first actual insurance contract, signed in Genoa in 1347. Policies were signed by individuals, either alone or in a group. They each wrote their name and the amount of risk they were willing to assume under the insurance proposal. That's where the term **underwriter** came from.

Underwriters play a big part in the insurance industry. They're the ones who calculate the risk, based on statistics, and decide what the premiums will be. In 1693, the astronomer Edmond Halley created a basis for underwriting life insurance by developing the first mortality table. He combined the statistical laws of mortality and the principle of compound interest. However, this table used the same rate for all ages. In 1756, Joseph Dodson corrected this error and made it possible to scale the premium rate to age.

By this time, the practice of insuring cargo while being shipped was

widespread throughout the maritime nations of Europe. Then in London, in 1688, the first insurance company was formed. It got its start at Lloyd's Coffee House, a place where merchants, ship-owners, and underwriters met to transact their business. Lloyd's grew into one of the first modern insurance companies, Lloyd's of London.

### **As commerce grew—so did the need for insurance**

In the 17th and 18th centuries, British commerce was rapidly growing. As commerce grew, risks increased. In a way, progress was actually working against the insurance industry—there were more and more ways of goods being damaged or lost, as goods were shipped greater distances and by more advanced methods. Therefore, there were higher payouts for claims.

The members of stock companies saw an opportunity for a profitable business here. They were chartered in the insurance business in England in 1720, and in 1735. The first American insurance company was founded in the British colony of Charleston, SC. In 1787 and 1794 respectively, the first fire insurance companies were formed in New York City and Philadelphia. The first American insurance corporation was sponsored by a church—the Presbyterian Synod of Philadelphia—for their ministers and their dependents. Then other needs for insurance were discovered and, in the 1830s, the practice of classifying risks was begun. Although there was religious prejudice against the practice of insurance by a church, after 1840 it declined and life insurance boomed.

### **Preparing for large losses**

So everybody was getting into the swing of insurance. People accepted the fact that they needed to pay premiums to protect themselves and their loved ones in case of loss, including major losses like fires. The insurance companies had a rude awakening to this fact in 1835 when the New York fire struck. The losses were unexpectedly high and they had no reserves prepared for such a situation. As a result of this, Massachusetts lead the states in 1837 by passing a law that required insurance companies to maintain such reserves. The great Chicago fire in 1871 reiterated the need for these reserves, especially in large dense cities.

Insurance companies had to work together to find a solution to the challenge of large losses. So they got together and devised a system called reinsurance whereby losses were distributed among many companies. This system is now commonly used in all types of

insurance.

## Property & Casualty Insurance Defined & Compared

**Property insurance** is insurance coverage that provides protection in the event the insured suffers a financial loss if **something owned or cared by the insured** is damaged or destroyed by an unexpected incident. Property insurance usually covers **first party** losses—as the insured is considered the first party in an insurance contract. (The insurance company is the second party, and claimants other than the insured are third party.) When people consider the meaning of Property insurance, they often think of Homeowners insurance. However, Property insurance includes much more than insurance on a home. For example, it also includes physical damage insurance on a car: if a car is damaged by hail, it is covered by the Property insurance that is provided by a Personal Auto policy.

**Casualty insurance** is insurance coverage for **liability loss** for damages to **someone else** or **someone else's property** due to an unexpected event—and caused by the insured's negligence. Therefore, Casualty insurance usually covers **third party** losses. When people consider the meaning of Casualty insurance, they often think of liability coverage to protect a driver if they strike and injure someone in a car accident. But, Casualty insurance is also present in a Homeowners insurance policy. For example, if a house guest slips, falls, and is injured on a homeowner's sidewalk, a Homeowners insurance policy can protect the insured for a liability loss.

The term **Property & Casualty** insurance is generally used to describe the protection collectively provided by Personal Auto, Homeowners, Personal Liability Umbrella, and Commercial policies. It does not include other types of insurance such as Life, Health and Disability.

## Types of Insurance Providers

A majority of property and casualty insurance providers fall into one of four categories—Lloyd's association, mutual company, stock company, and government owned. We will discuss each one in more detail.

- **Lloyd's Association**—the famous **Lloyd's of London** is actually not an insurance company. Instead it is an association of individuals and groups who agree to share insurance risks. This type of arrangement is known as a **Lloyd's association**. Its origin dates back to 1688 at the **Lloyd's Coffee Shop** in London.
- **Mutual Company**—a mutual insurance company is owned by its policyholders. In other words, it is owned by the people it serves. The

policyholders elect a board of directors—who in turn hire the top management to run the company. An advantage of the mutual organization is since there are no stockholders to answer to; the company can have a long-term focus instead of short-term. Since policyholders cannot sell their mutual ownership rights, this usually allows for more stability in the organization. A disadvantage of the mutual organization is it is unable to raise business capital by selling shares of stock. **State Farm, Nationwide, and Bear River** are examples of mutual insurance companies; they have large market shares of the property and casualty insurance business in the state of Utah.

- **Stock Company**—a stock insurance company is owned by stockholders—who may or may not be policyholders. Many stock companies own a large number of their own stock shares. This allows a company to have more control of its operations. A big advantage of a stock organization is it is able to raise additional business capital by creating and selling additional stock shares. There are some disadvantages of stock companies. Since the shares of stock companies are publicly traded, there is a tendency to please the shareholders—who often have a short-term focus instead of long-term. Stock shareholders are usually able to publicly sell their shares. Sometimes this can lead to instability for the organization. **Allstate** and **Farmers** are examples of stock insurance companies with large market shares of the property and casualty insurance business in the state of Utah.
- **Demutualization**—some mutual insurance companies have recently converted to stock companies. This process is known as **demutualization**. When this happens, the prior owners (policyholders) usually receive consideration such as cash or stock in exchange for giving up their mutual form of ownership. In the past few years several mutual insurance companies have demutualized—**Liberty Mutual, Prudential, MetLife, Provident, John Hancock, Principal, and Metropolitan**.
- **Government Programs**—in the United States, the federal and state governments participate in providing insurance programs—sometimes because particular programs cannot be underwritten by private insurance companies. Some examples of government insurance programs related to property and casualty insurance include:
  - **Flood Insurance**—the **Federal Emergency Management Agency** (FEMA) oversees the **National Flood Insurance Program** (NFIP). This program makes flood insurance available

in designated areas at a low cost. To qualify for flood insurance through this program, the property must be located in a community that has agreed to implement strategies to prevent or reduce flooding in the future. Private insurance companies are permitted to sell flood insurance under a "write-your-own" program. This program is backed by the United States government

- **Crop Insurance**—the **Risk Management Association** (RMA) is part of the **United States Department of Agriculture** (USDA) and operates the **Federal Crop Insurance Corporation** (FCIC). The FCIC promotes economic stability of the agriculture industry by providing policies for more than 100 crops. The corporation is managed by a board of directors under the supervision of the Secretary of Agriculture.
- **Workers Compensation**—in a handful of states, employers are required to purchase workers compensation insurance policies for their employees through a **monopolistic** state fund. In the other states—which are called **non-monopolistic** states—employers can purchase workers compensation insurance from the state fund (state pool) or from private insurance companies. In these states, the state pool caters to employers who are unable to purchase workers compensation insurance from private insurance companies. That's because they have a poor safety record or excessive claim history. Utah is a **non-monopolistic** state.

## Regulation

For hundreds of years, our society has recognized the importance of a stable and fair insurance industry. If the insurance industry were left unchecked, consumers could be subjected to unfair, unstable, and fraudulent practices. Therefore, insurance is a heavily regulated industry. In the United States, each state is charged with the responsibility of regulating the insurance business that is done within its border.

## State Insurance Departments

The **insurance department** of each state is responsible for protecting the interests of insurance consumers. Important objectives include allowing consumers to have a wide variety of insurance products to choose from and making sure the insurance companies remain **solvent**. (Solvent means to be financially stable.) In most states, the head insurance regulator is called a **commissioner**. In other states the title is **director** or **superintendent**.

The head insurance regulator in Utah has the title of **commissioner**.

Regarding Property and Casualty insurance, the duties of the state insurance departments include:

- Examine and approve property and casualty insurance forms and rates filed by the insurance companies
  - They check to make sure the rates filed are appropriate—not an excessive amount but enough for the company to meet its promises to its customers
  - They also ensure the forms and rates do not illegally discriminate against groups of people
- Respond to legal questions about insurance
- Regulate the licensing for insurance professionals and organizations, including initial licenses, renewal licenses, and continuing education
- Determine which insurance companies are authorized to conduct business in the state
- Analyze and verify the financial information of insurance companies; identify insurance companies who have financial difficulties and assist in rehabilitation; manage liquidation of insolvent insurance companies
- Provide assistance to consumers by handling complaints and inquiries
- Enforce compliance with insurance code and rules; conduct fraud investigations and prosecute individuals, organizations, and companies who violate insurance law; violators are subject to license suspension, license revocation, fines, or jail time

## **National Association of Insurance Commissioners**

The **National Association of Insurance Commissioners** (NAIC) is an organization consisting of the head insurance regulator from each state, including **Washington D.C.** and four **United States** territories. It was created in 1871. The NAIC's website is [www.naic.org](http://www.naic.org). Main objectives of the NAIC include:

- Promote communication and exchange of ideas between the individual state insurance regulators
- Develop uniform insurance regulations when appropriate

- Provide recommendations and expectations regarding insurance law changes in the individual states

## Financial Ratings

The financial strengths of insurance companies are rated by several organizations. Insurance companies are rated on their ability to meet ongoing obligations to both policyholders and creditors. Rating organizations include:

- **A.M. Best**—[www.ambest.com](http://www.ambest.com)
- **Moody's Investors Service**—[www.moodys.com](http://www.moodys.com)
- **Standard and Poors**—[www.standardandpoors.com](http://www.standardandpoors.com)

## 3—Insurance Company Operations

### General Operations

Like many other organizations, insurance companies have departments such as human resources, public relations, education, information systems, customer billing, and office administration. This chapter will focus on the operations that have unique functions related to insurance companies.

### Marketing

Marketing encompasses many important functions of insurance companies including advertising, sales promotion, agency development, product design and development, and distribution. Insurance companies utilize one (or a combination) of four types of **distribution systems**:

- **Direct writer**
  - Direct writers are employees who are licensed agents that sell insurance
  - They usually receive commissions in addition to their salary
- **Direct sales** (direct response)
  - Direct sales means insurance is sold by company employees who sell directly to customers via mail, phone, and/or the Internet
  - The employees who participate in the direct sales process are not considered agents, and are usually paid a salary—as opposed to commissions
- **Exclusive agency** (captive agency)
  - Insurance companies market their insurance products through agents who are independent business owners
  - Exclusive agents are not allowed to sell insurance for other insurance companies
  - Exclusive agents are paid on a commission basis; however, some insurance companies provide new agents with additional financial support while their agency is getting established

- If the exclusive agent's relationship with the insurance company is terminated, the agent forfeits all rights to the book of business (policies)
- **Independent agency**
  - Insurance companies market their insurance products through agents who are independent business owners
  - Independent agents are allowed to sell insurance for multiple insurance companies
  - Independent agents are paid a commission for the policies they sell and do not receive a salary
  - If the agency's relationship with the insurance company is terminated, the agent is able to keep the rights to his or her policies and write them with another insurance company

## Sales Management

As the name suggests, sales management is charged with managing the agents who represent the company. It must pursue and recruit new agent candidates. Once a decision is made to bring a new agent on board—and the candidate has secured an agent license with the state—sales management must appoint the new agent by submitting the necessary requirements to the state department of insurance. **Utah** administrative rule **R590-101-4** states, “All insurers shall file with the commissioner a **Certificate of Appointment** for any individual agent and organization authorized to conduct business on behalf of the insurer in this state.”

Sales management is also responsible for mentoring and directing new agents to help them be successful. This department must also examine the sales production make sure each agent is producing a high quantity and quality of business and doing a good job of retaining existing customers.

## Actuarial

The actuarial department develops and maintains pricing techniques and rating plans. Actuaries are well-trained professionals in mathematics and statistics. Their primary role is to predict, with reasonable accuracy, the probability that people of a particular risk classification will suffer a financial loss. Then keeping in mind the company is in business to make a profit, they determine the price people in that risk classification need to pay.

Actuaries ensure the company's products meet the necessary regulatory

requirements related to pricing. They also make sure the insurance company has enough funds in reserve to pay future claims and provide advice on how to invest the insurance company's assets.

## Underwriting

Underwriters analyze insurance risks. Based on the standards established by the insurance company, each risk is either accepted or rejected. Underwriting duties related to property and casualty insurance include examining the physical hazards and condition of the property—and examining the eligibility of the proposed insured based on criminal history, driving record, and prior claim history. Underwriters must be aware of **adverse selection**, which means customers with a higher-than-average risk are more likely to apply for insurance.

For most insurance companies, the job of underwriting is a balancing act. On one hand, they strive to increase their market share and policy count. That way of thinking results in lenient underwriting rules so more policies can be written. On the other hand, insurance companies are in business to make a profit. That school of thought dictates that underwriting should only accept the very best risks so losses can be minimized.

Underwriting departments have other important objectives. One is to classify the accepted risks so that the appropriate premiums can be charged. Another is to protect the company by making sure the policy application was submitted with the correct options and endorsements for that type of risk.

Proper underwriting practices and techniques have a critical role in the financial performance of an insurance company. The property & casualty insurance industry uses three standard measures to evaluate a company's financial results during a specific period of time:

- **Loss Ratio**—the percentage of premium that is paid out in claims. It is calculated by taking the amount of **incurred losses** and dividing it by the amount of **earned premiums**.

$$\text{Loss Ratio} = \text{Incurred Losses} / \text{Earned Premiums}$$

- **Expense Ratio**—the percentage of premium that is paid out in expenses (commissions, marketing, salaries, supplies, and other overhead expenses). It is calculated by taking the amount of **underwriting expenses** and dividing it by the amount of **written premiums**.

$$\text{Expense Ratio} = \text{Underwriting Expenses} / \text{Written Premiums}$$

- **Combined Ratio**—the sum of the **loss ratio** and the **expense ratio**. Historically, insurance companies have sought a combined ratio that is less than 100%, which means they have an underwriting gain.

$$\text{Combined Ratio} = \text{Loss Ratio} + \text{Expense Ratio}$$

According to the **Property Casualty Insurance Association of America's** web site—[www.pciaa.net](http://www.pciaa.net):

The net underwriting loss for all property/casualty lines in 2003 was only 1.2 percent of earned premiums, resulting in a combined ratio of 100.1, its lowest point in more than 20 years. Historical data over the last 20 years shows that property/casualty carriers have, on average, incurred \$108.10 in claim costs and other expenses for every \$100 of premiums collected. Of the \$108.10, about \$82 was for claim costs and about \$26 was for other expenses. Overall underwriting losses, expenses and dividends have totaled about \$528.2 billion during this time. Investment income helps hold down the cost of premiums for consumers and helps the property/casualty industry earn a modest return. From 1984 through 2003, the average all-lines operating result reflecting underwriting profits or losses plus investment gains was 1.8% of net earned premiums.

## Policy Processing

This area works closely with underwriting. In fact at some companies, underwriters and policy processors work together as a single unit. The responsibilities of policy processing include: application screening, rating, issuing, and assembling. Many companies have computerized systems that assist in these functions. Policy processing is also involved in servicing the policy after it has been issued. They perform maintenance tasks to satisfy insured requests to add or remove coverages and cancel the policy.

## Claims

The concept of insurance hinges on an insurance company's promise to pay a claim if certain conditions have been met. Therefore, the claims department's job is to make sure insureds and other claimants are "made whole" if they suffer a covered financial loss. When an insured reports a loss, an underwriter is assigned to investigate the loss and determine if it is a covered loss. That involves gathering information about when the loss occurred, how it occurred, where it occurred, who was involved, and what financial loss occurred. This information is then compared to the insured's policy that was in force at the time of loss to determine if the loss will be

paid.

## Legal

The legal departments of insurance companies have functions unique to the industry. For example, they must determine how the state insurance laws affect their business. They must ensure the company's insurance policies are compliant with state regulation. The legal staff also plays a crucial role in settling claims. Sometimes disputes arise between claimants and insurance companies regarding if a claim should be paid and how much should be paid to settle a claim. Attorneys represent insurance companies in negotiations and in court.

## Accounting & Finance

Insurance companies are heavily regulated by state insurance departments. Accountants and other financial experts are relied upon to make sure all the rules and regulations are followed regarding payment of agent commissions, handling of customer premium payments, standardized reporting, and reserves.

**Utah** administrative rule **R590-163** states, "All insurers domiciled in the State of **Utah** shall file quarterly statements with the **Utah** Insurance Department. The statements shall be prepared in accordance with the instructions and the accounting practices and procedures manual adopted by the National Association of Insurance Commissioners.

**Utah** administrative rule **R590-147-4** states, "All insurers shall file their annual statement with the **National Association of Insurance Commissioners** ("NAIC") on the form adopted by the NAIC. The statement shall be prepared in accordance with the latest edition of the annual statement instructions, and the accounting practices and procedures manual published by the NAIC. Annual statement filings are not complete until all supplemental schedules, exhibits and documents are filed as required by the instructions or as otherwise indicated by this rule."

**Reserve** is the term used to describe the amount of money an insurance company must have available to pay possible future claims. According to the **Property Casualty Insurance Association of America's** web site—[www.pciaa.net](http://www.pciaa.net)—as of December 31, 2003, total property & casualty industry policyholder surplus was about \$347.0 billion.

## Investments

Insurance companies have unique circumstances regarding investments. As

mentioned above, reserves must be available to pay possible future claims. Although it is prudent for insurance companies to invest their reserves so they can grow, preserving the capital is the primary investment goal. Therefore, investment experts are challenged to choose investment strategies that are safe and secure. High quality corporate bonds are often utilized by insurance companies as an investment vehicle for reserves due to their conservative nature. According to the **Property Casualty Insurance Association of America's** web site—[www.pciaa.net](http://www.pciaa.net)—in 2002 property and casualty insurers had \$1.04 trillion in assets and invested 55% of their assets in nonaffiliated bonds and 11% of their assets were invested in nonaffiliated common and preferred stocks.

## Risk Management and Reinsurance

The term **risk management** can mean different things to different people. For instance, individuals purchase insurance as a form of risk management. Insurance companies also need to manage their risk to reduce their chance of severe financial loss.

For example, suppose an insurance company sold a large number of homeowner policies with earthquake coverage in an area that is high risk for earthquakes. If a large earthquake occurred in that area, the insurance company could suffer an unusually large number of claims.

Insurance companies also need to monitor the business written by their agents. As an example, Athens Insurance Company has various rating classifications for its Auto policy based on how many miles the car is driven each year. Customers that drive more miles should pay more for their Auto insurance. Suppose a majority of the Auto applications submitted by Athens Insurance agents had a **low mileage** classification meaning the car is driven less than 7,500 miles per year. That situation would put the company at risk of financial loss, because they won't be charging the correct amount of premium for the exposure they are insuring.

Risk management experts identify situations that put the company at too much risk of financial loss. They also recommend corrective strategies.

One method of managing an insurance company's risk is through reinsurance. **Reinsurance** is insurance that is purchased by insurance companies to reduce the risk of large financial loss. For instance, the risk management experts at Edgar Insurance Company are concerned their exposure to storm losses is too high. Therefore, Edgar Insurance purchases a reinsurance policy from Rib Falls Reinsurance Company, which stipulates that Edgar Insurance is entitled to a claim payment if losses reach a specific level. The reinsurance contract allows Edgar Insurance to take on more

exposure than it otherwise could without reinsurance. The reinsurance contract described above is known as **treaty reinsurance**. Another type of reinsurance is known as **facultative reinsurance**, which provides an insurer with coverage for certain individual risks that are too large or too unusual to be covered by treaty reinsurance.

## Brokerage

Some property and casualty insurance companies have a **brokerage** department which allows their agents to sell insurance products that are not underwritten by that company. For instance, suppose Marathon Insurance is a multi-line company specializing in Auto, Home, Health, Commercial, and Life insurance. One of Marathon's agents has a customer who has already purchased six insurance policies. The customer just bought a new helicopter and would like to purchase insurance for it from the Marathon agent. Although Marathon Insurance Company does not underwrite helicopter insurance, it has a brokerage department that will act as intermediate between the customer and an insurance company that does underwrite helicopter insurance. Therefore, the customer will be able to continue to have all his or her insurance policies through the Marathon agent, and the Marathon agent will get a commission for selling the helicopter policy.

## 4—Agent Requirements & Responsibilities

### Utah Licensing Requirements

Depending upon their duties, some insurance professionals in the state of **Utah** are required to take an examination to demonstrate they have mastered a standard level of knowledge regarding the laws and rules of insurance services and products.

Once a person has passed the **examination**, he or she must fill out an **application** and send it to the **Utah Insurance Department** and pay the appropriate fee for that license. The **Utah Insurance Department** will then issue the license.

Some individuals who apply for a **Utah** insurance license are **exempt** from the examination requirements. Exempt individuals include certain types of insurance professionals who were licensed in another state and then moved to **Utah**. Also, persons who hold specific industry designations (CLU, FLMI, CPCU, ChFC, AIC) or a law degree are not required to take an examination for the line of insurance the designation or degree pertains to. If an individual is exempt from taking an exam, he or she must provide proof of exemption and also fill out the application and pay the required license fee.

An individual's license is good for **two years**. A license expires on the last day of the month two years after the licensed was effective. Licenses are renewed for successive two-year periods if the licensee meets the **continuing education** requirements and pays a renewal fee.

The **Utah Insurance Department** issues licenses to the following types of insurance professionals: producers, consultants, and adjusters.

For complete information about Utah insurance licensing requirements, visit this web site: [www.insurance.state.ut.us/LicensingProc.html](http://www.insurance.state.ut.us/LicensingProc.html).

### Producer Licensing

A **producer** is an individual appointed by an insurer to solicit, negotiate, and complete insurance transactions on behalf of the insurer.

To qualify for a **Utah Resident Producer** license, a person must: (1) be at least 18 years old; (2) be a **Utah** resident; (3) possess good character and competency; and (4) pass the license examination(s) required by insurance law (if applicable).

Before a producer can execute insurance transactions in the state of **Utah**, he or she must: (1) have a **valid** insurance license for the line of insurance being transacted; (2) have been **appointed** by an insurance company or organization that is authorized to conduct insurance business; and (3) be under **contract** with the insurance company or organization that appointed them.

If an individual possess a valid insurance license, but is not currently appointed by an insurance company or organization, his or her license remains active. However, that individual is not allowed to conduct insurance transactions.

Section 31A-23-312 of the **Utah Insurance Code** requires all licensees to notify the commissioner in writing, within 30 days, of any change of address or telephone number. The **Request Form for License Change or Certification** may be used to request this change. All correspondence from the Department is mailed to the licensee's business address on file with the department. If a PO Box is used, a street address must also be furnished.

**Producer licenses** issued by the state of **Utah** include:

- Life
- Variable Contracts
- Accident/Health
- Life and Accident/Health
- Property and Casualty
- Title
- Marketing Representative's Title
- Escrow
- Workers Compensation
- Personal Lines
- Surplus Lines

## Consultant Licensing

A **consultant** is usually a salaried individual who provides insurance information and advice.

To qualify for an insurance consultant license, a person must have worked or acted in such a way that prepared him or her to function as an insurance consultant for at least three out of the last four years at the time of the application. The preparation work or actions must be directly related to the line of insurance. An individual can apply for an insurance consultant license by contacting the **Utah Insurance Department** to attain approval and pass the required examination.

**Consultant licenses** issued by the state of **Utah** include:

- Life and Accident/Health
- Property and Casualty

## Adjuster Licensing

An **adjuster** is an individual who evaluates losses and settles insurance claims. Some adjusters are employees of the insurance companies they represent. Other adjusters are independent contractors who adjust claims for several insurance companies. There are also public adjusters: they represent policyholders and claimants and negotiate with insurance companies to get claims settled.

According to **Utah** state insurance law, a “regular salaried employee of an insurer” does not need a license to adjust losses for that insurer.

To qualify for an insurance adjuster license, an individual must meet the same qualifications as the ones needed to qualify for a **Utah Resident Producer** license.

Before an individual can apply for an insurance adjuster license, he or she must pass the required examination. However, the exam is waived for attorneys who are members of the **Utah** State Bar.

**Adjuster licenses** issued by the state of **Utah** include:

- Property and Casualty
- Accident/Health

## Continuing Education Requirement

The number of **continuing education** (CE) hours to be completed every two years, as a prerequisite to license renewal or reissuance, is 24 hours. Included in the 24 credit hours of CE must be three hours of ethics education. At least one-half of the required hours must be met through

classroom attendance. Not more than 12 hours of the required hours shall be satisfied by courses provided by insurers for whom the licensee is associated.

Insurance professionals who attend CE classes receive a certificate of completion issued by the CE class provider. Licensees must keep certificates of completion on file as proof of completion. The **Utah Insurance Department** conducts random audits of completed CE classes. If audited, a licensee must submit certificates of completion to the Department within 21 days from the date of the audit letter.

## Responsibilities to the Insurance Company

Insurance agents are expected to act on behalf of the insurance company. They are the eyes, ears, mouth, and hands of the insurance company. The process of selling insurance involves several steps. Insurance agents represent insurance companies by performing the following duties:

- **Marketing**—this includes activities such as advertising and establishing solid relationships with influential community business leaders (centers of influence).
- **Prospecting**—this means targeting and contacting specific individuals with the desire it will lead to a sale. The agent has a responsibility to the insurance company to seek customers that qualify based on the company's underwriting rules.
- **Explain and recommend coverages**—insurance agents are expected to be knowledgeable regarding insurance products so they can educate customers and answer questions that arise. They must be able to analyze the customer's exposures and provide advice to the customer regarding the type and amount of insurance coverages needed.
- **Field underwriting**—prior to submitting an application to the insurance company, an agent is expected to review the risk and determine with reasonable certainty the risk meets the insurance company's underwriting rules.
- **Gather information**—the agent is responsible for collecting all the information required by the company so the risk can be correctly underwritten and priced.
- **Quoting**—this means calculating policy premiums based on the coverages, options, limits, and deductibles—and preparing a written quotation for the prospect to review and consider.

- **Application completion**—once the prospect agrees to purchase a policy, the agent must complete a policy application and submit it to the insurance company for its review.
- **Payment processing**—agents are usually responsible for collecting and processing a payment equal to one or two months of premium at the time the policy is written—this is called a **down payment**. Thereafter, some customers prefer to make **regular payments** in the agent’s office which need to be processed by the agency. Regardless of what payment processing method is used, it is extremely important that premium payments are not **commingled** with other funds. (Commingled means mixed together.)
- **Countersigning**—some states have laws requiring the signature of a **resident agent** on an insurance policy if the policy is written in that state by a **non-resident agent**. In the past few years, several states have repealed such laws due in part to the NAIC’s desire to promote insurance industry competition and improve cross-state commerce.

## Authority

Insurance companies grant insurance agents the authority to act on their behalf. When agents exercise their authority, their actions are considered to have been performed by the insurance company. For instance, if an agent accepts a premium payment from an insured, it has the same significance as if the insured paid the money directly to the insurance company. In many sales situations agents have the authority to **bind coverage**. This means temporary insurance coverage is provided until the insurance company issues or denies the policy.

Generally, there are three types of authority that insurance agents have:

- **Express authority**—the authority that is spelled out in the written contract between the insurance company and the agent. For example, the contract may indicate the agent is authorized to sell certain insurance products in a specific geographical area.
- **Implied authority**—the authority an insurance company intends the agent to have, but is not expressed in writing. There is a need for implied authority, since it is impossible to write a contract that spells out every possible scenario that may occur. **Implied authority** is granted based on previous words or actions of the insurance company. For instance, Jane is an agent for Rietbrock Insurance Company and is expected to generate new business. She most likely has implied authority from Rietbrock Insurance Company to set up a booth at a

county fair to represent and promote Rietbrock Insurance—even though that specific action is not expressly authorized in the agent contract.

- **Apparent authority**—a legal doctrine stating that an agent has whatever authority a reasonable person would think the agent has. For example, Bill is an agent with Black Creek Insurance Company. Then, however, his contract with that company is terminated. If he continues to represent himself to the public as an agent with Black Creek Insurance, many people might buy insurance from him and pay him premiums—even though Bill has no express or implied authority to do so. Because the public still thinks Bill represents Black Creek Insurance, that company is bound by Bill's actions.

## Conduct

Agents have **fiduciary responsibilities** toward their customers. This means there is a strong relationship of trust, and agents are expected to do what is best for the customers. Insurance agents are expected to adhere to strict standards and rules of conduct required by their state insurance department. Some important topics regarding agent conduct include:

- **Misrepresentation**—simply stated, insurance agents must disclose the complete and accurate truth about insurance policies and the companies they represent. Regarding insurance contract law, an **insured** is not required to make sure what an agent says is true about an insurance policy. When disputes or lawsuits arise, the courts often rule in favor of insureds—instead of insurance agents and insurance companies. Misrepresentation can either be **unintentional negligence** or **intentional**. If it is unintentional, the misrepresentation can result in civil court penalties and also penalties and fines imposed by the state department of insurance. Unintentional misrepresentation is usually covered by the agent's errors and omissions (E&O) policy. The consequences for **intentional misrepresentation** are much more severe. It is considered fraud and can result in criminal prosecution in addition to the consequences already mentioned for **unintentional negligence**. An agent's **E&O policy** does not cover intentional acts.
- **Churning**—is the illegal practice of selling a new policy to a current or former customer with intent by the agent to make a larger commission. Many agents who receive commissions get a higher commission for selling a new business policy than for renewing an existing policy. Therefore, some agents are tempted to cancel an existing policy and then write a new policy so he or she can receive a

new business commission. Such actions are usually a detriment to an insured since policy cancellation tarnishes their policy history and makes them ineligible for longevity discounts.

- **Twisting**—is similar to churning and is also illegal. There are a few variations of twisting. A typical form of twisting is the practice of persuading a person to cancel a policy that an insured has with another company—and replacing it with a policy issued by the company the agent represents when it is not in the best interests of the insured.
- **Rebating**—is the act of giving or offering a benefit not specified in the policy with the purpose of persuading a customer to buy an insurance policy. Insurance rebating is illegal in most states including **Utah**. **Utah** administrative rule **R590-154-11** states, “A licensee may not give or offer to give any prizes, goods, ware, merchandise or item of value as an inducement to enter into any insurance or annuity contract or as an inducement to receive a quote, submit an application or in connection with any other solicitation for the sale of an insurance or annuity contract. However, anything with an acquisition cost of **\$3.00** or less shall not be considered an inducement.” (Rule **R590-154-11** does not apply to title insurers or agents. A separate rule—**R590-153**—applies to unfair inducements for title insurers or agents.) Another **Utah** administrative rule—**R590-154-12**—states, “A licensee shall not give or offer to give a premium reduction by means of commission contribution back to the insurer for any purpose, including competition, unless the reduction is for expense savings and is justified by a reasonable standard and with reasonable accuracy. The insurer's underwriting files must document the savings in order to enable the commissioner to verify compliance. This documentation must demonstrate legitimate expense savings realized by the insurer and its agent.”
- **Illegal discrimination**—some forms of discrimination are **legal** in the insurance industry. For example, it is legal in most states to charge men a higher rate than women for Auto and Life insurance. Other forms of discrimination are **illegal**. Regarding Homeowners insurance for instance, it is illegal to charge a different rate or determine eligibility based on an insured's gender, age, race, or religion.
- **Forgery**—it is criminal offense for an agent to sign someone else's signature.
- **Application alteration**—it is illegal for an agent to make a change to a policy application without the written consent of the applicant.

- **Money handling**—agent responsibilities may include collecting premium payments from customers and submitting them to the insurance company in a timely manner. Agents who collect premium payments and fail to submit them to the insurance company may be subject to criminal prosecution. Agents must also avoid mixing premium payments with their ordinary business and personal funds. Such a practice is known as **commingling funds** and is also illegal. To avoid problems, agents should have three separate checking accounts—premium, business, and personal. It is crucial that agents keep accurate records of all banking transactions and money flows.

# 5—Homeowners Insurance Policy

## Organization and Terminology

How insurance policy information is organized—and the terminology used to describe the policy components—varies by insurance company.

For example, the use of the term **insuring agreement** differs from one company to the next.

As another example, some Homeowners policies identify dwelling coverage as **Coverage A**, other structures coverage as **Coverage B**, and personal property coverage as **Coverage C**. Other policies may identify dwelling and other structures coverage as **Coverage A** and identify personal property coverage as **Coverage B**.

It is **not** the primary focus of this chapter to examine **how** each company organizes the information—**nor how** each insurance company identifies the various sections and coverage parts. Rather, the intent of this chapter is to focus on the basic fundamentals of Homeowners insurance policies.

## Declarations

Once an insured purchases a Homeowners policy, the insurance company produces a **declarations page** that is usually delivered to the insured by mail. Unlike other sections of insurance contracts, the declarations page is tailored and created specifically for the customer. A Homeowners policy declaration may contain the following information:

- **Insured**—name and mailing address of the person who is insured
- **Property Location**—address of the risk if different than the mailing address
- **Policy Period**—effective date and expiration date of the policy
- **Coverages and Limits**—coverages listed depend on what type of Homeowners policy was purchased by the insured. For Homeowners policies, coverages listed may include: dwelling, dwelling extension, personal property on premises, personal property off premises, loss of use, personal liability, and medical expense. The limit of insurance for each coverage is also listed. These limits specify the maximum amount the insurance company will pay on a claim for each coverage.

- **Loss Deductible**—amount of each covered loss the insured must pay. The insurance company pays the rest of the loss up to the policy limits.
- **Third Party Interest**—name and address of a person or business who is interested in knowing that insurance is in force for this property. The most common type of third party interest is a **mortgagee**. For example, a bank that holds the mortgage on a property wants to make sure it will get paid if the house is lost in a fire. Therefore, the insurance company may send evidence of insurance to the mortgagee each time the policy renews. For many policies, the mortgagee actually pays the annual Homeowners insurance premium by using funds collected monthly from the insured through escrow.
- **Additional Information**—policy number; name, address, and phone number of the agent who services the policy; any policy discounts granted by the company to the insured; any endorsements or options included in the purchased policy that are not specifically included in the standard policy text.

## Definitions

This section of the policy explains the meaning of terms used in the policy. Some common terms explained in the definitions section of a Homeowners policy include: **insured**, **insured location**, **property damage**, **bodily injury**, **occurrence**, and **vacant**.

## Property Coverages

The property portion of Homeowners insurance policies is usually identified as **Section I**. Section I includes five types of property coverages:

- **Dwelling**
  - This is the residence the insured lives in and the structures attached to it—including wall-to-wall carpeting, built-in appliances, plumbing, and permanently installed heating and air conditioning systems.
  - Also included are construction materials located on or next to the residence (if used to construct, alter, or repair the dwelling). Dwelling coverage does not include the land on which the residence is located.
  - The dwelling is covered for losses up to the **dwelling limit**

specified in the declarations. Most Homeowners policies provide dwelling coverage based on the **replacement cost** of the damaged building. That means the insurance company will pay out the amount needed to rebuild the damaged building—as opposed to merely paying out the **actual cash value** of the building or building portion that was damaged. To clarify, the insurance company will pay the entire replacement cost on a total loss if the insured has met the requirements of the policy. For example, some policies require that the dwelling must have 80% **coinsurance**. This means the dwelling must be insured for at least 80% of the cost to replace the dwelling. Other policies require 100% coinsurance. When a loss occurs and the insurance company determines these requirements were not met, the amount paid will be reduced.

- It is critical the dwelling limit is based on the actual replacement cost of the dwelling—not including the land. Other dwelling valuations such as **market value** and **tax assessment value** are quite often meaningless when it comes to determining the dwelling limit. **Appraised values** may be helpful, but cannot be relied upon. The best method is to use a long series of calculations that consider dozens of variables such as location, total square feet, finished square feet, number of stories, foundation shape and type, roof type and pitch, exterior type, property slope, wall height, flooring type, wall type, kitchen square feet, number of bedrooms, number of bathrooms, heating type, air conditioning type, and number of fireplaces. There are several computerized systems on the market that assist insurance professionals in calculating replacement cost.

- **Dwelling Extension**

- This is also known as **other structures** coverage. It includes structures not attached to the dwelling such as detached garages, sheds, driveways, sidewalks, fences, patios, retaining walls, and permanently installed yard fixtures. Structures used for business purposes are not covered under a Homeowners policy
- In most Homeowners policies the limit of insurance for dwelling extension is an automatic 10% of the dwelling limit. The dwelling extension limit is in addition to the dwelling limit. If the insured needs a limit more than 10%, the **other structures** option or endorsement must be purchased.

- **Personal Property**

- This is the personal belongings owned by or used by the insured anywhere in the world. If requested by the insured, the insurance company will also cover personal property owned by others.
- For personal property not included in categories having **special limits** (as identified below), personal property is covered for losses up to the personal property limit specified in the declarations. In most Homeowners policies, the personal property limit is automatically calculated based on a percentage (usually either 50% or 75%) of the dwelling limit. For personal property taken outside the United States or normally at another residence, the limit is normally 10% of the dwelling limit.
- Homeowners policies have **special limits** for certain categories of personal property. This means these items have limits that are much lower than the overall personal property limit. For instance, here are some of the categories along with their special limit as described in a “standard” Homeowners policy: money (\$200), securities (\$1000), jewelry (\$1000), theft of firearms (\$2000), silverware (\$2500), business personal property (\$2500), and electronic apparatus (\$1000). These limits can be increased by including or purchasing an option or endorsement.
- The “standard” Homeowners policy provides personal property coverage based on **actual cash value**, which is calculated as the cost to replace the damaged personal property minus **depreciation**. Many Homeowners policies include an option that provides personal property coverage based on the **replacement cost** of the damaged personal property. This means the insurance company will pay out the amount needed to replace the damaged personal property.

- **Loss of Use**

- This coverage will pay for **additional living expenses** an insured incurs when living away from the residence because of damage to the residence due to a fire or natural disaster. It covers the cost of hotel, meals, and other living expenses while the home is uninhabitable.
- The coverage limit for additional living expenses varies from

company to company. But, as a general rule the reimbursement of expenses is limited to the amount necessary for the family to maintain its normal standard of living.

- If the insured rents out part of their house, **loss of use** coverage reimburses the insured for the rent that is lost because the home is uninhabitable.
- **Loss of use** also provides coverage for situations where a **civil authority** prohibits the use of the residence due to direct damage to neighboring premises—for a period up to two weeks.

- **Additional Coverages**

- Homeowners policies include coverages such as debris removal, emergency removal of property, trees, plants, shrubs, fire department service charge, property removal, credit/debit card, forgery and counterfeit money, loss assessment, collapse, glass or safety glazing material, landlord's furnishings, grave markers, lock replacement, refrigerated foods, and outdoor antennas.
- Policies have limitations on additional coverages. For example, there is a \$500 limit on any one tree, plant, or shrub, with a limit for all trees, plants, and shrubs of not more than 5% of the dwelling limit. Trees, plants, and shrubs are not covered for loss due to wind or disease.
- The **fire department service charge** has a limit of \$500 for any one loss.
- **Inflation Protection**—this feature automatically increases the property limits to keep up with inflation. The amount of increase is determined by dividing the current year **cost index** by the cost index of the previous year.
- Some policies describe additional coverages as **supplementary coverages**.

## Property Perils Insured Against

Now that we have discussed what **things** are covered, we will explain what **causes of loss** are covered. In other words, what **event(s)** must happen before a loss will be paid.

- **Dwelling**—most Homeowners policies sold today provide **open peril** coverage on the dwelling and other structures. Open peril is also

sometimes called **special form**. Open peril means the policy provides insurance on the building for all **risks of direct physical loss** (RDPL) that are **not explicitly excluded** in the policy. For instance, fire, lightning, wind, hail, explosion, riot, aircraft, vehicles, smoke, vandalism, malicious mischief, and theft are **not** explicitly excluded in the policy. Therefore, they are covered perils. An example of a peril that is explicitly excluded is a loss caused by **vandalism and malicious mischief** if the dwelling has been vacant for more than 30 (or 60 in some policies) straight days immediately before the loss. Other examples of excluded perils are: flood, earthquake, theft in or to a dwelling that is being built, wear and tear, marring, deterioration, inherent vice, latent defect, mechanical breakdown, smog, rust, mold, wet or dry rot, settling, shrinking, bulging, expansion of pavements, patios, foundations, walls, floors, roofs or ceilings, birds, vermin, rodents, or insects, or animals owned or kept by an insured.

- **Personal Property**—many homeowner policies sold today provide for **named peril** coverage on the personal property. This means the policy provides insurance on the insured's property for only the causes of loss **explicitly listed** in the policy. For example, fire, lightning, wind, hail, explosion, riot, aircraft, vehicles, smoke, vandalism, malicious mischief, theft—and several others—are specifically listed. Therefore, these are covered perils. Any perils **not specifically listed**—such as flood, earthquake, mechanical breakdown, smog, rust, and mold—are not covered. (It is important to note that some policies provide for **open peril** coverage on the personal property.)

## Property Exclusions

The **exclusions** portion of the property section describes causes of loss in which loss caused directly or indirectly by that situation will not be covered. The exclusions apply to the five types of property coverages: dwelling, dwelling extension, personal property, loss of use, and additional coverages. Some common exclusions are loss due to: routine wear and tear, earth movement including earthquake, enforcement of law or ordinance, water damage including flood, intentional loss by caused by insured, nuclear hazard, war, power failure off premises, and the insured's failure to preserve property when a loss occurs.

## Property Conditions

The **conditions** portion of the property section describes the duties, responsibilities, and rights of both the **insured** and the **insurance company**. Some common conditions related to property coverages are:

- The insurance company will pay the amount of covered loss that is above the **deductible** amount—as specified in the declarations; insurance professionals usually recommend a property deductible of either \$500 or \$1000 to their clients
- The insured cannot **abandon** the property
- If the insured and the insurance company cannot agree on the amount of loss, either party may demand an **appraisal** of the loss
- If a loss is also covered by **other insurance**, the insurance company will only pay it's proportion of the loss
- If the insured or the insurance company **recover property** on which the insurer has made loss payment the other party must be notified
- The loss will be paid by the insurance company within 30 days of reaching an agreement with the insured
- When a loss occurs to an item that is part of a **pair or set**, the insurance company is not obligated to pay the value of the entire set

## Liability Coverages

The liability portion of Homeowners insurance policies is usually identified as **Section II**. Section II includes three types of coverages:

- **Personal Liability**
  - Covers damages the insured is **legally liable** to pay due to **bodily injury** or **property damage** caused by an occurrence covered in the policy.
  - **Bodily injury** includes bodily harm, sickness or disease, loss of services, required care, and death.
  - **Property damage** includes physical damage to or destruction of tangible property, including loss of use of this property.
  - Personal liability coverage applies to liability for bodily injury or property damage that occurs anywhere when caused by **unintentional acts** of the insured or acts of the insured's pets.
  - This coverage also applies to liability for bodily injury or property damage that arise from the **insured's locations**—**regardless** if they are directly caused by the insured's personal

activities. The insured's locations include: the premises described in the declarations, newly acquired residences in the policy period, location an insured is renting for personal use, location where an insured is temporarily residing, vacant land owned or rented by the insured, land in which the insured's residence is being built, and cemetery plots.

- Personal liability coverage also provides for **defense costs**. If a suit is brought against any insured because of bodily injury or property damage caused by a covered occurrence, the insurance company will provide legal defense at the insurance company's expense.
- A policy's personal liability **coverage limit** is specified in the declarations. For most homeowner policies, the standard personal liability limit is usually either \$100,000 or \$300,000. Most insurance professionals usually recommend at least \$300,000 to their clients.

- **Medical Expense**

- This coverage is sometimes called **medical payments to others**. The insurance company will pay the necessary medical expenses incurred within three years from the date an accident occurred that caused bodily injury to another party. In order for coverage to apply, the injured party must have sustained the injuries while the party was on the insured's location with the insured's permission. It will also be covered if the injury was sustained off the insured's location and was caused by the activities of the insured or by an animal owned by or in the care of the insured.
- Injury to the insured or residents of the insured's home are not covered. However, injury to a resident employee in the course of employment is covered.
- Unlike personal liability, with medical expense coverage the insured does not have to be **legally liable** for the injuries.
- A policy's personal liability coverage limit is specified in the declarations. For some homeowner policies, the standard medical expense limit is \$1,000. Most insurance professionals usually recommend at least \$5,000 to their clients.

- **Additional Coverages**—most Homeowners policies include coverages such as claim and defense expenses, damage to property of others,

first aid expense, and property owner loss assessments. Some policies describe these coverages as **supplementary coverages**.

## Liability Exclusions

The exclusions portion of the liability section describes causes of loss in which loss caused directly or indirectly by that situation will not be covered. The exclusions apply to both personal liability and medical expense. Some common exclusions are loss due to: intentional acts of the insured, business pursuits, rendering or failing to render professional services, aircraft ownership or use, ownership or use of motor vehicles that are subject to motor vehicle registration, ownership or use of some watercraft, war, sexual or physical abuse, transmission of communicable disease, law violation, and pollution.

## Liability Conditions

The **conditions** portion of Section II describes the duties, responsibilities, and rights of both the **insured** and the **insurance company**. Some common conditions related to Section II coverages are:

- **Bankruptcy** or **insolvency** of the insured will not relieve the insurance company of its obligations
- For any **one occurrence**, the insurance company will not pay more than the personal liability limit stated in the declarations regardless of the number of persons injured, number of claims made, or number of insureds
- To any **one person**, the insurance company will not pay more than the medical expense limit stated in the declarations
- Payment under medical expense coverage by the insurance company is **not** an admission of liability by the insured or insurance company
- If an accident or event occurs that the policy may cover, the insured must **notify** the insurance company promptly

## General Conditions

The **general conditions** portion of the Homeowners policy applies to both Sections I & II. They describe the duties, responsibilities, and rights of both the **insured** and the **insurance company**. Some common conditions related to Sections I & II include:

- Insurance on the property described in the declarations **begins** and

**ends** at 12:01 A.M Standard Time on the dates listed on the declarations; most homeowner policy periods are for **12 months**

- The insured may cancel the policy at **any time** for **any reason**
- The insurance company may cancel the policy by **notifying the insured in writing** of the cancellation date; the cancellation notice may be hand delivered or mailed to the insured
- If the insurance company decides to cancel the policy due to **non-payment of premium**, the insured must be notified at least **10 days** before the policy is cancelled
- If the policy has been in force for less than **60 days**, the insurance company can cancel the policy for **any reason**; however, the insured must be notified at least **10 days** before the policy is cancelled
- If the policy has been in force for **60 days** or more, the insurance company can cancel the policy if there was material misrepresentation, substantial change in the risk, or substantial breach of duty or warranty by the insured; in these situations, the insured must be notified at least **30 days** before the policy is cancelled
- If the policy is cancelled, any paid but **unused premium** will be refunded; the insurance company has a duty to refund the money within a reasonable time
- The policy may be continued for **successive policy periods** by payment of the premium on or before the effective date of the next policy period; if payment for the next policy period is not paid by the insured, the policy will expire at the expiration date of the prior policy period
- The insurance company is allowed to **not renew** the policy; if so, the insured must be notified at least **30 days** before the policy expiration date
- The entire policy is **void** if the insured commits fraud or intentionally misrepresents or conceals information
- If any part of the policy **conflicts with state law**, the insurance company will change that part of the policy to agree with state law
- The insurance company is allowed to **inspect the property** being insured

- The insurance company has the option of whether or not to renew the policy; if the company decides to **not renew**, the insured must be notified at least **30 days** before the policy expiration date

## Options and Endorsements

Various options and endorsement are available for Homeowners policies. This allows a customer to purchase a customized policy just for their situation. The term **option** is used to describe additional available coverages that are listed and explained at the end of the policy. The term **endorsement** is also used to describe additional available coverages. However, each endorsement is explained on a separate document—outside the regular policy. Any options and endorsements included in the policy or purchased by the customer at additional cost are listed in the declarations. Homeowners policies are usually not consistent regarding options and endorsements—one policy might call a particular coverage an option; another policy might call it an endorsement. Some common Homeowners options and endorsements include:

- **Personal Property Replacement Cost**—with this feature, the insurance company will pay to replace damaged personal property, without deducting for depreciation. (As stated earlier, the “standard” Homeowners policy provides **personal property** coverage based on **actual cash value**, which is calculated as the cost to replace the damaged personal property minus depreciation.) Some Homeowners policies include the personal property replacement cost coverage at no additional cost. With other policies this feature can be purchased for an additional cost.
- **Earthquake**—for an extra charge, this option or endorsement adds **earthquake** as a cause of loss to the policy and applies to Section I dwelling and personal property. (As stated earlier, cause of loss due to earthquake is excluded in a “standard” policy.)
- **Extended Coverage on Jewelry, Watches, Stones, Gems, and Furs**—this option or endorsement provides **open peril** coverage for these items. (As stated earlier, personal property is only covered for **named perils** in a “standard” policy.) Additionally, some insurance companies offer this option or endorsement with an increase of the limit for these items from \$1,000 to \$1,500 on any one article, with an aggregate limit of \$2,500. The same deductible shown in the declarations also applies to loss under this option or endorsement.
- **Scheduled Personal Property**

- With this option or endorsement, valuable property is specifically described in the declarations along with the limit it is insured for. This means these individual property items are not subject to the **special limits** that apply in a “standard” policy and allows these items to be insured for their **full value**. The insurance company usually requires the personal property to be **appraised** before it can be scheduled.
- This option or endorsement provides **open perils** coverage (instead of **named perils**). One important peril included in **open perils** is **accidental disappearance**, which covers an item if you lose it.
- **No deductible** applies to the scheduled property.
- There are several **categories** of valuable property: jewelry, cameras, furs, silverware, fine artwork, coins/stamps, golf equipment, tools, and musical instruments.
- **Additional Premises Coverage**—this option or endorsement extends the Section II coverages to cover an additional one or two family dwelling.
- **Other Structures**—this option or endorsement extends the Section I dwelling extension limit for unattached structures to include the additional limits shown in the declarations. (As stated earlier, on the “standard” policy the dwelling extension limit is automatically set at 10% of the dwelling limit.)
- **Watercraft Liability and Medical Expense**—this option or endorsement extends the Section II coverages to cover damage caused by watercraft that are owned by an insured and described in the declarations. (As stated earlier, liability is excluded for some types of watercraft in a “standard” policy.)
- **Home Day Care Liability and Medical Expense**—this option or endorsement extends the Section II coverages to cover an insured that provides day care in their home. (As stated earlier, liability is excluded for business pursuits in a “standard” policy.)
- **Office, School, or Studio Use**—this option or endorsement is for an insured that also uses their home for business use as an office, school, or studio **that they own**. Section I Personal Property is extended to a higher limit for business personal property such as equipment, supplies, furnishings, and merchandise while it is on the insured’s premises. This option or endorsement also provides Section II

coverage for business pursuits of the insured.

- **Employee Business Pursuits**—this option or endorsement is for an insured that is **an employee** and uses their home for business use. It extends Section II coverages and specifically covers an employee who is a sales person, teacher, clerical worker, collector, or messenger.
- **Increased Building Limits**—having this policy feature means the insurance company will settle covered dwelling losses at replacement cost for an amount that is **more than the dwelling limit** specified in the declarations. The amount is usually limited to 120% of dwelling limit. For example, let's say the dwelling is insured for \$200,000 and there is a total loss. If the cost to replace the dwelling runs over the limit of \$200,000, the insured will receive an amount up to \$240,000. However, to take advantage of this feature, the insured is required to insure the dwelling for at least 100% of replacement cost.

## Homeowners Policy Forms

Here is a review of the most popular Homeowners policy forms:

- **HO-3**
  - Many people consider this to be the “standard” Homeowners policy that other policy forms are compared to. Many of the features and characteristics previously mentioned are included in the HO-3.
  - This policy is also called **special form**, since the dwelling is insured for **open perils**. However, the personal property is insured for **named perils**.
  - Dwellings are insured on a **replacement cost** basis, and personal property is insured on an **actual cash value** basis.
  - Most insurance companies require 80% **coinsurance** for HO-3 policies. That means they have the dwelling limit set to at least 80% of replacement cost. The minimum **personal property limit** is 50% of the dwelling limit. The minimum personal liability limit is \$100,000.
  - The HO-3 provides the following coverages: dwelling, dwelling extension, personal property, loss of use, additional coverages, personal liability, and medical expense.
- **HO-4**

- This policy is very similar to the HO-3, except it does not provide dwelling or dwelling extension coverage. It is also known as the **tenants form** or **renters policy**.
- **HO-5**
  - The HO-5 is a newer policy form. Insurance companies have developed many variations of the HO-5. These products have a wide range of names including **comprehensive form**, **gold star**, and **special deluxe form**.
  - As a general rule, the Homeowners policies in this category have many of the same features as the HO-3—plus much more. Like the HO-3, they provide the following coverages: dwelling, dwelling extension, personal property, loss of use, additional coverages, personal liability, and medical expense.
  - Like the HO-3, **dwellings** are insured on a **replacement cost** basis. Unlike the HO-3, **personal property** is also insured on a **replacement cost** basis.
  - The **dwelling** is insured for **open perils**. In some HO-5 policies, **personal property** is insured for **open perils** and in others **named perils**.
  - Most insurance companies that sell this policy require the **dwelling limit** set to at least 100% of **replacement cost**. The **personal property limit** is usually set at a minimum of 75% of the dwelling limit. The minimum **personal liability limit** is usually \$300,000.
  - Other features that usually are automatically included in the policies in this category include: **Increased Building Limits** and **Extended Coverage on Jewelry, Watches, Stones, Gems, and Furs**.
- **HO-6**
  - This policy is very similar to the HO-3, except it provides **limited dwelling coverage**. To help determine the amount of dwelling coverage needed, the condominium owner should refer to the condominium association agreement or bylaws—which will explain what part of the building the insured is responsible for.
  - This policy is also known as the **condominium form** or **condo**

**policy.****• HO-8**

- These policies are generally designed for **older homes** or **unusual homes** having replacement values that are much greater than their market value. The need for this type of policy arises from the situation where a client is unwilling to insure a home for an amount that is at or near the replacement cost of the structure. This type of policy allows the client to insure the dwelling for less than 80% of the **replacement cost**.
- A significant difference with this type of policy is it provides **actual cash value coverage**—instead of **replacement cost** on the dwelling.
- Insurance companies have developed different variations of the HO-8. These policies are sometimes called **modified coverage form** or **custom value**.

## 6—Personal Auto Insurance Policy

### Organization and Terminology

When studying the Homeowners insurance policy, we learned the organization of insurance policy information—and the terminology used to describe the policy components—varies by insurance company. The same is true regarding the Personal Auto insurance policy.

For instance, some Personal Auto policies identify the coverages (liability, medical expense, uninsured motorist, physical damage) as parts I, II, III, and IV. Other Personal Auto policies identify these coverages as parts A, B, C, and D.

As it was in the Homeowners chapter, the focus is not on **how** each company identifies the coverages. Rather, the focus is on the basic fundamentals of Personal Auto insurance policies.

### Declarations

Once an insured purchases an Auto policy, the insurance company produces a declarations page that is usually delivered to the insured by mail. Unlike other sections of insurance contracts, the declarations page is tailored and created specifically for the customer. An Auto policy declaration may contain the following information:

- **Policy Number**—a number that uniquely identifies the policy
- **Named Insured**—includes the name, address, city, state, and zip code of the named insured
- **Policy Period**—effective date and expiration date of the policy; many auto policies have six-month policy periods
- **Vehicle Description**—the year, make, model, vehicle identification number (VIN), and vehicle symbol
- **Rating Information**—includes the rating classification that represents the primary use of the vehicle (pleasure, work, school, business, farm); number of miles driven annually; primary driver's age, gender, and marital status; territory that identifies the area where the vehicle is primarily stored and driven; demerit points reflecting driving violations

- **Coverages and Limits**—the automobile coverages shown in the declarations list only the coverages the insured has purchased. Coverages and limits listed on the declarations may include:
  - **Bodily Injury Liability Limit**—there are two numbers show for this limit. The first one is the most the insurance company will pay for bodily injury to any **one person** injured in an auto accident. The second number is the most the insurance company will pay for total bodily injuries from any **one auto accident** (occurrence) no matter how many people were injured. Most insurance professionals recommend their clients purchase bodily injury limits of at least \$100,000/\$300,000.
  - **Property Damage Liability**—this number is the most the insurance company will pay for property damage resulting from any **one auto accident** (occurrence) no matter how many vehicles or claimants were involved. Most insurance professionals recommend their clients purchase a property damage limit of at least \$100,000.
  - **Comprehensive Deductible**
  - **Collision Deductible**
  - **Uninsured Motorists Bodily Injury**—there are two numbers shown for this limit. (**Uninsured motorist bodily injury** is defined later in this chapter.) The first one is the most the insurance company will pay for bodily injury to any **one person** injured in an auto accident. The second number is the most the insurance company will pay for total bodily injury from any **one auto accident**—if two or more persons were injured. Most insurance professionals recommend their clients purchase uninsured motorist bodily injury limits of at least \$100,000/\$300,000.
  - **Underinsured Motorists Bodily Injury**—there are two numbers shown for this limit. (**Underinsured motorist bodily injury** is defined later in this chapter.) The first one is the most the insurance company will pay for bodily injury to any **one person** injured in an auto accident. The second number is the most the insurance company will pay for total bodily injury from any **one auto accident**—if two or more persons were injured. Most insurance professionals recommend their clients purchase underinsured motorist bodily injury limits of at least \$100,000/\$300,000.

- **Utah Personal Injury Protection (PIP) Coverage Amount**—the declaration shows the limits for each PIP benefit—or a coverage designation code that represents the limits for all PIP benefits.
- **Lienholder**—if the insured has taken out a loan on the vehicle, the bank or lending institution is considered a **lienholder**; the lienholder is listed on the declarations and will receive the claim payout in the event the vehicle is destroyed.
- **Titleholder**—if the insured operates a leased vehicle, the lessor that retains title to the vehicle is considered a **titleholder**; the titleholder is also an additional interest; the titleholder and additional interest are listed on the declarations and will receive the claim payout in the event the vehicle is destroyed.
- **Additional Information**—name, address, and phone number of the agent who services the policy; any policy discounts granted by the company to the insured; any endorsements or options included in the purchased policy that are not specifically included in the standard policy.

## Motor Vehicle Insurance Cards

At the time the auto declarations are issued, the insurance company normally will also provide service cards and proof of insurance cards to the insured.

A **service card** identifies the insured as having an Auto policy and provides instructions on what to do in case of an auto accident. It is intended to be kept with the insured or in the vehicle at all times.

A **proof of insurance card** provides evidence of auto insurance and describes the vehicle and the coverages on the policy. Many states require proof of insurance cards to be presented when obtaining vehicle registration. Some states also require insureds to carry a proof of insurance card or have it in the vehicle at all times, so it can be presented to law enforcement officers when requested.

## Definitions

This section of the policy explains the meaning of terms used in the policy. Some common terms explained in the definitions section of an Auto policy include: **car, private passenger car, your insured car, utility car, utility trailer, auto business, bodily injury, occupying, property damage,**

**relative, state, and use.**

## Liability Coverage

This coverage pays for compensatory damages the insured is **legally liable** for because of **bodily injury** or **property damage** due to an accident involving the use of a car or utility trailer.

It is important to note that liability coverage is provided for the insured when using **any vehicle**—not just the insured’s vehicle. For instance, if Tom borrows his neighbor’s car to run an errand, the liability coverage on Tom’s Auto policy will pay for any damages Tom is legally liable for.

Regarding auto liability coverage, under most circumstances an **insured** is defined as any of the following:

- The named insured as listed on the policy declaration
- The named insured’s **relative** who lives in the insured’s household and is related by blood, marriage or adoption
- Any person using the named insured’s auto who has the insured’s **permission** to use the auto
- Any person or organization that has **vicarious liability** due to the acts of an insured. For example, suppose Kenneth drives his car (or his neighbor’s car) to perform a job for his employer and gets into an accident that causes damage. Because the accident was during the course of employment, Kenneth’s employer may be vicariously liable for the accident. In this situation the liability coverage on Kenneth’s Auto policy will cover the employer’s liability. However, if Kenneth was driving his employer’s car, coverage from Kenneth’s Auto policy would not extend to cover the employer’s liability.

The insurance company will defend or settle any claim or lawsuit and will pay defense costs incurred by the insurance company. But, the insurance company will not defend or settle any claims or lawsuits once the limit of liability for damages as listed on the declarations has been offered or paid to the claimant.

Most Personal Auto policies will also pay for **additional payments** (or **supplementary payments**). These payments include:

- Charges up to \$250 for the cost of a bail bond that is required due to an accident or related traffic violations

- Premiums on appeal bonds or release attachment bonds
- Accrued interest on damages awarded but not yet paid to the claimant
- The expenses of the insured for rendering first aid to others at the time of an accident involving the insured's auto
- Loss of wages, salary, or earnings up to the amount stated in the policy due to the attendance of court hearings or trials at the request of the insurance company

The liability coverage part has a list of situations that are not covered. This list is called the **exclusions**. Most Personal Auto policies have exclusions for the following:

- Bodily injury or property damage caused by **intentional acts** of the insured
- Bodily injury or property damage arising out of using a vehicle to **carry people for a fee**; this exclusion does not apply to cost sharing situations such as carpooling
- Damage to property that is owned by—or cared by—the insured
- Bodily injury or property damage when the insured's car has been **leased** or **rented** to others
- Bodily injury or property damage that occurs during an organized **racing event**, including preparation for such event
- Bodily injury or property damage that occurs when using a vehicle—other than a covered vehicle—that is owned by the insured or otherwise available for regular use by the insured
- Bodily injury to an **employee** of the insured caused by an accident during the course of employment (this exclusion does not apply to some domestic employees)
- Bodily injury or property damage when the insured is covered under a **nuclear energy liability** insurance policy
- Bodily injury or property damage arising out of the use of motorized vehicles having **less than four wheels** or motorized **recreation vehicles** designed for all terrains

Nearly all states require motorists to conform to **financial responsibility laws**. According to the [www.insurance.utah.gov](http://www.insurance.utah.gov) web site, "Utah law

requires motorists to carry bodily injury and property damage liability insurance to help pay for damages they cause in an auto accident. The minimum amounts drivers are required to carry are: \$25,000 per person and \$65,000 for two or more persons for bodily injury liability and \$15,000 for property damage liability.”

Insurance companies certify that their Personal Auto policies provide **proof of future financial responsibility**. That means the policy is guaranteed to meet the requirements of the financial responsibility laws—even if the laws change in the future.

Since vehicles are often driven in more than one state, Personal Auto policies have an **out of state insurance** provision. This means the policy coverages automatically change to conform to the insurance laws of the state in which the car is being used.

When there are **two auto insurance policies** that cover a liability loss, an insurance company will pay only its share of the loss amount. If the insured is involved in an accident when using someone else’s car, the car owner’s insurance is primary, and the insured’s insurance is excess. That means the insured’s insurance will only pay the amount that is beyond what the car owner’s insurance will pay. So if there is a \$175,000 loss and the car owner’s insurance will only pay \$100,000, the insured’s insurance will only pay \$75,000.

## Personal Injury Protection

**Personal Injury Protection** (PIP) is a package that provides protection in accordance with the **Utah Automobile No-Fault Insurance Act**. This law requires **Utah** motorists to buy PIP coverage. No-fault legislation is designed to discourage small lawsuits by allowing policyholders to recover financial losses from their own insurance company without proving an accident was someone else’s fault. **Utah** PIP provides the following benefits for bodily injury to an **eligible person** when caused by a motor vehicle accident:

- **Medical Expenses—Utah** law requires motorists to buy a minimum of \$3,000 per person in medical expense coverage. However, some policies provide the option of purchasing up to \$100,000 per person. The insurance company will not pay more than the purchased per person limit.
- **Work Loss**—this benefit pays a weekly amount to a person who loses earnings because he or she is unable to work. Coverage for work loss usually begins once a person is unable to return to work after missing 72 hours of work. Generally speaking, **Utah** law requires motorists to

purchase coverage that protects at least 85% of gross income up to a maximum of \$250 per week for 52 weeks maximum. However, some policies allow work loss to be excluded for situations where the insured does not work. The insurance company will not pay more than the purchased weekly limit.

- **Essential Service Expenses**—this benefit includes the hiring of babysitters and housekeepers needed because an injured person is unable to perform these duties. **Utah** law requires motorists to purchase coverage that provides \$20 per day up to a maximum of 365 days. The insurance company will not pay more than the purchased daily amount.
- **Funeral Expenses**—this benefit pays funeral, burial, or cremation expenses. **Utah** law requires motorists to purchase coverage that provides a funeral expense benefit amount of at least \$1,500 per person. The insurance company will not pay more than the purchased per person limit.
- **Survivors' Loss**—this benefit pays upon the death of an eligible person. **Utah** law requires motorists to purchase coverage that provides a minimum survivors' loss benefit amount of \$3,000. The insurance company will not pay more than the purchased limit.

The chart below summarizes the minimum PIP limits that **Utah** motorists are required by law to purchase:

Medical Expenses (per person)	Work Loss (per week)	Essential Services (per day)	Funeral Expenses (per person)	Survivor's Loss
\$3,000	\$250	\$20	\$1,500	\$3,000

The following persons are eligible to receive benefits under the **Utah** PIP:

- The named insured or relative who is injured while occupying a motor vehicle or while a **pedestrian** when struck by a motor vehicle
- A person other than the named insured or relative who is injured while **occupying** the insured's motor vehicle with the named insured's consent
- A person other than the named insured or relative who is injured while

a **pedestrian** if the accident involves the insured's motor vehicle within the state of **Utah**

## Uninsured Motorist Bodily Injury

**Uninsured Motorist** (UM) coverage provides bodily injury coverage for the insured when involved in an accident where the legally liable party was an uninsured motorist. It is important to note that UM only provides **bodily injury coverage**—not property damage coverage. Therefore, damage caused by an uninsured motorist to an insured's car is not covered by UM. **Utah** law says UM must be provided unless the insured rejects this coverage in writing. Most insurance professionals in Utah highly recommend UM to their clients.

Regarding UM coverage, under most circumstances an **insured** is defined as any of the following:

- The named insured as listed on the policy declaration
- The named insured's **relative** who lives in the insured's household and is related by blood, marriage or adoption
- Any person **occupying** the insured's car
- Any person who has a right to recover damages due to bodily injury of an insured

An **uninsured motorist** is defined as any of the following:

- A person who operates a motor vehicle and is **not insured** by bodily injury liability coverage at the time of the accident—or has bodily injury liability coverage but the **limits are less** than the **Utah state minimums** of \$25,000/\$65,000 (however, a person operating a vehicle that is owned by the insured or available for regular use by the insured is not considered an uninsured motorist)
- An **unknown hit-and-run driver** who hits an insured, the insured's covered vehicle, or any auto the insured occupies
- A person who has bodily injury liability coverage at the time of the accident, but the insurance company does not pay due to insolvency, denial, or dispute.

Coverage for UM is excluded if bodily injury to a person occurs while occupying—or when struck by—a vehicle that is not insured by the policy and is owned by the insured.

## Underinsured Motorist Bodily Injury

**Underinsured Motorist** (UIM) coverage provides bodily injury coverage for the insured when involved in an accident where the legally liable party was an underinsured motorist. As it is with UM, UIM only provides **bodily injury coverage**—not property damage coverage. In **Utah**, UIM must be provided unless the insured rejects this coverage in writing. UIM is not contingent upon UM. An insured may select or reject either or both coverages. Most insurance professionals in Utah highly recommend UIM to their clients.

The UIM rules and concepts are similar to those of UM. An underinsured motorist is a person who operates a motor vehicle and is insured by bodily injury liability coverage at the time of the accident—but the coverage limits are **not enough to fully compensate** the injured insured for damages.

## Physical Damage Coverage

**Physical Damage** coverage pays for accidental loss to the named insured's covered auto, permanently attached equipment, utility trailer, and a non-owned car or utility trailer the insured is temporarily using or caring for.

Physical Damage includes **collision** and **comprehensive** coverages. The difference between them is the perils (or causes of loss) that each one covers. The combination of these two provides coverage for nearly all types of car damage.

**Collision** pays for car damage that results from:

- Impact with another car, including when the other car was driven by an uninsured motorist
- Impact with objects—other than live animals, missiles, and falling objects
- Car roll-over
- Hitting road potholes

**Comprehensive** pays for the following car damage:

- Glass breakage—other than collision
- Fire
- Falling objects and missiles

- Explosion
- Earthquake
- Wind, hail, flood, and water
- Theft, vandalism, and riot
- Contact with live animals

None of the states require motorists to purchase collision or comprehensive coverage. However, most **lenders** and **lessors** require these coverages if there is a loan on the vehicle or it is leased. For older vehicles with no loan or lease, it is common for an insured to decline collision and comprehensive coverages.

Insurance companies will reimburse the insured for the cost to repair the damaged car—minus the **deductible**. Most auto policies have a variety of deductibles for the insured to choose from. Insureds can lower their premium by choosing high deductibles. **Collision** coverage is usually sold with a deductible ranging from \$250 to \$1,000. **Comprehensive** coverage is usually sold with a deductible ranging from \$100 to \$500.

**Physical Damage** coverage excludes damage for the following losses:

- When the insured's vehicle is used to **carry persons for a fee**
- War or nuclear hazards
- Tapes, discs, or similar devices used to record or reproduce sounds, videos, or pictures, and radar detectors or similar devices
- Electronic receiving or transmitting devices—other than factory installed equipment supplied by the manufacturer
- Wear and tear, breakdown, freezing, and road hazard tire damage
- A vehicle not owned by the insured when used in an auto business such as selling, repairing, servicing, transporting, delivering, customizing, testing, storing, or parking vehicles
- The insured's car when **rented** or **leased** to others
- Occurring during an organized **racing event**, including preparation for such event
- Custom furnishings or equipment—other than factory installed

equipment supplied by the manufacturer

When there are **two auto insurance policies** that cover a physical damage loss, an insurance company will pay only its share of the loss amount. If the insured is involved in an accident when using someone else's car, the car owner's insurance is **primary**, and the insured's insurance is **excess**.

Most auto insurance policies automatically provide **theft coverage** which will pay up to \$20 per day up to a maximum of \$600 for transportation costs incurred by the insured that is without a car due to total theft of their vehicle. Theft coverage begins 48 hours after the theft is reported to the insurance company and the police.

## Policy Provisions

The terminology and organization of additional Auto policy provisions or conditions vary greatly by insurance company. Some policies contain the following provisions:

- The insured may cancel the policy at any time for any reason
- If the policy has been in force **less than 60 days**, the insurance company may cancel the policy by mailing notice of cancellation to the insured at least 10 days before the effective date of the cancellation
- If the policy has been in force **60 days or more** and the company desires to cancel the policy due to **non-payment of premium**, the insurance company may cancel the policy by mailing notice of cancellation to the insured **at least 10 days** before the effective date of the cancellation
- If the policy has been in force **60 days or more** and the company desires to cancel the policy due to a reason **other than non-payment of premium**, the insurance company may cancel the policy by mailing notice of cancellation to the insured **at least 30 days** before the effective date of the cancellation
- If the policy has been in force for **at least 60 days**—or the policy has renewed—the insurance company can cancel the policy only for the following reasons:
  - Non-payment of premium
  - Revocation or suspension of the insured or anyone who customarily drives the insured's car

- Fraud by the insured
- Significant change in the risk
- The **insured** can choose **not to renew** by the policy failing to pay the renewal premium or by notifying the insurance company. If the insured chooses not to renew, coverage will end on the expiration date of the policy term.
- The **insurance company** can choose **not to renew** the policy by mailing notice of non renewal to the insured **at least 30 days** before the end of the policy term. If the insurance company chooses not to renew, coverage will end on the expiration date of the policy term.
- If an accident or loss occurs, the insured has a responsibility to **promptly notify** and **fully cooperate** with the insurance company and provide all the information required by the insurance company. Furthermore, the **police must be promptly notified** in the following situations:
  - The insured's vehicle is **stolen**
  - A person is claiming uninsured motorist coverage because they were struck by a **hit-and-run driver**

## Other Optional Coverages

The terminology used to describe other Personal Auto optional coverages varies among insurance companies. If coverage applies, it will be listed on the declaration. Optional coverages may include:

- **Emergency Road Service (ERS)**—pays for reasonable towing and labor costs if the insured's vehicle becomes disabled or stuck; also pays for delivery of gas, oil, loaned battery, or change of tire; ERS does not pay for the cost of the delivered item; most insurers offer ERS only to auto customers that also have comprehensive and collision coverage
- **Uninsured Motorist Property Damage**—pays for damage to the insured's vehicle when caused by an uninsured motorist; this coverage will only pay if the owner, operator, or license plate number of the uninsured vehicle can be identified; this coverage is purchased only if the insured does not have collision coverage
- **Rental Reimbursement**—covers the cost of renting a substitute vehicle while the insured's vehicle is being repaired due to a covered

loss; most insurers offer rental reimbursement coverage only to auto customers that also have comprehensive and collision coverage

- **Newly Acquired Vehicle**—provides up to 30 days of coverage for the insured's newly purchased vehicles; includes replacement vehicles and additional vehicles and provides same coverage as the insured's other vehicles
- **Death and Dismemberment**—provides payment of specified amount listed on the declaration if the insured or someone riding in the insured's vehicle dies or is dismembered as a direct result of an automobile accident (regardless of who is at fault)

## Personal Liability Umbrella Policy

Although a Personal Liability Umbrella policy is technically a self-standing product, we have included it in this chapter for the sake of convenience.

As presented previously, the Homeowners and Personal Auto policies provide liability protection. A Personal Liability Umbrella policy extends coverage by adding a layer of protection over and above the primary protection provided by the Homeowners and Personal Auto policies. If a liability loss exceeds the primary coverage limits, the Personal Liability Umbrella policy takes over.

A Personal Liability Umbrella policy provides the following benefits:

- **Adds perils** not normally covered in underlying coverage including:
  - **Personal Injury**—libel, slander, humiliation, defamation of character, false arrest, invasion of privacy, wrongful entry, and wrongful eviction
  - **World-Wide Protection**—events that occur anywhere in the world, including renting or driving cars in other countries
  - Non-Owned **Watercraft**
  - Certain Claim and Defense Expenses
- Provides coverage for **liability losses that exceed the limits of the underlying insurance** such as policies for automobiles, motorcycles, primary and seasonal homes, recreational vehicles, watercraft, and one or two family dwelling rental dwellings

A Personal Liability Umbrella policy is often written for \$1,000,000 of **additional coverage**, but higher limits are sometimes available. To qualify

for a Personal Liability Umbrella policy, the insured must maintain **minimum liability limits** on the **underlying primary policies**. For example, many insurance companies require underlying auto insurance limits of \$100,000/\$300,000/\$100,000 and an underlying Homeowners insurance limit of at least \$100,000. If the umbrella policy limit is \$1,000,000, the addition of the umbrella policy extends the insured's combined liability limits \$1,000,000 above the underlying limits.