Auto • Home • Health • Life

the Complete Book of Insurance

Understand the Coverage You *Really* Need

- Liability Limits
- Medical Payments
- Exclusions and Inclusions
- Health Plans
- No-Fault Motorist Laws
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Foreword

The purpose of this book is to demystify the world of insurance for the average homeowner, car owner and driver, and apartment renter. It is almost impossible for ordinary consumers to make genuinely informed choices without understanding how the *business* of insurance works; what the different marketing channels for selling policies are; and, what is or is not typically covered by a given kind of policy.

Unfortunately, if the wrong choices are made and a loss occurs, the consequences can be all too interesting, frightening, and life-changing. Unsuitable insurance choices present the potential of no coverage for a substantial theft or fire loss or not enough coverage for a catastrophic liability lawsuit such as an automobile accident, that could force you into bankruptcy.

Is insurance a complete answer to all risks of adverse financial circumstances? No, of course not. But, within the realm of potential exposures to loss that the average person will face, insurance provides a relatively inexpensive way of helping to protect one's property and fortunes from ruin.

As an insurance coverage attorney, I have often seen the consequences of the failure to purchase insurance that could easily have provided protection from an avoidable, uncovered claim. Liability exposures underm homeowners and auto policies present potentially great financial exposures to the average homeowner, auto owner, tenant, or small business owner.

There is the crucial requirement that you maintain adequate insurance to value. There is also a need for you to do something to document your personal property and to maintain that record in a secure place, preferably off premises, in the event of a total loss. This book will highlight many similar issues.

I mean to inform, not lecture. I am as upset and angered by claims that are mishandled as by claims in which I see denials of coverage that are correct because the policyholders were uneducated or misinformed and therefore did not purchase appropriate coverage. Too often, individuals find themselves in litigation with their insurers, their insurance agent, or both over a claim that they believed was or should have been covered. Regardless of the correctness of the insurer's claim decision, such litigation can impose financial and emotional costs on the individuals involved.

I welcome the opportunity to provide the reader with information necessary to become an informed insurance consumer, and thereby afford those readers the peace of mind that insurance is meant to provide.

DISCLAIMER

I am an attorney and work for a law firm that represents a great many insurers. Thus, the following disclaimer.

The opinions expressed throughout this book are my personal opinions, not those of the law firm fo which I work, nor of any of that firm's clients: insurers, or otherwise.

I also give some examples in this book as to how certain coverage provisions may or may not apply or be interpreted. Unless the example comes from an identified court decision, these examples are purely hypothetical and should be considered illustrative only. In a real life situation, a judge or jury may disagree with how I suggest a policy provision should be understood or interpreted.

No attorney-client relationship exists, and shall not be deemed to exist, between any purchaser or reader of this book and the author, the law firm for which the author works, or of any of that firm's attorneys.

The discussions in this book are general and are intended to provide the reader with background information about various aspects of the business of insurance to assist the reader in making decision about insurance issues. No legal advice is contained in or offered by this book, and nothing stated in this book should be relied on as such. Any reader having specific questions needs to consult with a lawyer licensed to practice in the state where the reader lives. The facts of a particular situation and the ~~actual language of the reader’s policy, interpreted according to applicable local laws, will con~~trol the outcome of any particular issue or claim.

Introduction

This book deals mainly with what is referred to in the insurance industry as *property/casualty coverages*. For consumers, this means homeowners, auto, and tenants' policies. For small business owners, this means the simpler forms of commercial policies, represented generally by so-called business owners policies. Some basic concepts of life insurance policies are explained. Disability policies, as well as health insurance policies and managed care plans, are also discussed briefly.

This book attempts to cover a huge body of information in the space of a consumer guide. Reconciling these conflicting goals was a difficult task. There are few uniform national standards or laws that apply to the business of insurance. As explained in this book, there is no single *business of insurance*. There are at least three *businesses of insurance*:

(1) property-casualty insurance (*i.e.*, homeowners, auto, and business property and liability coverages);

(2) life and disability insurance; and,

(3) health insurance.

The first category is the primary focus of this book. This category of coverages is largely regulated by the fifty states. The second category, life insurance, is also largely regulated by the fifty states, except to the extent the investment aspects of certain types of life insurance policies implicate federa securities laws.

The third category of insurance discussed in this book, health insurance, is now largely regulated by the federal government. States can, and in some instances, do, impose regulatory requirements over and above those of federal law. This book will largely limit itself to the discussion of significant health insurance issues arising under the controlling federal laws.

This book is mostly about the coverages of the policies that matter most to the average personal insurance buyer: personal auto policies; homeowners, condo owners, and tenants policies; and, business owners policies.

As discussed elsewhere, the business of insurance is far-reaching and affects almost every business or personal economic transaction that takes place in the world. Even though insurance is an importan subject, most law schools in the United States do not have any significant, realistic, or practical courses in the law of insurance. If you read this book in its entirety, you will learn more about insurance than the average new law school graduate knows.

This book is about empowerment. It is about giving the consumer the ability to penetrate the often opaque business of insurance, particularly homeowners and personal auto insurance, and to provide the reader with the information with which to make intelligent decisions when it comes to choosing a agent and purchasing coverage.

Let me first tell you, the reader, what this book discusses, and how it relates to the insurance-buyin decisions you face. This book discusses and explains the principal coverages of the *Insurance Servic Office's* (ISO) homeowners and personal auto policies.

So what, you say. I have my homeowners and auto insurance with State Farm, Allstate, Liberty Mutual, Nationwide, or Farmers. The importance is, ISO is an insurance industry support, rating, and information organization. The policy forms developed and published by ISO are used by many insurers without alteration. Other insurers, like several of those just mentioned, use policy language drafted by ISO, or language that differs in varying, but usu-xii ally small, degrees from the language of the ISO policies. However, it would expand the scope of this book to enormous proportions to deta all of the differences between standard ISO policy forms and those of the major personal lines insure mentioned above.

Even though insurers, particularly personal lines (*i.e.*, homeowners and auto coverages) insurers, want to create the appearance that their products differ from one another, as a practical matter, they wan~~t their policy language to compare (on a general basis, at least) with that of the ISO forms s~~o as t take advantage of court decisions interpreting the ISO policy provisions. Doing so at least permits predictability when it comes to adjusting claims.

This book discusses the coverages of the ISO homeowners and personal auto policies so that the reader/consumer has a basis for questioning his or her agent regarding the coverages of the insurer or insurers the agent represents and how they may differ from those of the standard ISO forms. As note many insurers use the ISO policy forms. Several national personal lines insurers, however, do not. Although the coverages afforded by policies issued by insurers that do not use ISO forms usually depend largely on language similar to the ISO forms, the differences in the scope of coverage afforde can vary widely from insurer to insurer. Mere differences in price are not a valid basis for compariso between the policies of one insurer and those of another. The differences in the scope of coverage can be astounding in their details—details that can be significant to the consumer.

This book is intended to provide the reader with something he or she has not had before—the basis for genuine comparison shopping for something that we all must buy, but is all too often poorly understood. It comes down to this simple proposition—if homeowners and auto insurance policies ar things you must buy, don’t you want to get the most coverage for the least money? The existing system does not provide the consumer with the ability to engage in informed comparison shopping. This book is intended to rectify that situation.

Finally, while this book does not address all the issues that can arise in the claims context, there is some discussion about claims issues integrated into corresponding discussions of policies.

Chapter 1

The Role of Insurance in the Economy

Insurance. What a pain! Your mortgage lender requires that you carry fire and other perils coverag (*i.e.*, homeowners) insurance and sometimes even flood or earthquake insurance. Your auto lender requires that you carry physical damage coverage. Under the laws of many states, you are required to carry auto liability and/or *no-fault* liability insurance, often including *uninsured* motorist and *underinsured* motorist coverages.

To many, insurance just represents dollars out of pocket with no benefit. This is an unfortunate attitude. Insurance plays a broad role in the worldwide economy, helping to assure that millions of transactions and other activities, economic and noneconomic, can proceed.

Without insurance, local, state, national, and international business would quickly grind to a halt. Lenders would cease lending for purchases of land, buildings, homes, vehicles, or equipment. Withou premises liability insurance, a simple slip-and-fall claim could put a small business owner out of business.

Manufacturers could not sell products without liability insurance to respond in the event a defectiv product injures customers or other users of their products. Absent product liability insurance, a seller of a defective product who has no role in the design and manufacture of the product, could face a ruinous lawsuit or judgment.

The average individual has similar concerns. What are the consequences of an uninsured liability lawsuit—whether rising from an auto accident or a premises claim arising from homeownership question? The answer is often bankruptcy, which can follow a person for a lifetime. It can result in being turned down for a job, being denied credit, or receiving credit only at high interest rates.

The concept of insurance is really very simple. In exchange for the insured's payment of a relativel small sum of money—the *premium*—the insurer assumes the risk of financial consequences for the loss of the insured's property (such as a house or car) or the risk of the loss presented by the costs of defending a liability lawsuit (and where appropriate, paying a resulting settlement or judgment). Thi can provide financial security for the average consumer—that is *you*—which strengthens our econom as a whole and spurs further growth.

BRIEF HISTORY OF THE BUSINESS OF INSURANCE

Insurance has been around for a long time and has been a part of the economy of the world and this nation since before it *was* this nation. Frankly, the United States, as an indirect product of the initial commercial-empire building activities of Great Britain, owes its existence to the business of insuran in large part. Great Britain became a major commercial power in the 17th century, based on the risks taken by companies established to capitalize on the demand for spices, tea, sugar, dyes, fabrics, and other desired commodities.

The business of insurance as we know it in Great Britain and the United States grew out of what initially was risk-taking participation in the fruits of those commercial enterprises. It evolved to insure the risks of loss of or damage to cargoes.

The insuring entity, known commonly as *Lloyd's of London*, grew up out of those risky commercia endeavors. Lloyd's of London is an exceedingly complex organism. Lloyd's is not a company, nor is an insurer, nor a broker.

Lloyd's is an insurance market where persons known as underwriters, or underwriting syndicates, participate in providing insurance for risks pre sented to them by Lloyd's brokers. The Lloyd's brokers in turn have correspondent relations with insurance brokers worldwide. The aspects of commerce out of which Lloyd's grew continue to be a basis for the business of insurance, and the insurance markets in London, including Lloyd's, remain major players in the world's insurance markets.

A second major aspect of the development of the business of insurance found its roots in the growing peril of fire as urban centers developed in Great Britain and later in the American colonies. No running water existed at the time; construction was essentially unregulated. Even a small fire posed the risk of spreading rapidly.

The burden of response to fires and the risks posed by fires in such environments was addressed in variety of ways. One was the mutual fire protection societies in given areas of large cities. Members maintained fire buckets in their houses and businesses and pledged to assist in fighting fires when th occurred. This included the physical participation in fire fighting—that is, working as part of *bucket brigades* when fires broke out.

From these societies, two principal offshoots emerged as the world entered the Industrial Age. Thes were:

1. the growth of volunteer, and later, professional, paid fire departments and
2. the increased growth of these fire insurance societies and later, commercial insurance companie that grew out these societies.

The fire insurance societies evolved from merely providing mutual aid and assistance in the event fire to providing limited financial protection in the event of a fire loss. However, due to the localize nature of these fire insurance societies, they could not obtain the spread of risk necessary to the financial viability of the concept of insurance. Since all the properties insured were in relatively clos geographic proximity to each other, the risk of a single catastrophic fire that could overwhelm the physical ability to combat the fire existed, as well as the financial resources to fulfill the indemnification payment for loss of all members.

Nonetheless, with a number of developments—satisfactory water supplies; improved municipal regulation of construction (such as early set-back laws); regulation of permissible roofing materials; and, more careful risk selection, including the avoidance of insuring too many closely situated properties—the fire insurance business began to grow and flourish. As with so many other aspects of commerce, with the opportunity for profit, new insurers were established to compete for property owners' business.

As the business of insurance in the United States grew, it also diversified. Due to the importance of agriculture to the United States economy—and the fact that in the 19th and first half of the 20th centuries, agriculture was conducted largely by means of family farms—lenders required farmers to take out crop insurance when mortgaging their properties to obtain crop loans. This requirement greatly expanded the use of insurance.

Then, as you might expect, some of the biggest boosts to the growth of the business of insurance came with the development of the internal combustion engine, the widespread ownership of cars and trucks, and the risks of loss that operation of these vehicles posed.

There are, of course, other contributing threads. As society and industry grew, so did the risk of industrial injury and the resulting passage of workers compensation laws. When those laws were enacted, commercial insurers entered the market and began providing workers compensation insurance to employers.

The growth of our rail system also spurred growth of the insurance industry. The railroads provide transportation, but their operation created risks of losses due to fires from sparks thrown out of smokestacks of locomotives, and from collisions and derailments.

The business of insurance has continued to evolve. Recent times have seen the development and marketing of long-term care insurance, environmental impairment insurance, and insurance policies aimed at e-business. In e-business, exposures to loss often involve less risk of damage or destruction of t~~angible property in the commonly understood sense, but rather risks of economic losses as th~~e result of deprivation of service due to the activities of hackers, for example.

As human economic activity evolves, so will the business of insurance. Likewise, while coverage questions arise under existing policies based on the facts of novel claims and courts render decisions policy language will continue to evolve.

Coverage for some kinds of losses will always be clear—it will clearly exist or not exist. Claims in the gray areas will be decided one way or the other and will shape that which the average insurance buyer should or should not reasonably expect to be covered under his or her policies.

PART I: Insurance and You

Chapter 2

The Structure of the Business of Insurance

The business of insurance differs from most other businesses. Because insurers sell an intangible product—a promise to pay in the event of contingent losses—and because these promises potentially affect so many, the business of insurance is regulated more heavily than most other businesses.

The business of insurance is regulated by the states, not by the federal government (with the exception of certain antitrust laws). As a result, while there is necessarily much uniformity of regulation in the business of insurance from state to state, there are also differences.

NOTE: *For any state-specific question, contact the department of insurance in your own state.*

The laws regulating the business of insurance in some states differ so greatly from other states that many insurers establish separate companies solely for the purposes of writing policies in a given stat Texas and Illinois are two states where this often occurs because of the difficulties imposed by complying with the laws of those particular states.

Twelve states mandate some form of no-fault auto insurance. As a result of these differences, certa types of policies, particularly auto policies, must be written so that people can travel from state to state in their vehicles, yet not run the risk of uninsured losses due to variations in mandatory insuran requirements by state.

Because of state regulations and other business concerns, a given insurance organization typically comprises multiple insurers. State Farm advertises nationally on television and through other media, but the organization operating under the State Farm moniker is actually comprised of twelve differen insurance companies, each separately organized. Indeed, many of the separate insurance companies operating under a single trademark or service mark, such as State Farm, Farmers, Kemper, or Nationwide, have officers and a board of directors, but no actual employees.

There are a number of practical reasons why many insurance organizations do business in this manner, which vary from organization to organization. Some states' insurance codes and regulations are such that a given insurance organization will establish an insurance company solely for the purposes of writing all of its policies for insurance within a particular state. Another reason an insurance organization might establish multiple insurance companies to operate within a given state to help the insurance organization track and assess business results.

These business factors (and more), even before looking at the actual loss experience of an individu insured, can affect whether an insurer will categorize the insured as a *preferred* risk, a *standard* risk, or a *substandard* risk. Depending on how an insurance organization decides it wants to compartmentalize its ability to track its results, it may choose to do so based on a *preferred*, *standar* or *substandard* risk basis, regardless of the line of business. It may establish separate companies in which to write policies issued to each of these categories of its business.

KINDS OF INSURERS

The most common form of organization for domestic insurers is the capital stock company (*corporation*) organized and existing pursuant to the laws of whichever of the fifty states is its corporate domicile. The stock of individual capital stock insurance companies is not always publicly traded. Often, insur- ers are wholly-owned subsidiaries of one or more other insurance companies comprising a given insurance organization. For example, the group of companies known as America International Group, Inc. (AIG) owns, directly or through subsidiary companies, such well-known commercial insurers as National Union Fire Insurance Company, American Home Assurance Company, Lexington Insurance Company, Insurance Company of the State of Pennsylvania, and Birmingham Fire Insurance Company. The parent company of this group is the corporation known as American International Group, Inc. This corporation is not an insurer itself. Rather, it is what is commonly referred to as a *holding company*. If a person wished to invest in the insurance business of the ~~AIG companies, one would buy stock in American International Group, Inc. One could not~~ purchase stock directly in any of the member companies that comprise AIG.

The corporate domicile of a particular insurer may or may not be the same state where that particular insurer has its principal place of business. Just because an insurer is organized and exists a a legal entity under the laws of a particular state, and may even have its principal place of business in that state, does not mean that the insurer operates as an *admitted insurer* in that state. Insurers can be organized and exist pursuant to the laws of a particular state, and yet operate within that state on a nonadmitted (excess or surplus lines) basis.

The next most common form of insurance company organization is the *mutual* insurance company. Stated generally, a mutual insurer is an insurer corporation without capital stock that is owned by its policyholders collectively, who have the right to vote in the election of its board of directors. The principles governing the duties, powers, and obligations of the board of directors of a mutual insurer are generally the same as those applicable to other private corporations.

Many insurers that retain the word *mutual* in their names have long-since converted to the capital stock form of doing business. They retain the term *mutual* in their corporate names not only because of the company's history, but also because the use of the term *mutual* has a feel-good quality that helps support the image of security that insurers like to promote.

The third most common form of insurance company organization is what is called a *reciprocal insurer*, also called *interinsurance exchange*. In effect, all policyholders of a reciprocal insurer, who are also called *subscribers*, insure each other. In order to become an insured of a reciprocal insurer, each person or company executes a *subscription agreement* as part of the application for the policy. I the subscription agreement, that person or entity appoints an attorney-in-fact, who, pursuant to the terms of the subscription agreement, manages the affairs of the reciprocal insurer. The attorney-in-fact is often a separately constituted corporation. Through the corporation's employees or through contractual relationships with other entities, the attorney-in-fact arranges for underwriting, actuarial, claims, and other services, and enters into reinsurance contracts.

For example, the insurance offered by the American Automobile Association or its affiliated organizations in different states, such as the Automobile Club of Southern California, is offered through entities that are organized as reciprocal insurers. United Services Automobile Association is another well-known example. Reciprocal insurers are often organized and will insure only those persons who share some qualifying membership criteria, such as a club membership or service in the armed forces.

All three types of insurance companies are regulated in substantially similar fashion by the insurance departments of the fifty states. Mutual and reciprocal insurers give their policyholders the right to appear and vote at the annual meetings of insurers, just as stockholders of a corporation have the right to attend annual meetings and to vote to elect directors and pass resolutions on the agenda. This is a right that relatively few policyholders take advantage of. Both mutual and reciprocal forms of insurance company organizations are, in a certain sense, vestiges of a past world in which a relatively small group of localized individuals came together to create a means of providing insuranc to an unserved or underserved group of people or businesses. The voting rights aspect of these insurance company organizational forms reflects the different practicalities confronting those person that, as a small group of affected policyholders, the acts of the board of directors of the company affects directly.

As a practical matter, the differences between capital stock, mutual, and reciprocal insurance organizations affect the average consumer very little, except in the manner in which insurance is sold

The following comments are somewhat more true of reciprocal insurers than they are of mutual insurers, but nonetheless may apply. The policies offered by reciprocal and mutual insurers are often less ~~expensive than those offered by stock insurers. That factor has been one of the perceived~~ historical advantages that reciprocal and mutual insurers hold over stock insurers. In the past, their cost advantages had much to do with the fact that the underwriters and actuaries for such insurers had a good understanding of the risks posed by the limited classes of individuals to which policies would be issued and the limited geographical scope of the insurers' operations.

However, the less expensive nature of the policy sold by reciprocal and mutual insurers can be very deceptive in the modern-day world. Reciprocal and mutual insurers developed at a time when the world was much simpler. When everyone was selling nothing more than a standard fire policy, with the terms and conditions of the policy mandated by state law, all insurers were, in effect, selling the same *promises*. At that time there was a basis for a localized reciprocal or mutual insurer to offer savings to policyholders that mattered.

As society and insurance markets matured, that was no longer the case. Today, homeowners policies offer coverages that go beyond those of standard fire policies. The insurance purchaser needs to compare coverages offered and included (or not included) to determine whether the lower premiums often offered on policies of reciprocal and mutual insurers can be justified by the sometimes lesser coverages offered compared with those of other companies, including stock companies.

Chapter 3

The Marketing and Selling of Insurance

All too often consumers are led into purchasing policies that do not provide even remotely sufficie insurance to protect them from the effects of reasonably anticipated losses. It is crucial that you understand insurance well enough to be able to ask the necessary questions so you can assess the abilities of the potential insurance agents you contact and can help whichever agent you ultimately choose to procure insurance appropriate to your needs.

There are three primary marketing channels of property and casualty insurance, particularly homeowners and personal auto insurance, in the United States. They are:

1. independent agents;
2. captive agents; and,
3. various forms of direct marketing.

This latter category includes what nominally appears to be a variety of marketing channels often using direct mail. These channels are employed by GEICO, Progressive Casualty, certain American International Group mass-marketed insurances, often by direct mail, as well as other regional and national carriers, such as 21st Century Insurance (a primarily personal auto insurance carrier operati in California, Arizona, Nevada, Washington, and Oregon).

In some cases, a given insurer may employ multiple marketing channels.

INDEPENDENT AGENTS

An *independent insurance agent* is a person who is licensed by the department of insurance in the state (or states) where he or she conducts business. Licensure generally involves passing a written examination to show that the person meets minimum standards of knowledge regarding the business of insurance.

Independent agents are typically parties to contracts with several insurers by which the agent is authorized to write business (*i.e.*, policies) for that insurer. In most states, each insurer files a notice of appointment of each agent with the department of insurance in that particular state. Independent agents are usually compensated by the insurers they represent through payment of a commission tha is a fixed percentage of the premium of each policy sold. This commission percentage may vary wit the size of the premium or line of business. For example, insurers often pay higher commissions on commercial lines policies than they do on personal lines policies. This is due in part because the underwriting and production of personal lines policies is often less complex, presenting fewer variables, and typically involves smaller premiums per policy. The administrative costs to the insure of issuing a commercial policy for a small business and a personal lines policy are roughly the same.

Independent agents frequently state that one advantage of dealing with an independent agent is tha he or she often has the flexibility to obtain competing quotes from several insurers. These competin quotes may offer the insured broader or lesser coverage in response to greater or lower premiums, th offering the insured a range of choices.

An independent agent will not have a State Farm, Farmers, Allstate, or Nationwide logo in their Yellow Pages ad, or over his or her office. Independent agents are often members of professional/tra organizations, such as the *Professional Insurance Agents* (PIA) organization or *Independent Insuran Agents* (IIA) organization. Their advertising in the Yellow Pages and otherwise will usually make clear that they are independent agents, especially the fact that they represent several companies. In some regions, the Yellow Pages will have listings of agents who represent particular insurers that conduct their business even though they are independent agents—so checking by a particular name, such as *Hartford* or *Kemper*, may help you identify local independent agents.

CAPTIVE AGENTS

Captive agents represent only a single insurer. In some instances, they may even be employees of the ~~insurer. Examples of captive agents are agents who sell State Farm, Allstate, Nationwide, and~~ Farmers policies. A State Farm agent, for example, is limited to offering the policies offered by the State Farm companies. If a given customer seeks a type of insurance not offered by a captive agent insurer, the customer will end up having to go to another agent or broker to obtain a quote or a policy

Nonetheless, the captive agent manner of marketing of insurance, particularly personal lines policies, obviously has been successful. State Farm, Allstate, Nationwide, Liberty Mutual, and Farmers control a substantial portion of the United States personal lines insurance market.

However, if you really want to comparison shop for competing quotes involving considerations other than price from several companies, including from one or more captive agent companies, you will have to contact an agent from each company separately and compare the results on your own.

The most important thing the consumer needs to do is locate a competent agent. While there is no single yardstick by which to gauge an agent's competence, things to inquire about include:

education level (*i.e.*, is the agent in question a college graduate?—sometimes the ability to spot issues is crucial);

how many years of experience does the person have as a licensed agent?;

whether the agent is a member of any of the professional insurance associations. While not a perfec measure, such memberships can indicate a level of knowledge and commitment to a business and career; and, whether the agent has a chartered property casualty underwriter (CPCU) designation.

NOTE: *A CPCU designation is earned by completion of a series of college-level courses in various aspects of the business of insurance and by passing a nationally administered examination for each o the required courses. CPCU designations are sought and earned by many insurance industry personnel, such as underwriters and claims representatives, in addition to agents and brokers. Holding a CPCU designation is considered within the business of insurance a mark of commitment to an insurance career and a significant professional achievement within the business.*

There are competent and professional agents who are independent agents, and who are captive agents. You just need to understand enough about the various marketing channels to make a decision which form makes the best sense for you.

DIRECT WRITERS

As our economy and markets have changed, other insurance marketing channels have developed. While these alternate marketing channels for insurance initially focused on motor vehicle insurance, more recently they have expanded to include homeowners insurance as well.

The problem with these direct marketers is that there is no practical ability for the average insuranc buyer to compare the terms and conditions of the policies offered in order to determine whether or no the coverages offered meet the needs of the insurance buyer. And there is no one to provide any counseling with respect to decisions involved in the purchase. You do not have the ability to call on the services of an agent to help you choose the policy limits appropriate to guarantee that you have sufficient coverage to repair or replace your residence and possessions in the event of a major loss.

Many of the 800-number or Internet sellers of insurance have engaged in widespread television advertising of their policies. These TV commercials frequently emphasize potential premium savings as the inducement to buy that company's policies. *Premium savings* does not mean much without advice about variations in optional coverages or how much in limits the average person needs to purchase for adequate protection.

These direct sales operations present a potential trap for the unwary by creating a serious risk of uninsured or underinsured loss exposures. A particular disadvantage of many such direct marketing insurers is that there is often little or no opportunity to review the policy forms utilized to determine whether they contain unanticipated restrictive terms. Certainly, in order to be licensed to sell policies in any particular state, the policies’ terms necessarily will be in compliance with that state’s minimu ~~requirements. However, that does not ensure that such policies will necessarily provide the best~~ coverage for your particular needs.

Compounding this problem is that most insurers charge a penalty if a policy is issued and then cancelled at the insured’s request midterm.

EXAMPLE: You purchased a one-year policy and cancelled it after two weeks because you discovered it contained restrictive terms that did not provide coverage for a particular loss exposure. In this situation, you will receive a refund that is less than fifty-weeks worth of the premium. Unless direct marketing insurer offers the opportunity to examine the policy in advance or offers a no-charg return policy, you might want to pass. Instead, avail yourself of the services of a local agent you can meet in person and discuss your insurance needs with to obtain the best compromise between cost an extent of coverage provided.

RETAIL VERSUS WHOLESALE BROKERS

Many insurance consumers will never need to deal with the concept of *retail brokers* versus wholesale brokers. An insurance broker is the agent of the insured and can submit applications for coverage to insurers for which the broker does not have an agency appointment.

Some insurers will only accept applications from a broker with which they have an agency relationship. In addition, coverages can be placed with non-admitted insurers only through an excess or surplus lines broker.

A *wholesale broker* is a broker involved in the procurement of a policy that does not have a direct relationship with the insured. For example, an applicant for a personal auto policy might not be an acceptable risk to standard carriers due to a variety of underwriting factors, such as age or poor loss history (*i.e.*, excessive number of citations or accidents). The problem is, in many states, surplus line regulations and statutes are not scrupulously observed. And, when they are not, it is usually to the average consumer’s disadvantage. If an insurance agent you may have turned to suggests that he or she is going to provide you with a quote or recommends that you purchase a policy through a nonadmitted insurer (a surplus lines broker), you should start asking some pointed questions as to why.

A policy issued by a nonadmitted insurer in your jurisdiction is not protected by your state’s insurance guaranty fund. In the event that insurer becomes insolvent, your policy is *worthless*. For th sake of some premium savings, you are completely unprotected in the event of insolvency of a nonadmitted insurer.

When you place insurance with an admitted insurer, you are protected up to the limits established b your state’s insurance guaranty fund in the event your insurer becomes insolvent. In general, that means you get a lawyer appointed to defend you if you get sued and a covered judgment or settlemen will be paid up to the covered statutory limits of your state’s guaranty fund. It also means that your covered automobile physical damage claim or claim for damage to your house or possessions will be paid, subject to the statutory limits.

For example, in California, under Insurance Code section 1063, the maximum amount of a claim payable by the California Insurance Guaranty Fund is $500,000. That is an amount sufficient to cover most serious liability claims that the average homeowner is likely to face. It also is an amount sufficient to cover many partial losses to a residence and contents, even though, in the face of escalating construction costs, it may not, in some cases, be sufficient to cover total losses.

There is a reason why one of an insurance agent’s most essential functions is to place coverages on behalf of their customers with insurers that are financially strong. This is because the amounts typically available in the event of insurer insolvency under the various states’ insurance guaranty funds may be less than the loss exposures of many insureds.

State laws exist that require warnings to the insurance purchaser of the risks involved in purchasing ~~insurance from a nonadmitted carrier. However, few, if any, brokers involved in the sale of such~~ policies generally warn of or explain these risks and the trade-offs involved to their customers adequately. This is particularly true in the personal auto liability coverage context, where these abuse are most prominent.

A far too common circumstance, particularly in major urban areas, with large numbers of *substandard risk* insureds, is for high-volume brokers to run mass-marketed commercials, promising to be able to provide auto insurance to *anyone*, and at great savings. Such mass marketers of insuranc often emphasize that coverage can be available for low down payments, and low monthly payments. These representations are often highly deceptive. Such operations often sell ridiculously expensive, low-limits policies, often issued by nonadmitted insurers. Rarely do such operations inform their customers of their state's *assigned risk* programs, which, if applicable, usually provide better coverage than that from a nonadmitted insurer.

Unfortunately, the fact is that while certain high-risk insureds may need to consider purchasing insurance from nonadmitted insurers, these insureds are usually commercial insureds with higher exposure to risk and loss histories—individually or as an industry classification. This leaves them perceived as high-risk from an underwriting standpoint. The average personal auto or homeowners insured should rarely be in such a position.

Other disadvantages exist using a nonadmitted insurer. Nonadmitted insurers prey on persons who have been advised that they are substandard risks, particularly in the personal auto context. The clain service offered by nonadmitted insurers is generally poor or nonexistent. They offer and sell policies that are often apparently cheap (compared with the premiums that would be charged by an admitted insurer) and they let the insured nominally satisfy their state's financial responsibility/proof of insurance laws. However, their promises are often functionally smoke and mirrors.

An insurer that does not pay claims promptly or does not step in and defend an unsured when he or she has been sued has given none of the protections expected by someone who has purchased an insurance policy. It does you little good when you are faced with a lawsuit resulting from an accident to find yourself having to fight a two-front war—one against the person suing you and a second against your insurer to obtain the coverage that you paid for.

Brokers that routinely place personal lines policies with nonadmitted carriers may argue that they are saving their customers money. These claims are usually illusory. In most cases, however, the premium savings do not offset the risks of an uncovered loss in the event of insolvency of the insurer or in the case of a nonadmitted insurer simply failing to observe its policy obligations. Many nonadmitted insurers are domiciled outside the United States, making suing them and recovering an uncertain proposition.

There is almost never any need for an individual or a family to turn to a surplus lines/nonadmitted insurer for personal auto or homeowners insurance. Many states have what are called *alternative market* mechanisms.

Examples of such *alternative market* mechanisms are automobile *assigned risk* plans, and *FAIR* plans. (FAIR refers to fair access to insurance requirements, under the plan established under the California Insurance Code.)

Under such plans, all admitted insurers writing automobile or property insurance are required to participate or fund these plans. In the case of most *assigned risk* auto insurance plans, when a person qualifies (usually by virtue of proof of refusal to issue a policy by a certain minimum number of insurers), he or she is assigned to an insurer that must issue a policy. This is subject to such policy limit and premium limitations as may be established by the plan.

Nonetheless, the ability to purchase a policy through an assigned risk plan guarantees that an individual is going to be able to obtain coverage from a standard lines admitted carrier. Assigned risk plan ~~policies are more expensive, but the insured has the security of coverage with an admitted~~ insurer. If the policyholder *cleans up* his or her loss, violation, or infraction history, he or she can eventually purchase coverage in the standard insurance markets and will no longer need to rely on coverage through an assigned risk plan.

FAIR plans are alternative market mechanisms for hard-to-place homeowners or other property insurance polices. These are used in areas such as Southern California, urban areas that are underserved by standard lines insurance markets, and other areas that are considered higher than normal risk (such as homes located in and near *brush* areas). Again, the issuers of policies offered through these types of programs are entitled to charge premiums that reflect the increased risk assumed. However, for most persons, policies procured through such plans are preferable to policies from nonadmitted insurers. This is due to the protections afforded by the fact that these policies are covered by each state's insurance guaranty funds and because of better and more reliable claims service.

GUARANTY FUNDS

Each state has an insurance *guaranty fund*. Each operates in substantially the same way. In the even of insolvency of an insurer whose policies are covered by the guaranty fund (*i.e.*, an admitted insurer in that state), policyholders of that insolvent insurer are covered up to the statutory limit. This limit varies from state to state, but is sufficient to cover most anticipated property claims and all the genuinely catastrophic liability claims. In addition, the guaranty fund statutes provide for defense of liability claims in addition to paying judgments or settlements up to the amount of the statutory limi

The protection offered by the guaranty fund is not perfect protection. But, the protection offered is far better than having none and is a substantial reason to purchase insurance coverage from an admitted insurer as opposed to a nonadmitted insurer.

Guaranty funds are funded by you and every other policyholder in your state. You are all providing protection for each other. The initial capitalization (*i.e.*, start-up funds) for guaranty funds comes fro assessments of all admitted insurers doing business in that state, in proportion to the respective amount of premiums written by each insurer in that state. Under the guaranty funds statutes of all states, the insurers that have paid these assessments to provide the start-up capital to establish the guaranty fund were, and are, entitled to recover the costs of those assessments. This is recovered by premium surcharges on all of their policyholders. If you were to examine your premium billing notic over a period of time, you will notice such surcharges, typically between $1 and $5. This charge is imposed by your insurer proportionately on all of its policyholders to cover the costs of assessments has been obligated to pay to fund the guaranty fund in your state.

The guaranty fund in each state operates much like an insurance company. Guaranty funds set reserves, retain defense counsel, and settle and defend claims. They also adjust property claims. The primary difference is in the source of their funding. Insurance companies fund their operations primarily by charging premiums and by realizing investment income on their reserves (premium reserves and loss, loss adjustment expense, and other reserves). Guaranty funds likewise generate income by investments received on reserves. They do not have, however, premium income as a sourc of income. Nor do guaranty funds have the overhead associated with marketing and selling policies, a do insurance companies.

When an insurance guaranty fund needs to generate income because the claims it has paid are depleting it imposes assessments on all admitted insurers doing business within the state.

CHOOSING WHAT IS BEST FOR YOU

A good independent agent is likely to be the best place for most insurance consumers to start. By employing an independent agent, you preserve the maximum number of options for yourself. And, yo