



Inflation and Insurance


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Inflation, Valuation, and Errors & Omissions

- The issue
 - Suggestions/Recommendation Error (type and limit of coverage)
- Why
 - Inflation has not gone away
 - Commercial Property still largest percent
- What do the stats show
 - Claim count – 14.15%
 - Loss amount – 24.23%
- What's an agency to do
 - We suggest, they choose
 - We remind them that higher limits and or additional coverages may be available



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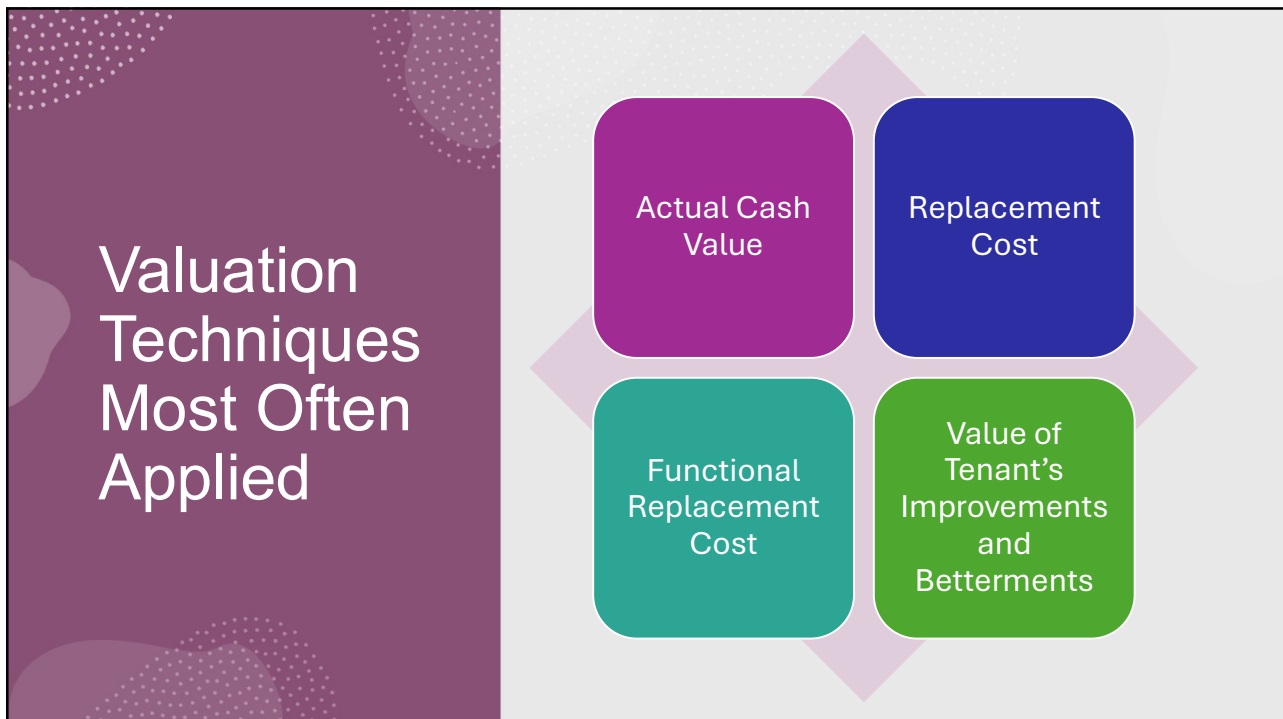
Inflation and Insurance

Valuation of Commercial Property


In the event of a loss, the primary concern of insureds is typically how much they will be able to recoup from their insurance policy. Remember, most agent's errors and omissions claims arise from not having adequate limits on the property policy.

Valuation of property refers to how the financial value of an insured property is determined. The valuation is what is used in setting a limit of insurance when the policy is written but for payment of claims for lost or damaged property valuation is determined at time of loss.

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Valuation

- Actual Cash Value – State Laws May Vary
 - Fair Market Value – price a willing buyer would pay to buy property from a willing seller in a free market.
- Replacement Cost Less Depreciation – cost to replace property at the time of the loss minus its physical depreciation.
- The Broad Evidence Rule – a judicious application of either of the above to the unique circumstance of claim, whichever is more favorable to the insured.

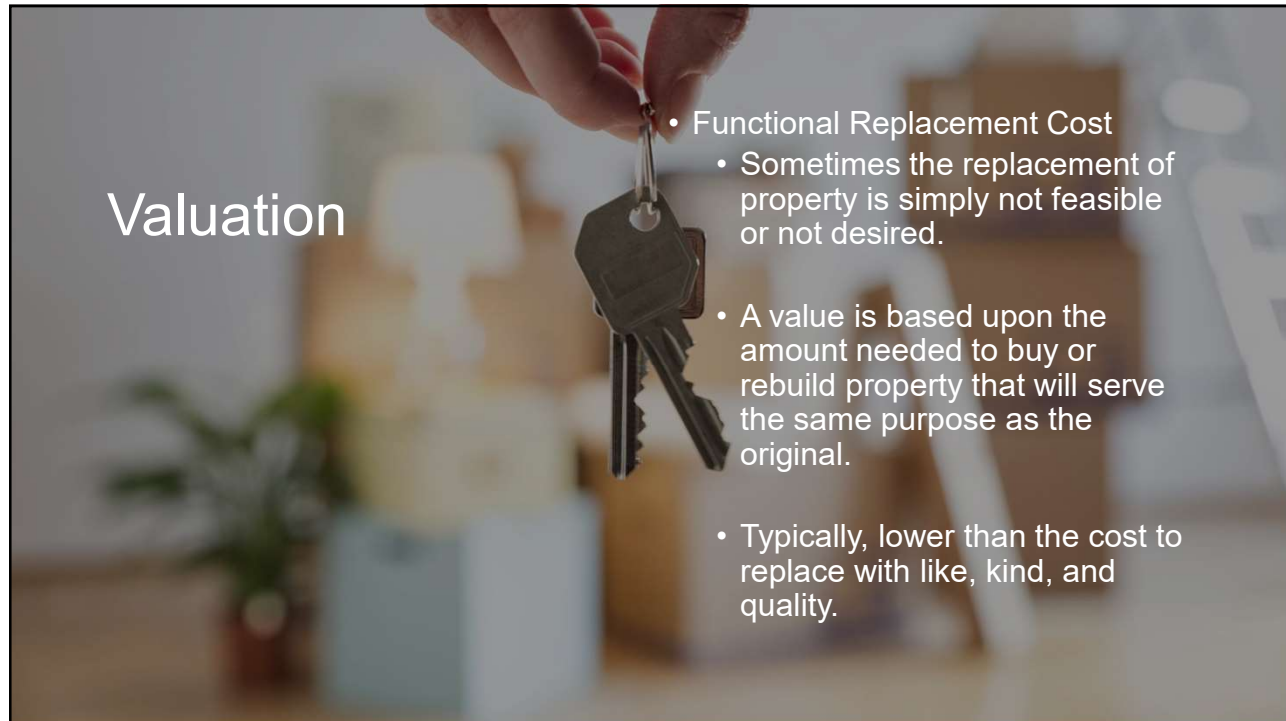
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Valuation

- Replacement cost (RC)
 - Commonly used valuation method
 - Cost to repair/replace with like kind and quality at today's dollars
 - No depreciation
 - “New for Old” – would seem to violate the principle of indemnity where the insured is made whole after a loss not giving “new for old” but it grew in popularity due to the practical limitations of ACV in financing loans for the acquisition of property.




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Valuation

- Functional Replacement Cost
 - Sometimes the replacement of property is simply not feasible or not desired.
 - A value is based upon the amount needed to buy or rebuild property that will serve the same purpose as the original.
 - Typically, lower than the cost to replace with like, kind, and quality.

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Valuation

- Value of Tenant's Improvements and Betterments
 - Commercial tenants leasing property sometimes make their own improvement and betterment to the property – lighting fixtures, wall coverings, walls, etc.
 - Legally and practically becomes part of the building which the tenant does not own but does have a use interest in the I&B.
 - This is addressed in the policy.

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The Purpose of Coinsurance

Most building property losses do not result in a total loss. Knowing this insureds may be inclined to lower the amount of property insurance. Being underinsured could result in financial ruin after a catastrophic event for an insured but it could also negatively affect how carriers forecast their loss payments.

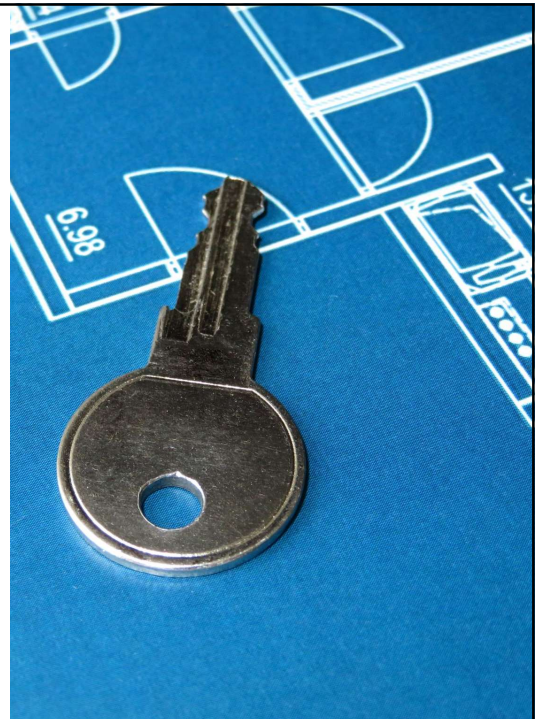
To avoid this most insurers will include a coinsurance clause.



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Valuation

- Agreed Value
 - This coverage provides for a predetermined amount to be paid in the event of a total loss to the described property. Upfront agreement between the insured and the insurance company on the fixed value of the property.
 - Coinsurance does not apply to Covered Property to which this Optional Coverage applies. However, the rules state the insured must carry an amount equal to 80% of the building's value or 90% for risks written on a blanket basis.
 - Insured must complete the Statement of Values endorsement – CP 16 15 – at the beginning of the policy term and with each renewal.
 - If the expiration date for this Optional Coverage is not extended, the Additional Condition Coinsurance is reinstated, and this Optional Coverage expires.



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Now We Know How Property is Valued Let's Assess the Options

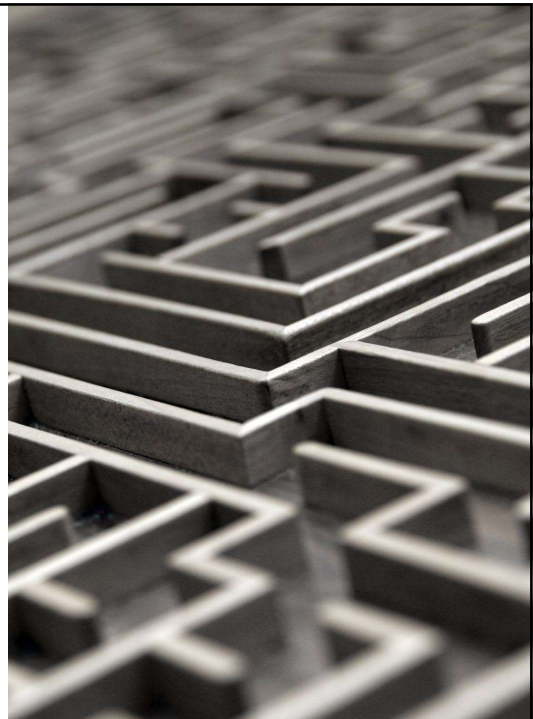
- Specific Insurance
 - Applies a specific limit to a building or personal property at a single location.
- Scheduled Insurance
 - Policy shows separate limits of insurance applied to individually listed properties.



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Now We Know How Property is Valued Let's Assess the Options

- Blanket Insurance
 - Takes the value of all reported properties – this may also include personal property of others and tenant's improvements and betterments.
 - Total limit is available to pay losses regardless of what property or location suffers the loss.
 - Makes it easier to manage and provides the insured more room for a mistake when estimating the valuation of their properties.
 - Insured will have 100% of coverage at each location when they carry the required minimum coinsurance clause –usually 90%.



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Business Personal Property



From the one-person shop or store to a highly complex global manufacturing or industrial giants they all have property exposures that need to be addressed.

Personal property is any property that is not affixed to the real estate or that can be physically moved.

These exposures include owned or leased real property, processed or unprocessed inventory, property of others but in the care, custody, or control of an insured, property in transit, and much more.

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Business Personal Property - Examples

- Stock – defined term
- Furniture and fixtures
- Machinery and equipment
- Other personal property owned by you and used for your business
- Leased personal property for which you have a contractual responsibility to insure
- Labor, materials, and service that you furnish for the property of others
- Use value to a tenant of improvements and betterments

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Leased Property, CP 14 60



Leased property must be specifically described.



Property covered by this endorsement should not be included when calculating a value for the insured's personal property or the property of others.



Insured may select a valuation other than ACV (such as Replacement Cost) on an item-by-item basis.



Agreed value – coinsurance provisions still apply.


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Your Business Personal Property Separation of Coverage, CP 19 10

- Various categories of business personal property may be assigned individual limits of insurance.
- Also functions as a way to exclude certain types of personal property since any categories not listed with an individual limit of insurance are not covered at the specified locations.



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Outdoor Trees, Shrubs and Plants, CP 14 30

- The building and personal property form provides up to \$1,000 coverage, subject to a limit of \$250, per item for outdoor trees, shrubs, and plants.
- Only for the perils of fire, lightning, explosion, riot or civil commotion, or aircraft.
- This endorsement increases the coverage on these items and expands it to make them subject to the perils of the policy.
- Insured may choose to exclude loss caused by vehicles.
- Can not be grown for commercial purposes.

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Outdoor Signs, CP 14 40

-  The commercial property form provides \$2,500 for outdoor signs.
-  Coverage provided includes all causes under the applicable causes of loss form.
-  This endorsement is used to provide more dollars for signs.
-  Schedule contains information about location, materials from which they are constructed, individual limits, coinsurance percentage, applicable causes of loss form and additional premium.
-  Unscheduled signs remain subject to limit and the limited causes of loss in the coverage extension.

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Spoilage Coverage CP 04 40

- Used to extend direct coverage for spoilage of perishable stock that the insured processes, stores, or sells.
- Three classes of products.
- Certain coverages offered – breakdown or contamination (refrigeration maintenance agreement must be in force) and contamination by the refrigerant.
- Deductible is separate from the rest of the policy.
- Insured may select to value the property at selling price. The insurer determines the value of the property at selling price less any discounts and expenses.



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Distilled Spirits and Wines Market Value CP 99 05

- Changes the valuation of distilled spirits and wines from actual cash value to market value.
- Items may be either the insured's stock or the property of others in the insured's care.
- Insured schedules the locations to which the endorsement applies.
- There are five categories of distilled spirits.
- Wine is divided into two categories – bottled winery products and bulk wine.



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Functional Personal Property Valuation (Other Than Stock), CP 04 39

- Coinsurance does not apply to this endorsement and blanket insurance is not allowed.
- Any items scheduled on the endorsement should be excluded from coverage under the building and personal property coverage form.
- The situation is the same when the values are reversed. Computer purchased two years ago has an ACV of \$50,000. However, due to advances in technology, the same computer may now be purchased for \$30,000. With this endorsement the insured may cover the computer for \$30,000.



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Value Reporting Form CP 13 10

- The purpose of this endorsement is to allow an insured who has property that fluctuates in value to be fully protected and to pay premiums based on the values at risk – provided the insured reports values correctly and promptly.
- The insured sets an initial policy limit that reflects the year's highest projected values.
- The value reporting form requires a 100 percent coinsurance requirement.
- Reporting options – daily, weekly, monthly, quarterly, or by policy year.



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Value Reporting Form CP 13 10



Penalties – if insured does not submit an initial report any loss payable is reduced by 25 percent. If the insured fails to submit subsequent reports, any loss is adjusted based on the value last reported.

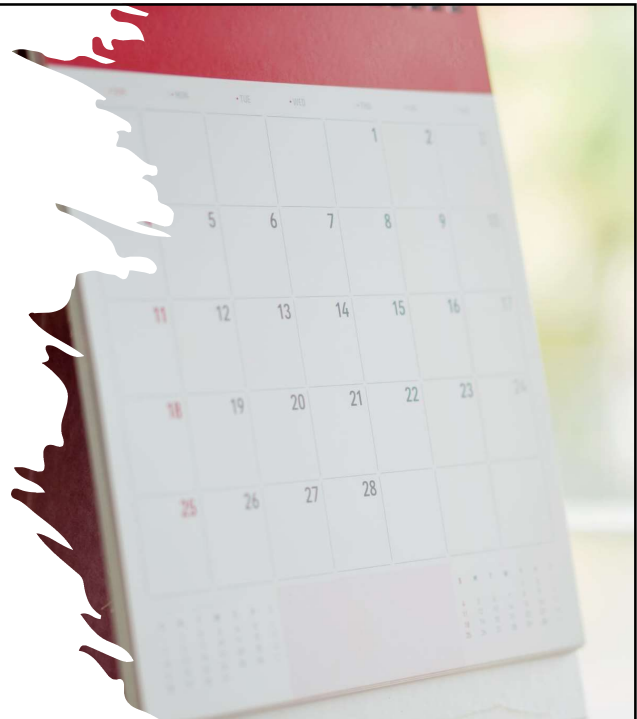


The insured pays only for what was at risk, and the insurer receives a premium that matches the insured's exposure.

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Peak Season CP 12 30

- Automatically increases the limit for the insured business property for a specified period(s) of time to ensure appropriate coverage.
- Allows for identification of the property needing additional coverage, showing the beginning and ending date of increase in the property values, and scheduling of that property with a specific amount of insurance that is added to the limit shown on the declarations.
- Multiple time periods may be applied, if necessary.



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Peak Season CP 12 30



The effectiveness of this endorsement lies in the adequacy of the additional amount of insurance chosen for the time period.



The insured chooses the property that increases in value, the amount of the insurance, and the applicable time periods.



Outside of the specified time periods, the limits of insurance return to those shown in the declarations.



The same causes of loss apply.



Can not be used with a value reporting form or on property written on a blanket.

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It Is Not Just A Commercial Issue

- Commercial Property vs. Homeowners
 - Coinsurance vs. Loss Settlement Provision
 - Coverage A and Coverage B both affected in the Homeowners Policy
 - Coverage C settled on ACV



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Loss Settlement RC or ACV

- Replacement Cost
 - Building – Coverage A
 - Building – Coverage B
- Actual Cash Value
 - All Personal Property – Coverage C
 - Non-buildings – Coverage B
 - Carpeting
 - House Appliances
 - Awnings
 - Grave Markers

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Endorsements That May Help Personal Property and Certain Non-building Structures

Personal Property Replacement Cost Loss Settlement – HO 04 90

Changes coverage for personal property, carpeting and household appliance from ACV to replacement cost loss settlement without deduction for depreciation. Also requires that property be replaced if the loss is over \$500.

Replacement Cost Less Settlement For Certain Non-Building Structures On The Residence Premises – HO 04 43

Changes coverage for Other Structures which are not buildings (such as fences, patios, driveways, and certain in-ground pools) from ACV to replacement cost loss settlement.

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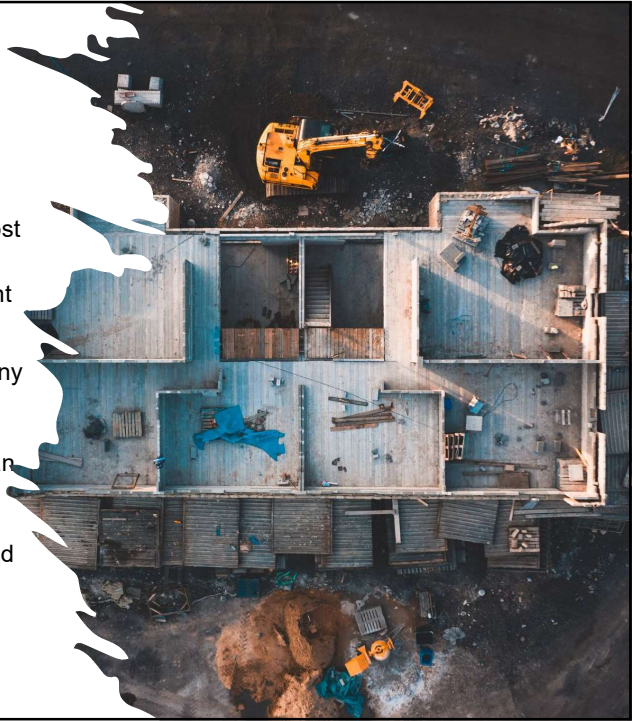
Loss Settlement of Buildings – Coverages A & B

Building Insured For At Least 80% Of Its Replacement Cost At The Time Of The Loss

If the building is insured for at least 80% of its replacement cost at the time of the loss, then the Loss Settlement Condition states that buildings under Coverages A and Coverages B will be valued at replacement cost without any deduction for depreciation in value.

Replacement cost will not be paid until repair or replacement is complete unless the loss is BOTH less than 5% of the limit of insurance on the building and less than \$5,000.

Insured may also choose an ACV settlement. If the insured later decides they would like to proceed with repair or replacement of the damaged dwelling and would like to claim additional coverage, the insured must notify the carrier within 180 days after the date of the loss.



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Loss Settlement of Buildings – Coverages A & B

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Greater of Formula or Actual Cash Value


Limit of Liability on Policy (Did)

Replacement Cost x 80% (Should) x Loss

Equals Payment

Or

Actual Cash Value



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Example


Bob's house was damaged by a fire. He carries \$210,000 coverage on his home with a replacement cost of \$350,000. The total cost to repair his home was \$30,000. The actual cash value \$22,000. How much will the insurance company pay?

210,000 (did) x \$30,000 = \$22,500.


280,000 (should)

Formula - \$22,500

Actual Cash Value - \$22,000



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Endorsements That May Help

- HO 04 20 – Specified Additional Amount of Insurance For Coverage A Only
 - Dwelling must be insured to 100% replacement cost.
 - Does not increase Coverage A but provides an additional 25% to 50% (amount selected) if needed.
- HO 04 11 – Additional Limits of Liability for Coverages A, B, C and D
 - May be available to provide an additional amount of insurance to rebuild the dwelling at time of loss.
 - Coverage will be increased to equal the current replacement cost.
 - Other coverages based on a percentage of Coverage A are also increased.
 - Premium will be adjusted for increased coverage.