Chapter 10: Managing Property and Liability Risk: 10.2h Who Sells Insurance?
Book Title: Personal Finance
Printed By: Xzavier Shugars (xfshugars@eiu.edu)

10.2h Who Sells Insurance?

Sellers of insurance, called **insurance agents** (Representative of an insurance company authorized to sell, modify, service, and terminate insurance contracts.) , represent one or more insurance companies. They have the power to enter into, change, and cancel insurance policies on behalf of these companies. Two types of insurance agents exist: independent agents and exclusive agents.

Independent insurance agents are independent businesspeople who act as third-party links between insurers and insureds. Such agents earn commissions from the companies they represent and will place each insurance customer with the company that they believe best meets that customer's particular needs.

Exclusive insurance agents represent only one insurance company for a specific type of insurance. They are employees of the insurance company they represent. Life insurance, for example, is often sold through exclusive insurance agents.

Direct sellers (Companies that market insurance policies through salaried employees, mail-order promotions, newspapers, the Internet, and even vending machines.) are companies that market their policies through salaried employees, mail-order promotions, newspapers, the Internet, and even vending machines. Any type of insurance can be sold directly.

Each type of seller presents both advantages and disadvantages. Independent agents may provide more personalized service and can select among several companies to meet a customer's needs. Exclusive agents can provide personalized service as well but are limited to the policies offered by the one company they represent but their sales commissions tend to be low. For people who know what coverage they need, the lowest-cost insurance premiums can be found with direct sellers.

Concept Check 10.2

1. Define *insurance*.
2. Distinguish among the three types of hazards.
3. Why is the principle of indemnity so important to insurance sellers?
4. Identify four key points to review when reading an insurance policy.
5. Summarize how to use deductibles, coinsurance, hazard reduction, and loss reduction to lower the cost of insurance.

6. Differentiate among independent agents, exclusive agents, and direct sellers.

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10.3 Homeowner's Insurance

Whether you own or rent housing, you face the possibility of suffering property and liability losses.

> Learning Objective 3 - Design a homeowner's or renter's insurance program to meet your needs.

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Chapter 10: Managing Property and Liability Risk: 10.3a Coverages
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10.3a Coverages

Homeowner's insurance (Combines liability and property insurance coverages that homeowners and renters typically need into single-package policies.) combines the liability and property insurance coverages needed by homeowners and renters into a single-package policy.

Property Coverage

Homeowner's insurance provides protection for various types of property damage losses, including the following:

(1) damage to the dwelling,

(2) damage to other structures on the property—referred to as **appurtenant structures**,

(3) damage to personal property and dwelling contents, and

(4) expenses arising out of a loss of use of the dwelling (for example, food and lodging).

Additional coverages are usually provided for such items as debris removal, trees and shrubs, and fire department service charges.

The property protection in a homeowner's policy is written on a named-perils or open-perils basis. **Named-perils policies** (Cover only losses caused by perils that the policy specifically mentions.) cover only those losses caused by perils that are specifically mentioned in the policy. **Open-perils policies** (Cover losses caused by all perils other than those that the policy specifically excludes.) (or **all-risk** (Cover losses caused by all perils other than those that the policy specifically excludes.)) **policies** (Cover losses caused by all perils other than those that the policy specifically excludes.) cover losses caused by all perils other than those specifically *excluded* by the policy. All-risk policies provide broader coverage because hundreds of perils can cause property losses, but only a few would be excluded. Common exclusions are flood, earthquake, and mold unless caused by some nonexcluded event such as burst water pipes. Coverage for excluded perils can often be purchased for an additional premium if desired.

Liability Coverage

Whenever homeowners are negligent or otherwise fail to exercise due caution in protecting visitors, they may potentially suffer a liability loss. Liability insurers have three major duties:

(1) the duty to indemnify, and

(2) the duty to settle a reasonably claim, and when appropriate

(3) the duty to defend.

Homeowner's general liability protection (Applies when you are legally liable for another person's losses, other than those that arise out of use of vehicles or your professional duties.) applies when you are legally liable for the losses of another person and can include legal fees and damages assessed up to the limits of the policy.

Homeowners often wish to take responsibility for the losses of another person regardless of the legal liability. Consider, for example, a guest's child who suffers burns from touching a hot barbecue grill. **Homeowner's no-fault medical payments protection** will pay for bodily injury losses suffered by visitors regardless of who was at fault. In the preceding example, such coverage would help pay for the medical treatment of the visitor's burns. **Homeowner's no-fault property damage protection** will pay for property losses suffered by visitors to your home. An example of such a loss might be damage to a friend's leather coat that was chewed by your dog.

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10.3b Types of Homeowner's Insurance Policies

Six distinct types of homeowner's insurance policies exist: HO-1 through HO-3 and HO-8, HO-4 and HO-6, as described in Table 10-1. Each is a standardized package of protections designed to cover the perils that commonly affect homeowners and renters. The same terms and identifying numbers are generally used by most insurance companies.

Table 10-1

Summary of Homeowner's Insurance Policies

	HO-1 **(Basic Form)**	**HO-2** **(Broad Form)**	**HO-3** **(Special Form)**
Perils covered (descriptions are given below)	Perils 1–11	Perils 1–18	All perils except those specifically excluded for buildings; perils 1–18 on personal property (does not include glass breakage)
House and any other attached buildings	Amount based on replacement cost, minimum $15,000	Amount based on replacement cost, minimum $15,000	Amount based on replacement cost, minimum $20,000
Detached buildings (appurtenant structures)	10 percent of insurance on the home (minimum)	10 percent of insurance on the home (minimum)	10 percent of insurance on the home (minimum)
Trees, shrubs, plants, etc.	5 percent of insurance on the home, $500 maximum per item	5 percent of insurance on the home, $500 maximum per item	5 percent of insurance on the home, $500 maximum per item
Personal property	50 percent of insurance on the home (minimum)	50 percent of insurance on the home (minimum)	50 percent of insurance on the home (minimum)

	HO-1 (Basic Form)	HO-2 (Broad Form)	HO-3 (Special Form)
Loss of use and/or additional living expense	10 percent of insurance on the home	20 percent of insurance on the home	20 percent of insurance on the home
Credit card, forgery, counterfeit money	$1000	$1000	$1000
Liability coverage/limits (for all policies)		**Special limits of liability**	
Comprehensive personal liability	$300,000	For the following classes of personal property, special limits apply on a per-occurrence basis (e.g., per fire or theft): money, coins, bank notes, precious metals (gold, silver, etc.), $200; computers, $5000; securities, deeds, stocks, bonds, tickets, stamps, $1000; watercraft and trailers, including furnishings, equipment, and outboard motors, $1000; trailers other than for watercraft, $1000; jewelry, watches, furs, $1000; silverware, goldware, etc., $2500; guns, $2000.	
No-fault medical payments	$1000		
No-fault property damage	$500		

List of perils covered	13. Weight of ice, snow, sleet

HO-1 (Basic Form) **HO-2 (Broad Form)** **HO-3 (Special Form)**

1. Fire, lightning
2. Windstorm, hail
3. Explosion
4. Riots
5. Damage by aircraft
6. Damage by vehicles owned or operated by people not covered by the homeowner's policy
7. Damage from smoke
8. Vandalism, malicious mischief
9. Theft
10. Glass breakage
11. Volcanic eruption
12. Falling objects (external sources)

14. Collapse of building or any part of building (specified perils only)
15. Leakage or overflow of water or steam from a plumbing, heating, or air-conditioning system
16. Bursting, cracking, burning, or bulging of a steam or hot water heating system, or of appliances for heating water
17. Freezing of plumbing, heating, and air-conditioning systems and home appliances
18. Injury to electrical appliances and devices (excluding tubes, transistors, and similar electronic components) from short circuits or other accidentally generated currents

HO-4 (Renter's Contents Broad Form)	**HO-6 (For Condominium Owners)**	**HO-8 (For Older Homes)**
Perils 1-9,11-18	Perils 1-18	Perils 1-11
10 percent of personal property insurance on additions and alterations to the apartment	$1000 on owner's additions and alterations to the unit	Amount based on actual cash value of the home
Not covered	Not covered (unless owned solely by the insured)	10 percent of insurance on the home (minimum)
10 percent of personal property insurance, $500 maximum per item	10 percent of personal property insurance, $500 maximum per item	5 percent of insurance on the home, $500 maximum per item

	HO-1 (Basic Form)	HO-2 (Broad Form)	HO-3 (Special Form)
Chosen by the tenant to reflect the value of the items, minimum $6000	Chosen by the homeowner to reflect the value of the items, minimum $6000	50 percent of insurance on the home (minimum)	
20 percent of personal property insurance	40 percent of personal property insurance	20 percent of insurance on the home	
$1000	$1000	$1000	

This table describes the standard policies. Specific items differ from company to company and from state to state. When you want a limit that exceeds the standard limit for your company, you usually can increase the limit by paying an additional premium.

Policies for Owners of Single-Family Dwellings

Do It in Class

The **basic form (HO-1)** is a named-perils policy that covers 11 property-damage-causing perils and liability-related exposures. The **broad form (HO-2)** is a named-perils policy that covers not 11 but 18 property-damage-causing perils and liability-related exposures. There are special limits on certain classes of personal property, such as loss of jewelry or money. The **special form (HO-3)** (Provides open-perils protection (except for the commonly excluded perils of war, earthquake, and flood) for four types of property losses.) is the most common type purchased by homeowners. It provides all 18-perils protection (except for glass breakage) and protection from liability-related exposures. There are special limits on certain classes of personal property, such as loss of jewelry or money. The **older home form (HO-8)** is a named-perils policy that provides actual-cash-value protection on the dwelling; not replacement protection. The replacement value of older home may be much higher than its market or actual cash value. Thus, the policy only provides that the dwelling be rebuilt to make it serviceable; not rebuilt to the same standards of style and quality.

Policies for Renters

The **renter's contents broad form (HO-4)** (Named-perils policy that protects the insured from losses to the contents of a rented dwelling rather than to the dwelling itself.) is a named-perils policy that protects the insured from losses to the contents of a dwelling rather than the dwelling itself. It covers 17 perils (except for glass breakage) and provides some liability protection. HO-4 also provides for living expenses if the dwelling is rendered uninhabitable by one of the covered perils.

Financial Power Point

Renter's Insurance Is Very Inexpensive

Renter's insurance can cost as little as $20 a month and discounts are available if you buy from the same company that provides your auto coverage.

Policies for Condominium Owners

The **condominium form (HO-6)** is a named-perils policy protecting condominium owners from the three principal losses they face: losses to contents and personal property, losses due to the additional living expenses that may arise if one of the covered perils occurs, and liability losses. (The building itself is insured by the management of the condominium.)

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10.3c Buying Homeowner's Insurance

In keeping with the large loss principle you need to select appropriate amounts of coverage on your dwelling and its contents as well as to protect you from liability losses.

How Much Coverage Is Really Needed on Your Dwelling?

If you own your home, your first step is to determine the dwelling's replacement value. You could either use the services of a professional liability appraiser and/or consult with your insurance agent to determine replacement value. Note that over one-half of the homes in the United States are said to be underinsured.

Homeowner's insurance policies usually contain a **replacement-cost requirement** (Stipulates that a home must be insured for 80 percent of its replacement value (some companies require 100 percent) in order for any loss to be fully covered.) that stipulates that a home must be insured for a specified percentage of its replacement value (historically, 80 percent, and companies are increasingly requiring 100 percent). Thus, a home with a replacement value of $200,000 would need to be insured for $160,000 (or perhaps $200,000), and this amount would be the maximum that the insurance company would be obligated to pay for a total loss (after payment of the deductible by the policyholder). If you fail to meet your replacement-cost requirement, you will not be considered fully insured and must coinsure partial losses as well. The amount of reimbursement for partial losses will be calculated using the **replacement-cost-requirement formula**:

$$R = (L - D) \times [I \div (RV \times 0.80 \text{ or } 1.00)] \tag{10.2}$$

where

$$\begin{aligned}
\boldsymbol{R} &= \text{Reimbursement payable} \\
\boldsymbol{L} &= \text{Amount of loss} \\
\boldsymbol{D} &= \text{Deductible, if any} \\
\boldsymbol{I} &= \text{Amount of insurance actually carried} \\
\boldsymbol{RV} &= \text{Replacement value of the dwelling}
\end{aligned}$$

Do It in Class

Consider the example of Selena Torres from Las Cruces, New Mexico, who owns a home with a replacement value of $200,000 with a $500 deductible. Selena had insured her home for $144,000, even though the policy required coverage of 80 percent of the replacement cost. Last month a fire in

her home caused damage amounting to
$80,500. Applying Equation (10.2), Selena's calculations are as follows:

$$\begin{aligned} R &= (\$80{,}500 - \$500) \times [\$144{,}000 \div (\$200{,}000 \times 0.80)] \\ &= \$80{,}000 \times (\$144{,}000 \div \$160{,}000) \\ &= \$80{,}000 \times 0.90 = \$72{,}000 \end{aligned}$$

As this calculation shows, Selena will be reimbursed for only $72,000 of her loss. Her failure to insure her house for 80 percent of its replacement cost, or $160,000 ($200,000 × 0.80), means she will be covered for only 90 percent ($144,000/$160,000) of its value, and she must pay 10 percent of any partial loss—in this case, $8000.

Meeting an 80 percent replacement-cost requirement enables you to avoid coinsurance on small losses but might still result in inadequate coverage on large losses that, though rare, exceed the policy limit. Thus, it is wise to insure your dwelling for 100 percent of its replacement cost. You will also want to sign up for **inflation guard protection** to have your insurance company increase your coverage automatically each year to keep up with inflation.

A standard property insurance policy will replace a damaged property so that it is the same or similar as before. If a house was built a long time ago, building a similar structure as a replacement may not satisfy new building code regulations that will be required in the rebuild. This is especially true in areas that may have experienced natural disasters such as wildfires, windstorms, and flooding. **Law and ordinance protection** is a special insurance endorsement that pays for demolishment and/or repairs to meet modern building standards.

How Much Coverage Is Needed on Your Personal Property?

Did You Know?

How to Insure High-Value Items

Some high-value items of personal property are subject to specific item limits in the homeowner's policy. For example, the typical policy provides maximum coverages of $200 for cash, $5000 for personal computers, and $1000 for jewelry. This is because most people do not have such items above these values and do not need higher levels of coverage. If your home inventory reveals a higher valuation on such items, you can simply ask your company for extra coverage and pay the higher premium required.

Making a **personal property inventory** of, and placing a value on, all the contents of your home are time-consuming but important tasks. Table 10-2 shows the inventory and valuation for the contents of and personal property in a typical living room. You should conduct such an inventory for each room, the basement, garage, shed, and yard possessions. When totaled, these values will enable you to select proper policy coverage limits. Most homeowner's policies are designed to automatically cover contents and personal property for up to 50 percent of the coverage on the home. For example, if your home is insured for $240,000, you automatically would have $120,000 in personal property insurance. If you need more coverage, simply notify your agent.

Table 10-2

Personal Property Checklist: Living Room

Item	Date Purchased	Purchase Price	Actual Cash Value	Replacement Cost
Furniture				
Sofa	8/10	$ 750	$ 375	$ 950
Chair	11/08	250	100	375
Lounger	12/11	575	300	695
Ottoman	12/11	100	50	120
Bookcase	4/13	275	225	300
End table (two)	7/14	300	250	300
Appliances				
TV	1/14	550	500	600
DVD	6/13	400	300	400
Wall clock	7/08	60	10	100
Furnishings				
Carpet	6/07	375	50	600
Painting	12/11	125	225	225
Floor lamp	4/09	150	50	225
Art (three items)	10/13	600	600	800
Table lamp	4/09	75	40	100
Table lamp	5/13	125	100	135
Throw pillows	7/10	45	20	60

Item	Date Purchased	Purchase Price	Actual Cash Value	Replacement Cost
TOTAL		$4,755	$3,195	$5,985

Notice that Table 10-2 lists three estimates for the value of the contents of a room: the purchase price, the actual cash value, and the replacement cost. Historically, property insurance policies paid only the **actual cash value** (Represents the purchase price of the property less depreciation.) of an item of personal property, which represents the purchase price of the property less depreciation. The **actual-cash-value (ACV) formula** is:

$$ACV = P - [CA \times (P \div LE)]$$

(10.3)

where

$$\begin{aligned} \boldsymbol{P} &= \text{Purchase price of the property} \\ \boldsymbol{CA} &= \text{Current age of the property in years} \\ \boldsymbol{LE} &= \text{Life expectancy of the property in years} \end{aligned}$$

Consider the case of Marianna Kinard, a music teacher from Joanna, South Carolina, whose nine-year-old heating/air-conditioning unit was struck by lightning. The unit cost $2400 when new and had a total life expectancy of 12 years. Its actual cash value when it was struck by lightning was:

$$\begin{aligned} ACV &= \$2400 - [9 \times (\$2400 \div 12)] \\ &= \$2400 - (9 \times \$200) \\ &= \$600 \end{aligned}$$

Marianna could not replace the unit for $600. A more realistic replacement cost might be $3000. **Contents replacement-cost protection** (Option sometimes available in homeowner's insurance policies (including the renter's form) that pays the full replacement cost of any personal property.) is an option sometimes available in homeowner's insurance policies that pays the full replacement cost of any personal property. The standard limitation that applies to contents (50 percent of insured value of the dwelling) remains in effect if contents replacement-cost protection is purchased. The overall limit on contents may need to be raised, as it is easy to reach the 50 percent figure when replacement-cost valuation is used.

Did You Know?

What's Covered while You Are Away at College

College students and their parents sometimes wonder about the student's insurance coverage while attending school away from home. Students who have moved into their own residence to live year-round need to buy their own renter's and automobile insurance policies. This is because the family's homeowner's and auto coverages will only apply if the student (1) lives in a dorm or fraternity/sorority house or (2) lives in off-campus housing in what is clearly a temporary arrangement (that is, the student returns home during semester breaks and over the summer).

If you are covered by your family's policies, here are some guidelines to remember:

1. Property stored away from home is often only covered for up to 10 percent of the coverage on the home. If the family home is insured for $150,000, for example, then $15,000 of total coverage applies regardless of how many students are in the family.

2. Expensive items such as jewelry or computers are subject to specific limits in the homeowner's insurance policy. Auto insurance rates are based on where the vehicle is garaged (or parked) at night. The insurance agent should be notified if a covered vehicle is used while away at school. It is better to pay a slightly higher rate than to face denial of coverage for a loss because of misinformation. A discount is common for a college student listed on a parent's policy if the student does not have a car at school and the school is at least 100 miles from the parent's home.

How Much Coverage Is Needed for Liability Losses?

Newly written standard homeowner's policies provide $300,000 ($100,000 for older policies unless amended) of personal liability coverage, $1000 of no-fault medical expense coverage, and $500 of no-fault property damage coverage. It is smart to apply the large-loss principle here and increase the policy limits for all three of these coverages (or consider an umbrella liability policy discussed later). The extra cost is small because the odds of such larger losses are low.

Financial Power Point

Stay out of the Doghouse

One-third of homeowner's insurance liability claims are associated with dog bites. Notify your insurance company that you have a dog, because they might not renew your policy if you make a claim and did not tell them about the animal. And raise your liability limits for better protection.

Concept Check 10.3

1. Describe the types of losses covered under the property insurance portion of a homeowner's policy.

2. Give three examples of liability protection under homeowner's insurance policies.
3. Name the three types of homeowner's insurance policies for most residences; HO-3, HO-4, and HO-6.
4. Identify four types of personal property for which the covered loss is limited to a specific dollar amount under standard homeowner's insurance policies (see Table 10-1).
5. List the three questions you should ask yourself when determining the policy limits for a homeowner's insurance policy.

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