INTERPRETING YOUR INSURANCE CONTRACT

Understanding Differences

An Insurance policy is a written document setting forth the rights and obligations of the parties to the agreement. Generally, an insurance policy is viewed by the policyholder as a boring document and as a result, is frequently ignored until a loss occurs. The policyholder relies on the agent to understand his needs and to issue a policy accordingly. Only when a loss occurs does the fine print spring to life as both the insurance company and the policyholder try to determine the extent and amounts of coverage.

Interpreting an insurance policy involves careful reading of the policy in light of legislative and judicial definitions of key words and phrases. This information is intended to provide interpretive help so that a policyholder can determine their rights and liabilities under property insurance policies. Its purpose is to be a practical guide to the layman client of a public insurance adjuster or loss consultant when a loss occurs.

Kinds of Insurance

Ordinarily, there are three basic types of insurance: (1) property insurance, including fire and allied lines, inland marine insurance, multi-peril insurance and miscellaneous. (2) casualty insurance (principally liability insurance, and (3) life, health and accident insurance.

Property insurance policies often contain casualty and occasionally medical coverage provisions. This information only concerns the property coverage portions of property policies relating to losses to improvements on real estate (structures) or to the contents of structures, or a loss of profits by a business (business interruption coverage) caused by a direct loss to property. Typically, losses are caused by fire or storm.

Forms of Insurances Policies

The forms of insurance policies have evolved over time. Insurance is regulated by insurance departments, boards or commissioners in each state. Each state requires fire and other property policies to be a standard form prescribed by the state insurance regulatory body. As a general rule, the fire insurance policy standard adopted by New York State in 1943 has become, with minor modifications, the accepted standard for fire policies in all states.

Replacement Cost Value (RCV) /Recoverable Depreciation

Property insurance policies are often written on a replacement cost basis. With this coverage, the policyholder is able to replace or repair the property without having to finance the difference between replacement cost and the actual cash value (ACV) of the property if the property has depreciated from a new condition.

After a loss

...is not the time to begin understanding your policy.

Most replacement cost coverages for structures require that the property actually be replaced before the full replacement cost can be collected on the claim. In this situation, the insurance company usually pays the actual cash value of the loss as soon as it is determined and withholds the difference between replacement cost and actual cash value (this should be the extent of the depreciation of the property), until replacement has been completed and invoices and cancelled checks have been reviewed by the insurance company.

For the payment of replacement cost claims, standard policies once required that the property be replaced at the same location. Today that requirement is rare, but still appears in some policies.

Some policies provide that the property be insured to a specified minimum extent of its replacement cost before the policyholder is eligible for replacement cost coverage as provided by the policy.

Even with replacement cost coverage, a dispute sometimes develops concerning the meaning of "replacement cost". Consult your Concordia Claims Manager for details.

Actual Cash Value (ACV)

Property policies almost universally describe the measurement of recovery for loss in terms of actual cash value or actual value. The two terms mean the same thing. There has been a great deal of litigation and judicial writing specifically concerning the proper type of formula and evidence needed to measure a loss and arrive at the actual cash value, a fairly large amount of literature addresses this topic.

What is meant by actual cash value, or actual value, is not usually described in the policy. Typically, considerably different values are reached from various approaches used to measure actual cash value, which basically are: (a) replacement cost less depreciation, (b) reconstruction cost less depreciation, (c) fair market value, and (d) income data (if the property is income-producing property).

By far, replacement cost less depreciation is the most familiar and commonly used. However a recent California court ruling known as the Kirkwood Decision has changed insurance settlement practices. The courts have ruled that the insurance company must consider the physical condition of the item prior to the loss. Age is no longer the single determining factor for depreciation.

Other standardized property insurance policies are in use, notably the homeowners and multi-peril policies. In less frequent use are manuscript policies which are more or less tailor-made for a particular risk or group of risks. Although the property policies tend to be very similar, there is a great deal of variety between them, and if they are to be understood, there is no acceptable alternative to thoroughly reading the policy in question.

The Basics of an Insurance Contract

There are four basic parts to an insurance contract:

- **Declaration Page**
- **Insuring Agreement**
- **Exclusions**
- **Conditions**

It is important to understand that multi-peril policies may have specific exclusions and conditions for each type of coverage, such as collision coverage, medical payment coverage, liability coverage, etc. You will need to make sure that you read the language for the specific coverage that applies to your loss.

- The **Declaration Page** is usually the first part of an insurance policy. It identifies who is an insured, what risks or property are covered, the policy limits, and the policy period (i.e. time the policy is in force). For example, the Declarations Page of an automobile policy will include the description of the vehicle covered (e.g. make/model, VIN number), the name of the person covered, the premium amount, and the deductible (the amount you will have to pay for a claim before an insurer pays its portion of a covered claim). Similarly, the Declarations Page of a life insurance policy will include the name of the person insured and the face amount of the life insurance policy (e.g. $25,000, $50,000, etc.).

- The **Insuring Agreement** summarizes the major promises of the insurance company, as well as states what is covered. In the Insuring Agreement, the insurer agrees to do certain things such as paying losses for covered perils, providing certain services, or agreeing to defend the insured in a liability lawsuit. There are two basic forms of an insuring agreement:

    - ***Named-perils coverage***, under which only those perils specifically listed in the policy are covered. If the peril is not listed, it is not covered.

    - ***All-risk coverage***, under which all losses are covered <u>except</u> those losses specifically excluded. If the loss is not excluded, then it is covered. Life insurance policies are typically all-risk policies.

- The **Exclusions** take coverage away from the Insuring Agreement. The three major types of Exclusions are:

    - Excluded perils or causes of loss

    - Excluded losses

    - Excluded property

Typical examples of excluded perils under a homeowners policy are flood, earthquake, and nuclear radiation. A typical example of an excluded loss under an automobile policy is damage due to wear and tear. Examples of excluded property under a homeowners policy are personal property such as an automobile, a pet, or an airplane.

- The **Conditions** are provisions inserted in the policy that qualify or place limitations on the insurer's promise to pay or perform. If the policy conditions are not met, the insurer can deny the claim. Common conditions in a policy include the requirement to file a proof of loss with the company, to protect property after a loss, and to cooperate during the company's investigation or defense of a liability lawsuit.

Definitions

Most policies have a **Definitions** section, which defines specific terms used in the policy. It may be a stand-alone section or part of another section. In order to understand the terms used in the policy, it is important to read this section.

Endorsements and Riders

An insurer may change the language or coverage of a policy at the time of the policy renewal. **Endorsements and Riders** are written provisions that add to, delete, or modify the provisions in the original insurance contract. In most states, the insurer is required to send you a copy of the changes to your policy. It is important that you read all Endorsements or Riders so you understand how your policy has changed and if the policy is still adequate to meet your needs.

Obtaining a Copy of Your Policy

To obtain a copy of your insurance policy, you should contact your insurance company or your agent/sales representative.

Get More Information

Contact Concordia Sr. Claims Managers if you have questions regarding your policy or if you are having difficulty obtaining a copy of your policy from your insurance company. You may link to your state Insurance department's Web site by visiting www.naic.org. Click on NAIC States & Jurisdictions to find your state insurance department's website.

Your Policy: What it is

An insurance policy is a legal contract between the insurance company (the insurer and the person(s), business or entity being insured (the insured). Reading your policy helps you verify that the policy meets your needs and that you understand your and the insurance company's responsibilities if a loss occurs.

Many insureds purchase a policy without under-standing what is covered, the exclusions that take away coverage, and the conditions that must be met in order for coverage to apply when a loss occurs.

We want you to know that reading and understanding your policy can help you avoid problems and disagreements with your insurance company in the event of a loss.