

Viewpoint

AMERICAN ASSOCIATION OF INSURANCE SERVICES

AAIS

Winter 2008



Liability in the age of surveillance

How much information is too much—or too little?

ALSO
INSIDE

*The 2008
AAIS
Main Event*

*Windstorm
mitigation
discounts*

*Insuring
farm personal
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*Hurricanes:
A lesson in
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Over-Under

Sherry Taylor worked many years in farm insurance sales and underwriting before becoming AAIS’s manager of farm and agribusiness in 2007.

From her unique perspective, she knows that farmers often find themselves underinsured or, more rarely, over-insured for their farm personal property.

That’s because agents and . . . 14

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[From the editor]

My editor's note only appears in the print edition of Viewpoint, so you can be confident that your reading of this is not being tracked or recorded by electronic means--unless, of course, you are reading this in a location monitored by surveillance cameras.

As our lead story indicates, we live in an age of surveillance, when our daily activities are recorded and preserved through a web of ubiquitous electronic checkpoints.

As citizens, we may be alarmed by the growth in the collection and storage of personal data, yet we accept the process and enable it by acquiescing to regular demands for such data.

While it's still unclear what impact "dataveillance" will have on the exposure of general liability insurers, it is almost certain that the growth in collection and storage of data will produce legal challenges that will redefine what constitutes privacy, and violations thereof.

Part of AAIS's role is to look beyond the immediate impact of recognized hazards to analyze other developments that could affect risk in our society and economy. Our Main Event conference is designed to do just that.

This year's Main Event, April 20-22 in Ponte Vedra Beach, Fla., features one of the nation's most renowned economic commentators, plus experts in critical issues for insurers: products liability, e-commerce insurance, catastrophe modeling, and the development of rating variables.

In response to input from previous attendees, this year's Main Event also features expanded roundtable discussions and opportunities to share ideas with AAIS staff members who lead our product development teams in personal, commercial, and farm lines.

Of course, we'll have to collect some information when you register, and we can't help the fact that your comings and goings will be recorded by the airlines, rental car companies, hotel, and restaurants.

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Joseph S. Harrington, CPCU

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Liability in the age of surveillance

How much information is too much—or too little?

“There’s no such thing as too much surveillance,” says Brian Smith. “I wouldn’t want one square inch not covered.”

That’s not surprising to hear, given that Smith is in the business of providing surveillance camera service to retail operations.

What’s equally important, however, are the measures he takes or recommends to protect himself and his clients from general liability arising from his firm’s surveillance activities.

Smith installs independent servers at each of his clients’ sites that they can control, and he requires that they sign a statement releasing him and his firm from liability for use or misuse of the information gathered.

Furthermore, Smith advises his clients “to be upfront about what they’re doing.

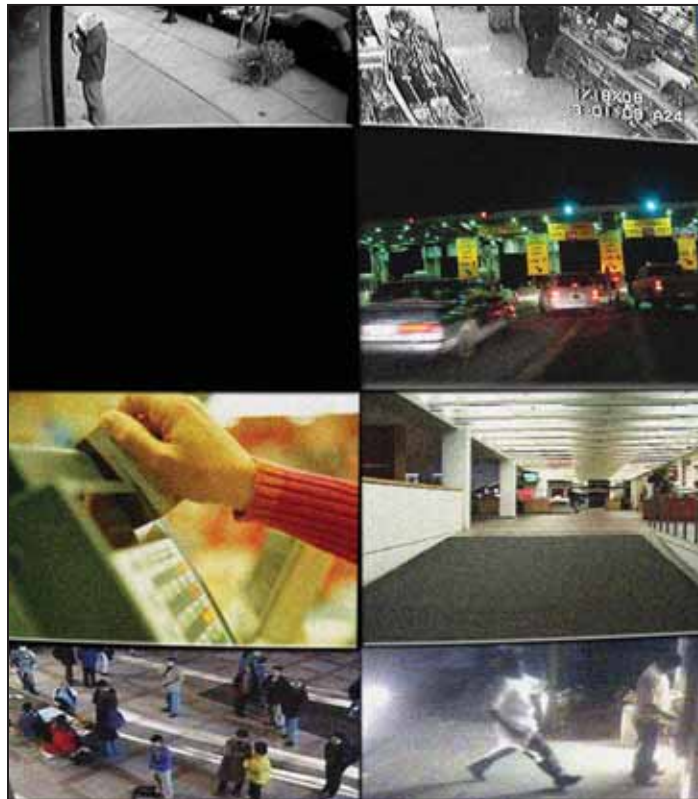
“Tell [customers] that you’re recording, including audio, but don’t tell them specifically where or how they’re being recorded.”

Despite all that, Smith finds that he’s facing more questions when it’s time to renew liability insurance for his operation, Digital Surveillance Consultants, Windham, N.H.

Gray area

According to Smith, the question of when and whether to conduct surveillance and gather information on individuals is increasingly a “legal gray area” whose boundaries vary from state to state.

To illustrate, Smith says that he knows of a doughnut shop employee who successfully sued an oil company because its surveillance system (not one of Smith’s) made audio recordings of her conversations in the space the doughnut shop shared with a gas station.



(Presumably it was a general liability claim, as the woman was not an employee of the gas station chain.)

In another case, he relates that one company opted to take down its surveillance cameras after an individual was attacked in a remote section of a parking lot.

According to Smith, the company faced questions about its response to indications of threats captured on video, and reasoned that it would protect itself from charges of negligence if it did not use surveillance at all.

“ Privacy laws are not keeping up with technological developments.”

— Thomas Wilkinson,
Cozen O’Connor

“ Tell [customers] that you’re recording, including audio, but don’t tell them specifically where or how they’re being recorded.”

— Brian Smith, president,
Digital Surveillance
Consultants

‘Dataveillance’

For someone like Smith-and, apparently, his insurance underwriters-it is increasingly difficult to know what constitutes an actionable violation of privacy in our age of surveillance-or, as some say, “dataveillance.”

Ours is an age when our daily activities are tracked and recorded, perhaps forever, by our use of credit cards, tollway passes, computers, cell phones, and other personal conveniences. Consciously or not, willingly or not, we “consent” to surveillance in public places by closed circuit television cameras and other means used by private and public organizations.

To cite one example of how technology has progressed in this regard, Digital Surveillance Consultants now provides the capability to combine video surveillance and data collection at a point of sale. Retrievable records are made of the products being purchased and the prices paid for them while the customer and clerk are being recorded.

This information is typically captured to help control theft and illegal sales of alcohol and tobacco, as well as employee collusion in these illicit activities. But the process conceivably can capture and preserve information on an individual’s medications, reading habits, and other personal matters.

Such information has been available for some time through credit card records, but the significance of new surveillance and information-gathering methods is that control over the information collected shifts from financial institutions that are well-schooled in privacy protection to smaller operations.

“Privacy laws are not keeping up with technological developments,” says Thomas Wilkinson, a member (partner) of Cozen O’Connor, a Philadelphia-based law firm prominent in insurance defense.

“Privacy protection is a big topic,” Wilkinson says,” because companies, including

insurers, can acquire a great deal of information about people much more readily than in the past, and the consequences are wide-ranging.”

Most legal sources readily acknowledge that the careless release or dissemination of personal information usually violates a statute or constitutes a tort. What’s becoming less clear is whether it can be an offense to collect information or conduct surveillance at all.

“It’s definitely moving in that direction,” says Larry Ponemon, founder and president of the Ponemon Institute, an organization dedicated to advancing responsible privacy and information management practices.

“The greater the public concern, the greater the risk that [members of] the public and their advocates will bring a case against an organization,” he says. “From an insurance point of view, [information gathering] becomes a higher risk proposition.”

Stewardship

Wilkinson emphasizes two principles when advising companies about the collection and management of personal information.

First, limit your information activities to the minimum needed to accomplish reasonable objectives.

“If you don’t have a legitimate plan to [use] the data you receive, then is it wise to collect it at all?” he asks. “I think it’s best not to secure information and data you have no purpose for, and when you have no intention of following up on it.”

“Once you acquire all this personal information about clients, customers, and third parties, then there’s a much greater chance of inadvertent disclosures of that information to people who are anxious to have it for marketing or identity theft purposes.”

Ponemon agrees: “The more information you collect, the more risk you bring into your organization. You only want to collect the



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“I think we’re going to see lots of litigation over privacy, but that doesn’t mean we’re going to see lots of coverage actions.”

— Charles Kingdollar,
vice president, Gen Re

information that is necessary and nothing more than that.”

Given that, Wilkinson’s second maxim is that organizations should not collect any information on people unless they are committed to safeguarding it.

“Many companies have well-written data storage and retention policies, but fewer companies actually follow their policies in that regard,” he says. They typically don’t follow up.



“From an insurance underwriting standpoint, you want to know to what extent you have liability coverage in force against intentional, improper, or inadvertent disclosure of personal information.”

Too little?

Given the risks arising from data leaks and violations of privacy, it might seem advisable to counsel insureds to simply avoid gathering information and conducting surveillance. But it’s not that easy, because the possibility exists that an organization could be found negligent if it engages in too *little* surveillance.

For example, certain types of businesses could be found negligent if they fail to implement adequate surveillance of their premises.

“Convenience stores, fast food restaurants, any type of entity that has a history or potential for robberies is probably remiss if it does not have a video surveillance system,” Wilkinson says. “The easier and less expensive it is to install a system, the more likely it’s going to be deemed negligent not to have such a system in place.”

The standard of care expected when screening employees and applicants will also test the limits of “privacy.”

“If you see through a social networking site that [an employee or applicant] is engaged in criminal conduct, what is your obligation?” Wilkinson asks.

“I don’t think that case law has

caught up with that, but there’s a general trend in liability law to do away with old notions of privity and find potential for third party liability” for injurious acts of employees to members of the public.

CGL exposure

While rights and responsibilities regarding surveillance and information gathering have been well-explored under employment law, there are more unanswered questions regarding organizations’ general liability toward the public in this regard.



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Insurers are watching legal developments carefully to see if there is an increase in exposure under general liability policies for violations of privacy related to the increase in surveillance and information gathering.

"I think we're going to see lots of litigation over privacy," says Charles Kingdollar, vice president of the emerging issues unit for General Reinsurance, Stamford, Conn. "That doesn't mean we're going to see lots of coverage actions, however."

"Insurance coverage for this will depend on all the facts, including if the private information is made public."

Randy Maniloff, an attorney who specializes in policy analysis, agrees.

"Any potential CGL coverage for violation


of the right of privacy typically requires oral or written publication of material," he says.

It is telling that, for Jewelers Mutual Insurance Company in Neenah, Wis., concern for control of first-party property losses is still the paramount consideration related to information gathering and surveillance.

Jewelers Mutual is a niche writer that specializes in insuring all types of jewelry businesses, as well as personal jewelry.

According to Andrew Indermuehle, product manager, Jewelers Mutual has seen no litigation concerning violations of privacy arising from information-gathering and surveillance, even though its clients necessarily employ surveillance to protect their valuable property.

Continued on page 25



**The
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April 20-22, 2008
Ponte Vedra Inn & Club
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*Where insurance leaders
come together to explore
product issues, discuss
solutions, exchange ideas . . .*

Schedule in brief

Sunday, April 20
Opening reception

Monday, April 21
Breakfast
Business Session
Golf Outing
Boat Cruise
Reception

Tuesday, April 22
Breakfast
Business Session
Spouse/Guest tour of Jacksonville
Business Luncheon
Roundtable Discussions
Beach Party closing event

Our Conference Program...

Keynote Speaker



W. Michael Cox

Our keynote speaker this year is **W. Michael Cox**, senior vice president and chief economist of the Federal Reserve Bank of Dallas, who will speak on “Ten Important Long-Term Trends in the Economy.”

Dubbed the “Prophet of Boom” by *Wired* magazine, Cox authors the Dallas Fed’s annual essays on living standards and the expanding global economy. Cox’s observations on the progress in Americans’ level of material well-being receive extensive coverage in major publications, and he is a frequent guest on national media.

Hazardous Imports and Products Liability

Products of all kinds have been in the headlines for hazardous substances that have originated overseas. Where does the chain of products liability lead when injury results from these substances? **Josh Greenbaum**, a member of the commercial litigation practice of Cozen O’Connor, will discuss what the firm has learned as it defends companies involved in imports-related products liability litigation.



Josh Greenbaum

The Growth and Evolution of Rating Variables



Jeff Kucera

Insurers are engaged in a high-stakes competition to identify and develop new variables for determining the level of risk posed by different individuals, households, and organizations. **Jeff Kucera**, a consulting actuary from EMB America, will describe what leading companies are doing in this regard and what all companies can do to stay competitive.

Underwriting E-commerce Insurance

Insurance coverage for electronic information and business operations entails a unique combination of property and liability exposures. No one knows better how to analyze those exposures, underwrite them, and implement effective loss control than **Robert Parisi**, Marsh USA’s national practice leader for network risk, technology and telecommunications.



Robert Parisi

Catastrophe Modeling



Robert Healy

It’s been more than 15 years since Hurricane Andrew, and the catastrophe modeling practices embraced after that event have matured through refinements in data and modeling techniques.

Robert Healy has been with the EQECAT catastrophe modeling service since its inception in 1994, and played a major role in developing it into one of the leading catastrophe risk modeling and consulting firms. Healy, now senior vice president of ABS Consulting, which owns EQECAT, will describe the evolution of catastrophe modeling and point out the possibilities and challenges that lie ahead.

SOCIAL EVENTS



Monday afternoon, April 21

Golf Outing The Lagoon Course Ponte Vedra Inn & Club

Participants in this year's golf outing won't have to travel far. Our 12:15 p.m. shotgun start will give participants plenty of time to complete a full round and relax before our Monday evening reception.

Schooner cruise

Attendees who are not participating in the golf outing have the option of spending time on their own, or joining others for a cruise aboard the schooner Freedom, a replica of a 19th century blockade runner.



Tuesday, April 22

Guest/spouse tour to Jacksonville

Sites include the Merrill House, Memorial Wall, and the famous Florida Theatre. Lunch is at Alfred duPont's former home, now the Epping Forest Yacht Club.

Tuesday evening, April 22

Beach Party closing event

In addition to food and drink, our evening will feature horseshoes, volleyball, music and dancing, along with a classic beach bonfire.

To register:

For copies of the conference and hotel registration forms, go to www.AAISonline.com or call Joe Harrington at 800-564-2247

AAIS Update

This year's presentation on AAIS initiatives focuses on three themes:

- **"New Distinctions in Rating and Classifications"** will describe current AAIS initiatives to refine its fire protection classifications, develop an experience rating plan in Homeowners, incorporate modeled data into property lines, and institute ZIP Code-based rating territories.
- **"The Next Wave in Rating Considerations"** will preview changes on the horizon for AAIS rating plans. These include separate rating by peril for package policies, particularly Homeowners, and revision of rating factors to reflect results of multivariate analysis and predictive modeling.
- **"Key Coverage Issues"** will highlight certain exposures being addressed by changes in AAIS policy language, such as the definition of "agritainment" in farm liability, refinements to Homeowners provisions addressing water damage, and commercial umbrella language that will apply independently of the underlying policies.

Roundtable Discussions

Additional time is being allotted to this year's roundtable discussions. Attendees can select from four of them:

- Personal Lines, moderated by **Susan Luecke**, AVP of personal lines.
- Commercial Lines, moderated by **Tony Leist**, AVP of commercial lines.
- Farm and Agriculture, moderated by **Sherry Taylor**, manager of farm and agribusiness.
- Executive, moderated by **Paul Baiocchi**, AAIS president.

Also participating will be:

- **Greg Jaynes**, director of actuarial services; and
- **Debi Summerlin** vice president of insurance lines



Susan Luecke



Tony Leist



Sherry Taylor



Paul Baiocchi



Greg Jaynes



Debi Summerlin

CEO Panel

A panel of company CEOs will address political and economic issues that impact companies' pricing and underwriting decisions. Among the panelists will be:

- **Darin Kath**, president and CEO of Jewelers Mutual Ins. Co., Neenah, Wisc.;
- **Robert Restrepo**, chairman, president, and CEO of State Auto Ins. Cos., Columbus, Ohio; and
- **Robert Wadsworth**, chairman and CEO of Preferred Mutual Ins. Co., New Berlin, N.Y.

AAIS Chairman **James Sullivan**, president and CEO of Co-Operative Ins. Cos., Middlebury, Vt., will moderate the panel.



Pricing incentives

Will mandatory discounts and credits encourage homeowners to invest in windstorm damage mitigation?

For years, natural disaster experts outside the insurance industry have wondered whether the pricing of property insurance could be used to give homeowners incentives to upgrade or retrofit their structures to mitigate damage from windstorms.

The logic seems simple enough: If dwellings and related structures are reinforced and secured to withstand wind damage, that should translate into fewer losses and lower cost insurance.

That logic runs into a stubborn fact, however: The cost of implementing wind mitigation features on a home often far exceeds the annual cost of homeowners insurance, even in distressed markets with relatively high rates.

For example, the average homeowners insurance premium in Florida in 2005 was about \$1,500, according to figures from the Florida Office of Insurance Regulation. By most accounts, that cost has risen considerably since the state was hit by four major hurricanes that year.

Even so, the cost of installing hurricane shutters, a basic mitigation measure that typically involves no structural modifications, “can range from \$6,000 to \$30,000” in Florida, says Debbie Wagner, vice president of sales for e2Value, Inc., Stamford, Conn.

E2Value provides automated online construction valuation services available on the *AAISdirect* Internet service, as well as directly.

According to Wagner, “\$6,000 to \$10,000 would be the low end for an average home of

about 2,400 square feet with no unusual windows.”

So, even at the lower end of the cost range, it would take several years of completely free property insurance to recoup the cost of even the most basic mitigation measures. Given that, a small insurance discount is hardly a factor in deciding whether to spend thousands of dollars on mitigation measures.

Mandates

For that and other reasons, the development of insurance pricing incentives for retrofitting existing structures have apparently not met the expectations of certain public officials in hurricane-prone states.

“[Insurance pricing incentives] weren’t developing on their own,” says Florida State Sen. Steven Geller, former president of the National Council of Insurance Legislators and a prominent proponent of publicly mandated premium discounts for windstorm damage mitigation measures.

“I’m as much of a free market guy as the next guy,” he says, “but people were putting up shutters and getting a 2% discount when it should have been much, much more.

“We gave insurers a chance to [provide discounts] voluntarily, but people will never go out and spend \$10,000 on shutters if they only get a \$100 a year discount.”

Led by Geller and others, Florida enacted a law several years ago requiring insurers to provide premium credits to residential



policyholders who had structural features in place deemed to mitigate loss from hurricanes. For example, the discounts must be offered for protecting windows and securing a roof.

(The credits are inter-related and not entirely cumulative. A policyholder that protects his/her windows and secures his/her roof could get a discount greater than either of those measures alone, but not necessarily equal to the sum of both.)

The size of the credits was later increased as part of the package of insurance measures enacted by the Florida legislature in January 2007.

Since Florida took action, Connecticut, Louisiana, and South Carolina have followed suit.

In Connecticut, insurers must offer credits on the standard rate of insurance for homes that have storm shutters and/or building glass installed.

Louisiana requires all homeowners rate filings submitted after March 31, 2008 to include premium discounts when a dwelling is built or retrofitted to comply with requirements of the state's uniform construction code, has damage mitigation features installed, or is retrofitted to utilize construction techniques demonstrated to reduce windstorm loss.

Qualifying mitigation measures include roof bracings and secondary water barriers, among others.

South Carolina requires insurers to develop separate rating factors for building features that affect propensity for wind damage. In that state, insurers must offer credit factors for roof shape, storm shutters,

roof-to-wall attachments, and other features that affect propensity for wind damage.

South Carolina also mandates a premium debit for having an unrestrained wall-to-foundation connection.

AAIS is taking filing action to fulfill these mandates on behalf of its affiliates in affected lines and states. To date, AAIS has received approvals from Connecticut, Florida, and South Carolina.

Activism

Apart from these initiatives, other states are enacting measures to regulate insurance pricing for windstorm loss.

North Carolina has joined those states that allow wind and hail coverage to be excluded from homeowners policies covering properties eligible for the state's wind pool. Premium credits must be provided to reflect removal of that coverage.

" People will never go out and spend \$10,000 on shutters if they only get a \$100 a year discount."

— Fla. State Sen. Steven Geller

“We are not in favor of mandatory discounts.”

— Julie Rochman, president,
Institute for Business
and Home Safety

In Rhode Island, separate, higher deductibles are now permitted for hurricane losses, but not for other types of windstorm loss. However, the hurricane deductible cannot exceed 5% of the dwelling limit, and must be waived when property is protected by certain windstorm loss mitigation measures.

For many public officials, mandated premium discounts serve to convey a message more important than the dollars at stake for homeowners or insurers. In their estimation, anything that encourages people to implement mitigation measures will ensure that more homes remain habitable in the aftermath of a disaster, thus reducing the severity and cost of a public emergency.

This state activism gets, at best, a lukewarm reception from insurance groups, including those whose mission it is to encourage citizens and communities to prepare better for hurricanes and other natural disasters.

“We are not in favor of mandatory discounts,” says Julie Rochman, president and CEO of the Institute for Business and Home Safety, an organization created by property insurers to promote construction and land use practices that will reduce disaster losses.

“By mandating, you don’t allow people to be creative,” she says. “It ought not always be up to the insurer to tell people to protect their property. It benefits others besides insurers.”

Given the relatively low cost of residential property insurance compared to mitigation measures, “the financial incentive is just not there,” says Robert Detlefsen, vice president for public policy at the National Association of Mutual Insurance Companies.

According to Detlefsen, premium discounts, whether mandated or voluntary, will have little impact on homeowners’ decisions until insurers have more flexibility to structure and price policies in hurricane-prone states.

For example, he says, restrictions on writing multi-year policies suppress a technique that might allow some insurers to provide long-term coverage discounts that can show policyholders a return on their mitigation investment.

Level

Whether they provide effective incentives or not, the implementation of mandated discounts and credits may not prove to be too onerous for the insurance industry.

“Publicly, insurers say they don’t like mandates,” says Robert Klein, a professor of insurance and risk management at Georgia State University. “Privately, however, some will say, ‘Well, if we’re all mandated to do the same thing, it’s less of a problem. At least they’re maintaining a level playing field.’”

Geller, the Florida state senator, argues that the mandates will improve conditions for insurers.

“If we get older structures [retrofitted], it will help individuals and reduce the demand for reinsurance,” he says. “If we reduce the demand for reinsurance, the cost of reinsurance will go down.” ■

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Over-Under

Common pitfalls of insuring farm personal property



Sherry Taylor worked many years in farm insurance sales and underwriting before becoming AAIS's manager of farm and agribusiness in 2007.

From her unique perspective, she knows that farmers may find themselves underinsured or, more rarely, over-insured for their farm personal property.

That's because agents and underwriters sometimes have misconceptions about the provisions of standard farm property forms, and commit oversights or take shortcuts in the heat of competition that can come back to haunt them at the time of a loss.

Blanket

Many of the misconceptions, she says, are rooted in the casual and misleading use of the term "blanket" to describe the coverage provided under a standard farm property form, particularly as it applies to unscheduled farm personal property.

"The idea of a blanket is often misunderstood," she says. "The insured may think that all personal property is covered, but several items of property are excluded under a farm personal property form."

Generally speaking, the term "blanket" comes from commercial insurance, and refers to coverage for one type of property in multiple locations, or multiple types of property in one or more locations. Blanket coverage contrasts with "specific" insurance, coverage for one type of property at one location.

In fact, the word "blanket" is rarely used in standard farm property forms, and not at all in AAIS forms.



Sherry Taylor

While "blanket" may serve as convenient shorthand for describing the variety of property covered under a farm property form, those forms are more properly understood as a combination of blanket and specific coverage, with several particular restrictions added.

(For those not familiar with farm coverage, standard farm property forms typically cover scheduled barns and other structures at described insured locations, plus scheduled and unscheduled personal property at insured locations, with limited coverage for personal property away from insured locations.)

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Confusion about the “blanket” nature of farm property coverage leads to common errors in writing coverage, according to Taylor.

Inventory

Problems start when agents and underwriters fail to scrutinize “inventories” of unscheduled property for items that are excluded or ineligible for coverage.

Inventories are commonly used lists of farm personal property and values, but they are not standardized. Unlike schedules of certain types of insured property, inventories are not part of a policy.

For example, an inventory submitted by a farmer and his/her agent may include the value of harvested fruits and vegetables stored in an outbuilding, but fruits and vegetables are

excluded from standard coverage for unscheduled farm personal property.

Other types of ineligible property include irrigation equipment, non-farm vehicles (such as all-terrain vehicles), and animals other than livestock (such as exotic animals like alpacas, llamas, and elk).

“If an item of property is shown on the inventory, but is not eligible for coverage, who is responsible, the agent or the underwriter?” Taylor asks.

As a practical matter, the underwriter could be the one on the hook, if the carrier decides not to risk the ill will and regulatory sanction that could result from balking at paying a claim for which premium was collected (even if it offers to refund the premium).

“If an item is shown on the inventory, but not eligible for coverage, who is responsible: the agent or the underwriter?”

— Sherry Taylor, AAIS manager of farm and agribusiness



“Over time, farm personal property loss costs can rise higher than they should because the premium being collected is not a true reflection of the value insured.”

— Sherry Taylor, AAIS
manager of farm
and agribusiness

To the extent that claims for ineligible property are paid, a company’s loss cost information is distorted.

“Assuming that the loss is paid because the premium is paid,” Taylor says, “that loss goes against the company’s future loss cost calculations.”

Taylor’s advice: Don’t simply assume that the total at the bottom of a farm property inventory is an appropriate valuation of the insured property. Examine the inventory for eligible and ineligible property.

Coinsurance

One would think that including ineligible property in insured values would at least avoid coinsurance penalties, but that’s not always the case.

(Standard coverage for unscheduled farm personal property carries an 80% coinsurance requirement. There is typically no coinsurance requirement for coverage of specifically scheduled items of farm property.)

According to Taylor, farmers commonly purchase a limit for *unscheduled* farm personal property coverage equal to 80% of the value indicated on an inventory. After that, however, the actual cash value of the insured property is generally not valued until the time of a loss.

“Total insured values are generally not questioned until the time of a loss, unless an inspection is done,” she says. “As a result, two things happen.

“First, the limit will come into question at the worst time--when the farmer has a large, debilitating loss.

“If the valuation of insured items is too low, then the limit is generally 80% of too low a value. In that case, the farmer may be assessed a coinsurance penalty.

“Secondly, over time, your unscheduled farm personal property loss costs can increase more than they should because the premium being collected is not a true reflection of the value insured.”

Conditions

There is another commonly overlooked condition that can leave a farmer vulnerable to a coinsurance penalty.

If the insured does not want to insure certain items of unscheduled property that are eligible for coverage, they must be explicitly excluded on the policy declarations. Otherwise, they are included in the coinsurance calculations.

“Standard farm property policies typically have a provision under the ‘property not covered’ section allowing for the exclusion of otherwise covered property, but the exclusion must be shown on the declarations,” she notes.

One thing working in the farmer’s favor, is that the value of farm property recently acquired (within the previous 30 days) is not included in the determination of insured values for coinsurance requirements *provided* the property is not acquired in replacement of insured property.

However, the acquisition of new equipment does not, in itself, increase the overall limit for unscheduled personal property. In the event of a large loss, the acquired property will tend to dilute the limit.

Another potential underwriting pitfall is the handling of mid-term endorsements.

“Often, in the haste to keep processing times to a minimum, changes to the unscheduled farm personal property limits are not closely reviewed,” says Taylor. “In fact, endorsement requests often just ask for an increase or decrease without indicating why a change is being made.

“Again, the only time the total limit comes into question is at the time of loss, but is that really when one wants to be asking what’s included in the running limit--especially if the item damaged is a category of farm property not previously shown on the inventory list?”

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Surprise

Beyond that, there are other conditions that could result in a farmer being unpleasantly surprised by his recovery for farm personal property following a loss.

By and large, says Taylor, agents and underwriters need to be more aware of additional policy limitations and restrictions, among them:

- Coverage for livestock is subject to the lesser of a series of sublimits.
- The 10% coverage extension for crops in the open falls within, not in addition to, the overall limit for unscheduled personal property. Also, this coverage extension does not apply to all types of crops.
- The following are not eligible for coverage as unscheduled farm personal property:

- Race horses, show horses, and show ponies;
- Certain types of building contents, such as heated chicken fryer or broiler houses; and
- Portable building or structures.

Then, of course, there can be shortcomings in the coverage for scheduled farm personal property, if the items on the scheduled are not adequately valued at time of renewal.

In all, a farm personal property form is a complex document reflecting the unique challenge of insuring diverse risks on a standardized basis.

The measure of a farm insurance professional will be how well he or she understands the complexities, explains them to agents and insureds, and avoids unpleasant surprises at claim time. ■



By Rebecca Sukharev,
Manager of content production,
Insurance Solutions Group,
Wolters Kluwer Financial Services

GUEST ESSAY

Hurricanes: A Lesson in Catastrophe Risk

This is the latest in a series of guest essays by associate members of AAIS. To learn more about associate membership, contact Rick Maka, director of marketing, at rickm@AAISonline.com, or by calling 800-564-AAIS.

In 1992, the financial fallout from Hurricane Andrew made it clear to the insurance industry and insurance regulators that natural disasters have a significant impact on the industry's ability to diversify and contain catastrophic risk. With 790,000 insurance claims and \$26 billion in damage, Andrew became the costliest catastrophe in U.S. history.

Although catastrophe models are now used in preparation of spreading the risk associated with catastrophes of that magnitude, there is still room for improvement.

According to the National Conference of Insurance Guaranty Funds, the insurance company insolvencies resulting from Andrew led to nearly 25,000 unpaid claims totaling \$500 million.

Shortly thereafter, insurers began using catastrophe models to better predict the risk associated with natural disasters, as regulators were forced to begin evaluating varying methods to ensure economic stability of insurers and the availability and affordability of property coverage.

The challenge for insurers is that catastrophic events, by their very definition, are unexpected occurrences that offer very little predictability.

Seven of the top 10 most costly hurricanes in U.S. history occurred during the 2004-05 season, according to the National Oceanic and Atmospheric Administration (NOAA). When Hurricane Katrina hit in 2005, it resulted in an astronomical \$80 billion loss to an already costly two-year season.

The 2004-05 season had already produced approximately \$70 billion in combined damage from Hurricanes Charley, Wilma, Ivan, Rita, Frances, Jeanne and Dennis. Since catastrophe models are largely based upon historical data, it is unlikely that the models used prior to 2004-05 would have predicted the season's heightened hurricane activity.

Unsurprisingly, catastrophe models and weather experts began to call for significant hurricane activity in 2006 and 2007. Fortunately, the 2006 season was

relatively uneventful, and projections for 2007 were gradually downgraded.

Despite predictability and reliability challenges with catastrophe models, it is likely that the cost associated with catastrophic events will continue to rise.

Regardless of whether global warming is a contributing factor, population growth and inflation will require additional risk management remediation. According to a report from the International Consortium of Insurers, damages resulting from natural disasters are expected to double every 12 years.

According to the Insurance Information Institute, insurance companies have been inundated by well over 1.7 million claims for damage following the devastation of Katrina.

In addition, approximately 800, or roughly 90 percent, of all new or amended regulatory property-related actions issued for those states in 2007, also specifically reference flood, wind or hurricanes.

A topical analysis of the regulatory actions in 2007 indicates regulators realize that hurricane damage may still jeopardize the solvency of insurers and could cause a subsequent financial burden for those who suffered loss.

The following breakdown of the 2007 activity shows a substantial focus on insurer solvency, financial requirements, as well as risk sharing/residual market mechanisms.

Bearing in mind that the availability of property coverage for coastal areas from the private sector is dwindling, or in some cases nonexistent, and the wind versus flood

conundrum is still tying up Katrina claims in court, it is no surprise that regulators are focusing on risk sharing/residual market mechanisms.

Each state mentioned in this article has a FAIR Plan, Beach Plan or Wind Pool, designed to provide coverage to those who have been denied insurance in the private sector.

According to the Insurance Information Institute, the number of policies issued under state FAIR Plans from 1990 to 2005 have doubled and loss exposure has increased ten-fold. This transfer of risk will not ultimately solve the problem however, as the Insurance Information Institute also reported, that in 2005, state FAIR Plans were operating under a \$1.9 billion deficit.

Additional sources of coverage are under consideration on a federal level, as the U.S. House of Representatives passed the Flood Insurance Reform and Modernization Act of 2007 (FIRM), which proposes to add windstorm coverage under the

National Flood Insurance Program (NFIP).

Opponents of FIRM state that this initiative will place a significant burden on taxpayers. This premise is further supported by the fact that the NFIP had to borrow from the U.S. treasury to pay Katrina claims totaling \$16.3 billion, eventually expected reach a payout of \$22 billion.

Another argument against the provision of windstorm coverage under the NFIP is the potential decrease of competition in the free market, which, if left alone, should be able

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The double-edged sword for regulators is to ensure the financial solvency of insurers and yet provide some guarantee of affordable coverage.

An evaluation of the 2004-07 regulatory actions for the southern coastal states of North Carolina, South Carolina, Georgia, Florida, Alabama, Mississippi, Louisiana and Texas, reflects 4,300 regulatory changes that pertain to property insurance, of which 86 percent contain a reference to flood, wind or hurricanes.

Continued on page 25

AAIS invites participation in personal injury data call

Property/casualty insurers are invited to participate in a special AAIS research study regarding the frequency and severity of claims for personal injury, such as libel, slander, and violation of privacy.

Carriers that provide personal injury claims data for the study will receive a report with the aggregate results, including actuarial analysis. Participation is open to all P/C insurers, whether they are AAIS members or not.

The study seeks to determine how the frequency and severity of personal injury claims have been affected by the growing use of e-mail, blogs, networking sites, and other forms of electronic communication; as well as by the growing incidence of “cyber-bullying” and other offensive behaviors.

Because of advances in electronic communications, harmful comments can now be transmitted instantaneously to worldwide audiences. Some multi-million dollar judgments have been reported for offenses involving transmissions over the Internet.

“As an industry, we know there is more exposure for personal injury today than in years past,” says Greg Jaynes, AAIS director of actuarial services. “We would like to determine how much.

“This study of personal injury claims experience is part of our



Greg Jaynes



larger ongoing efforts to monitor emerging exposures that have an impact on P/C coverage.”

Any carrier that writes personal injury coverage can respond to the AAIS data call, whether it is a member of AAIS or not. Companies that provide data will receive a report with the aggregate results, plus analysis.

For information on participating in the study, contact Greg at gregj@AAISonline.com, or by calling 800-564-AAIS.

AAIS revises its simplified fire protection classifications

AAIS is updating the classifications it provides insurers for assigning fire protection rating factors. Since its introduction in the late 1970s, the AAIS method has allowed insurers to place a risk in one of three fire protection classifications:

Protected, which refers to buildings located within 1,000 feet of a fire hydrant and within five road miles of a responding fire department;

Partially Protected, which refers to buildings located more than 1,000

feet from a fire hydrant but within five road miles of a responding fire department; and

Unprotected, which refers to buildings that are not classified as protected or partially protected.

With the revision now being filed countrywide under the AAIS Commercial Properties Program, the “Protected” classification is being replaced with five separate tiers (Protected 1, Protected 2, and so on) that correspond to the distance of a risk from a responding fire department (but all still within five miles).

The Commercial Properties filings have a proposed effective date of Sept. 1, 2008. Revised fire protection classifications will be filed over coming months under other AAIS insurance line programs that provide property coverage.

“The AAIS simplified fire protection classification system was developed to help users assign fire protection classifications using readily available information,” says Haoying Ewing, AAIS senior product development specialist for commercial lines.

“The latest revision continues to rely on information that is readily available, either through the use of geographical information systems or through standard application entries.”

AAIS develops Homeowners manual implementation tools

Insurers that use the AAIS Homeowners Program and the *AAISdirect* Internet service have access to new automated Manual Implementation Tools to help them adopt the latest revision to the program.

AAIS recently released new tools over *AAISdirect* to facilitate the rating of policies under the revised AAIS Homeowners Program:



A Homeowners Rating Worksheet, developed using Microsoft Excel, incorporates countrywide manual rules, formulas, and factors to help verify premium calculations by company systems during implementation of the new program. Homeowners rating examples demonstrate how the worksheets operate using hypothetical cases.

The new Manual Implementation Tools will expand on existing Homeowners rating information data sets provided in Excel and XML format. In addition to the existing state-specific data sets for basic Homeowners rating information, AAIS will also provide state-specific data sets for optional coverage loss costs, rating factors, and territorial definitions.

The new Manual Implementation Tools arise from an initiative led by Janice Nieman, a longtime AAIS staff member who is now serving as director of technical product support.

“These tools will allow companies to upload the latest rating information into their systems,” Nieman says. “They can help companies rate policies and perform comparative rating between the new revision and the version they are using.”

Nieman adds that, “The rating worksheet automates the rating formula so companies can quickly rate a policy or pull the formula apart to program a formula into their own systems.”

New COP endorsements and schedules filed

Several new or revised endorsements and schedules are being filed under the AAIS Commercial Output Program (COP) with a proposed effective date of May 1, 2008.

Three of the endorsements and accompanying schedules would allow COP users to implement the following:

Separate deductibles for loss caused by windstorm or hail (flat deductible or percentage deductible options are available);

Deductibles that vary by peril and scheduled location; and

Separate income coverage limits for domestic and foreign dependent locations (locations operated by others that the insured’s business depends upon).

Another endorsement would

allow carriers to exclude losses at selected locations caused by named hurricanes or tropical windstorms, and another schedule is filed that would allow coverage under a blanket policy to be excluded for specified locations.

A fifth schedule is revised to include a new provision addressing a premium reporting requirement under Statutory Accounting Principles.

Latest *Inland Marine Cause of Loss Report* posted on *AAISdirect*

The latest version of AAIS’s annual *Inland Marine Cause of Loss Report* has been posted on the *AAISdirect* Internet service, where it is available free of charge to AAIS inland marine affiliates that use *AAISdirect*.

The report provides premium and loss data for nearly 50 filed and nonfiled classes of inland marine insurance. The latest version provides data on about \$2 billion in premium and more than \$725 million in reported losses for the period 2002-2006, broken down into these categories:

Yearly written premium and paid losses for each class, and the ratio of paid losses to written premium;

Yearly earned premium and incurred losses for each class, and the ratio of incurred losses to earned premium; and

The amount and percentage of paid losses, along with average loss severity, categorized by nine different causes of loss.

Those causes of loss are fire, extended perils, collision, burglary and robbery, theft and disappearance, breakage/collapse/landslide, water damage and flood, marine perils, and all other.

Companies not affiliated with AAIS for inland marine can purchase a copy of the report for \$250. To order a copy, or to sign up for *AAISdirect* service, contact Rick Maka, director of marketing, at rickm@AAISonline.com or by calling 800-564-AAIS.

AAIS Factbook revision released

AAIS recently released the latest revision to the *AAIS Factbook*, the “user guide” for getting the most from an AAIS affiliation.

Written to anticipate and respond to commonly asked questions, the *Factbook* provides lists of all programs and services, plus summary descriptions of support services for customizing, pricing, automating, and filing AAIS programs.

Among other things, the latest revision of the *Factbook* describes the expanded compliance services available from AAIS, the expanded access to reports and risk evaluation information through the *AAISdirect* Internet service, and updated contact information for AAIS staff.

For more information on the *Factbook* and on how to utilize the services described in it, contact Patricia Peters, AAIS director of member relations, at patp@AAISonline.com, or by calling 800/564-AAIS.

Inland Marine Guide tornado table reissued with updated NOAA data

The Tornado Table provided in the Radio and Television Towers section of the *AAIS Inland Marine Guide* has been updated with new federal data. Using data collected by the National Oceanic Atmospheric Administration/National Climatic Data Center, the updated Tornado Table shows the annual average number of tornadoes per 10,000 square miles for individual states.

Some states show an overall increase in the reported number of tornadoes compared to the previous edition of the table. That increase is attributed to stepped-up observation of tornadoes by enlarged populations, and does not necessarily indicate an increase in the frequency of tornadoes.

The updated Tornado Table will be released as an attachment to a bulletin issued Friday, Nov. 2. *Guide* users are instructed to refer to the updated table when executing one of the suggested rating steps for radio and television towers.



AAIS releases revised and expanded Compliance Guide

AAIS recently received a newly revised and expanded guide to state compliance requirements related to policy forms and rating information.

For 18 years, AAIS has provided its members with a free annual guide to state filing requirements. This year’s edition is renamed the *AAIS Compliance Guide* to reflect the expanded scope of information provided in it. In addition to updated information in existing sections, the *Compliance Guide* includes the following additions:

- A new section with tables listing requirements regarding the use of “SERFF,” the System for Electronic Rate and Form Filing developed under the auspices of the National Association of Insurance Commissioners. The tables indicate which jurisdictions have adopted the SERFF policy coding matrix, which ones are accepting electronic fund transfers via SERFF, and what other requirements jurisdictions may have.
- A new section with information on filing requirements for umbrella policy forms, endorsements, rules, and rates. This includes a table with citations from state laws governing umbrella policy filings, plus state-by-state information on how to adopt and/or modify AAIS Personal, Commercial, and Farm Umbrella products.



- New “company action” sections within existing sections with instructions for companies seeking to implement an AAIS form, rule, or rating information filing, whether it be in a new line or state or for an existing line and state affiliation.

“AAIS has been expanding the compliance material contained in this guide consistently over the past few years,” says Larris Larsen, AAIS assistant vice president for compliance. “The new name reflects the Compliance Guide’s new content and AAIS’s continuing effort to improve and expand the compliance related resources material it publishes.”

In all, the *Compliance Guide* provides nearly 600 pages of compliance information, broken down into sections and sub-sections covering general information, form filing requirements, rate and rule filing requirements, special inland marine filing requirements, state qualifications for “exempt commercial policyholders,” and other topics, in addition to the new SERFF and umbrella policy sections.

One section covering “Applications, Binders, and Certificates of Insurance” was updated and reprinted with the

permission of ACORD, Inc., Pearl River, N.Y., an organization devoted to improving agency-carrier communication through the standardization of forms and data transmission.

The *Compliance Guide* is available electronically for no additional charge to all companies that utilize at least one AAIS program.

Companies not affiliated with AAIS can purchase an electronic copy for \$400. For information, contact Rick Maka, director of marketing, at rickm@AAISonline.com, or by calling 800-564-AAIS.

'Download cart' added to AAISdirect

The latest set of enhancements to *AAISdirect* includes a feature that allows subscribers to add documents to a 'download cart' and, when ready, compress and download the contents of the cart to the user's PC or network.

Similar to the experience one finds in a shopping cart at an online retail site, users can add "items" to the download cart in groups or one at a time. The items remain in the cart while the user browses other parts of *AAISdirect*, moves to other websites, or even logs off *AAISdirect*. When the user returns to *AAISdirect*, the contents of the cart are still there.

For information on a free trial of the *AAISdirect* Internet service, contact Rick Maka, director of marketing, at rickm@AAISonline.com, or by calling 800-564-AAIS.

Sample fungi exclusion available under Homeowners

A countrywide AAIS Homeowners bulletin issued recently makes available a sample exclusion for fungi that is more restrictive than the exclusion built into the newly revised Homeowners forms.

Whereas the built-in exclusion preserves coverage for damage arising from fungi and bacteria (including mold) that arises from a covered peril, the sample

endorsement excludes coverage for *all* mold-related losses except those identified in the endorsement.



The sample endorsement excludes property coverage for all fungi losses except those arising from fire or lightning. The endorsement also excludes liability losses arising from fungi except for those involving food poisoning, slips and falls on slick surfaces, or bodily injury to farm employees.

As drafted, the sample endorsement can be used with the revised and filed Homeowners forms, but companies will have to file the sample endorsement themselves.

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Letters

Thanks for noticing

Many thanks for mentioning the Construction Risk and Insurance Specialist (CRIS) continuing education and certification program in the fall issue of Viewpoint.

There are now more than 1,400 CRIS designees with 1,700 more enrolled in the program nationwide. It has been endorsed by the Construction Financial Management Association (CFMA), which is recommending that their members obtain the certification and also consider it as one indicator that an agent or broker is qualified to write their insurance.

Most importantly, while the program started out online, it is moving into the classroom. We are partnering with state Independent Insurance Agents and Brokers associations across the country to offer classes based on the five part core curriculum. The Florida Association of Independent Agents was the pilot program, and we expect at least ten additional state associations to offer the classes in 2008.

Thanks again for mentioning CRIS in your article.

*Jack P. Gibson, president
International Risk Management Institute, Inc.*

Viewpoint welcomes your letters and comments. Send them to Joseph Harrington, editor, at joe@AAISonline.com, or mail them to Joe at 1745 S. Naperville Rd., Wheaton, IL 60187.

Surveillance, continued from page 7

“Appropriate video surveillance is often necessary,” he says. “We both require and recommend security measures, but we make no guarantee that such security will prevent a loss.”

Jewelers Mutual gathers some information about individuals in the jewelry operations that it insures, but the information is limited to individuals’ past work experience and loss experience related to the coverage being sought.

“We expect the insured to have completed background checks for employment purposes, as we have no say as to whether someone is hired or not,” he says.

For the time-being, at least, commercial insurers, appear to be shielded from expanded general liability exposure for surveillance and information-gathering activities—as long as their insureds are not careless with the information they collect.

That could change, of course, with one breakthrough lawsuit. Given the level of public concern over privacy and surveillance, insurers should not become complacent. ■

Guest Essay, continued from page 19

to set risk-appropriate premium rates.

Despite the recent regulatory activity focused on ensuring the financial stability of the insurance market and the use of catastrophe models by insurers to predict future risk, there is still no ideal solution in place to diversify catastrophic risk and ensure a plan of recovery.

The lessons learned from Andrew and Katrina purport that even if you have insurance with flood or windstorm coverage, you may not get a settlement sufficient to cover your losses. In addition, any coverage offered under a FAIR Plan or federal program can pose a hazard to the competitive nature of the free market and subsequently place a significant burden on taxpayers.

Therefore, unless we look at other potential solutions, or force the 53 percent of the U.S. population living in coastal areas to move inland to “safer” states, like Idaho and Utah, we are setting the stage for continued failure to plan for, survive and recover from catastrophic events.

Rebecca Sukharev has worked in the insurance industry for 10 years, analyzing insurance laws and regulations to evaluate industry trends and help connect insurers with the information they need to identify and understand the latest regulatory changes. She is currently manager of content production in the Insurance Compliance Solutions group at Wolters Kluwer Financial Services in Waltham, Mass. ■

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