Personal Lines Insurance Coverage Gaps: Analysis and Resolution

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PERSONAL LINES INSURANCE COVERAGE GAPS: ANALYSIS AND RESOLUTION

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Personal lines consumers have a wealth of insurance products and options to choose from in the United States. Yet, many of these policies contain myriad exclusions and resulting coverage gaps that can be difficult to find and to understand. These uncovered exposures are often not effectively communicated to insurance consumers. These gaps, appearing after a loss occurs, may cause consumers undue financial burdens. In addition, these gaps can result in unwanted publicity for agents and insurers, which can ultimately harm the reputation of the property and casualty (P&C) insurance industry if ignored.

Due to competitive pressures and a tendency to concentrate on commission-earning endeavors, personal lines agents have a greater incentive to focus their attention on increasing insurance sales volume rather than providing good risk management advice to their clients. The abovementioned coverage gaps illustrate the need for an important paradigm shift for personal lines insurers and agents alike, particularly for agents with wealthier clientele who have complex loss exposures. In effect, agents need to become their clients' risk manager.

About the Author

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To do so effectively, the personal lines risk manager should not only understand insurance coverages but also be familiar with other risk management techniques, such as loss control, risk avoidance, contractual risk transfer, and retention.

Forward-thinking insurers can assist agents in this risk management process by becoming aware of important coverage gaps. Providing broader policies or offering premium-bearing endorsements would be two possibilities to resolve the gaps. Also, arming underwriters and even marketing representatives with information for agents on the following risk management techniques is crucial.

- Risk avoidance;
- Risk mitigation via sound loss control recommendations
- Contractual risk transfer, particularly when the insurer cannot provide the needed coverage

Insurers can champion this endeavor and gain a reputation (among the insurance agency and consumer community) of being problem solvers, not only through the sale of policies and additional endorsements but also through timely advice from underwriters and marketing representatives to their agency force on a host of risk management techniques and solutions. On the same theme, agencies can gain a reputation in their community of being holistic risk managers, rather than insurance order takers. Thus, this paper will look at a variety of pertinent personal lines exposures and corresponding coverage gaps and explore ideas to resolve the gaps. The coverage gaps that will be addressed include the following.

- Home ownership transferred to a trust and other entities
- Inadequate dwelling limits
- Condominium coverage
- Sewer backup losses
- Domestic workers
- Contractor's injuries at an insured's home
- Improper coordination of overall insurance program

Note that this certainly is not an exhaustive list; it would be easy to double or even triple this list of important coverage gaps. This list is simply meant to illustrate some of the more common coverage gaps.

Home Ownership Transferred to a Trust and Other Entities

More and more families (not simply rich families) are transferring the ownership of their homes, and valuables such as jewelry and boats, to other entities, such as trusts, limited liability companies (LLCs), and limited liability partnerships. Since a trust is the most likely entity to attain this type of ownership, and due to space constraints in this article, the focus in this section will be on trusts. That said, many of these comments also apply to these other types of entities as well.

Individuals and families are increasingly learning the value of personal trusts and using these to avoid probate, reduce taxes, and pass property on to their heirs. For example, probate takes time and can cost up to 5 percent of the value of the estate; probate matters are also open to the public.[1] Thus, a trust provides assurance that probate will be eliminated and a person can thus preserve the estate, avoid legal delays, cut taxes, and maintain privacy. These features may make trusts as common as wills in the future.

It seems, however, that attorneys and accountants who create these trusts are often oblivious about the insurance implications created by the trust. For example, one online book advises the following.

> Don't bother notifying your homeowner's insurer that you placed your home in a trust. Know that for as long as you live, for all real-world purposes including the IRS & homestead rights, that you are the owner of your home. But if you tell your insurance company about the transfer, they might raise problems and questions that you'll have to waste time answering. Don't risk the hassles.[2]

This advice, written by an attorney who specializes in trusts and estate planning, clearly illustrates the need to arm insurance agents with information to convey to insureds of the risk management and insurance implications of placing a home or other personal property in the name of a trust. What many attorneys may not realize is that the homeowners policy was developed with individuals—not entities—in mind as the owners of homes. A traditional homeowners policy does not convey any contractual benefits to any party other than a person. For example, such coverage applies to "you" (the named insured and resident spouse) and "family members." If the trust is not a natural person, then it cannot have a spouse or family members. If the trust now owns the home, and no adjustments are made

[1]NOLO Legal Encyclopedia, www.nolo.com/legal-encyclopedia/why-avoid-probate-29861.html (July 31, 2019).

[2]Denis Clifford, Make Your Own Living Trust (Berkeley, CA: NOLO Publishing, March 2019).

to coverage, the unfortunate and unintended consequence is that the insurance coverage may now be inadequate. A look at a typical trust will make this point apparent.

Assume that John and Mary Doe, a married couple in their 60s, take the advice of their attorney and transfer their $3 million home (as well as much of their valuable personal property, such as jewelry and a small yacht) into a trust. John and Mary thus become the grantor under the trust (sometimes called the "settler"). They appoint Mary's brother, Alan White, as trustee of the trust. (The trustee could be an individual or even a qualified trust company such as a bank, which holds and manages the property in the trust.) John and Mary continue to live in the home; Alan lives in another city. Alan, as the trustee, thus holds the legal ownership or legal title to the home. John and Mary hold the equitable/ beneficial ownership. The basic principle underlying the trust is that it separates the legal title to property, which carries the right to dispose of it, from the equitable or beneficial title which carries the right to use and derive benefits from the property. At the time of the death of both John and Mary, their daughter Susan (the beneficiary) receives the assets of the trust.

Now assume that John and Mary do not notify their agent or insurer about this change in ownership. Thus, there is no change regarding the named insured listed in their homeowners, watercraft, and personal umbrella policies. Three months later, the home burns to the ground due to a faulty electrical circuit. Could the insurer, upon asking for a copy of the title and finding it in the name of Alan, as trustee of the trust, decline dwelling coverage? This scenario is a distinct possibility. Although, legal research and interviews have turned up no major indications of denied claims or major lawsuits, this is still an evolving and growing concern. Could the insurer argue that neither the trust nor trustee is an "insured" under the unendorsed homeowners policy? Even in the best-case outcome, there could be numerous hassles in sorting it all out along the way.

Now let's assume that John and Mary had a houseguest who was badly injured in the fire. If the guest files a negligence suit, it surely would be directed to the owner of the property; thus, the trust would be named in the suit. An argument could be made that the insurer would be under no obligation to extend coverage to an entity not named in the homeowners declaration page. An online search yields no court rulings in which the insurer is required to extend coverage to an entity not named on the policy.

Some major insurers are wary about writing a homeowners policy if the home is in the name of the trust, particularly a corporate trust. This is because the situation is viewed as more of a business-type exposure. But, if it is a personal rather than corporate trust, they are more apt to consider it. Some insurers contend that the named insured needs to be a human being, not a legal entity. Thus, if the home is in the name of the trust, these insurers will only cover it via a dwelling policy—which typically offers less coverage than a typical homeowners policy. The trust would then need to add a premises liability endorsement to the dwelling policy to protect its interests; the grantor/occupant(s) would need to procure a homeowners tenants or contents (HO 4) form as well to protect his or her interests. Thus, the overall costs could be higher (with more restrictive coverage) for the grantor/occupant(s) than with simply one homeowners form.

One approach that some insurers take is to simply add the trust as an additional insured under the homeowners policy, with no changes to the named insured. Problems can result for the trust, however, because the additional insured is provided no coverage for personal property, loss of use, or medical payments. Thus, if the trust owns some of the jewelry or if there is a rental exposure (tenants or roomers), coverage gaps can result.[3]

According to some experts, a better approach to protect the exposures of the grantor/resident and the property and liability exposures of the trust and trustee is to list all parties as co-named insureds on both the underlying and umbrella policies.[4] For example, the declarations could list the named insured as "John and Mary Doe and Alan White, as Trustee of the John and Mary Doe Trust dated September 6, 2019."

This approach, though, can result in unintended exposures for the insurer. If a family trust is listed as a named insured, personal property losses to trust property in other states may not have been anticipated and underwritten by the underwriter. In addition, any business-related loss exposures of the trust are a concern for insurers. For these reasons, some insurers do not like this approach, having legitimate concerns that they may pick up other liability exposures of the trust unrelated to the home itself. Care would need to be taken to properly limit the loss exposures surrounding the trust to the residence premises. To address this concern, an insurer-developed manuscript endorsement, such as the following, could be used.

> If the "trustee" does not regularly reside on the residence premises, the personal liability and medical payments coverage only applies with respect to bodily injury and property damage arising out of the ownership, maintenance, or use of the "residence premises." In addition, there is no coverage under this policy for any resident of the "trustee's household."

In 2017, the Insurance Services Office, Inc. (ISO), developed the **trust endorsement (HO 06 15)** to avoid some of these aforementioned challenges.

[3]Jill Gidge, "Insuring Wills and Trusts," INSURE-ED Webinar sponsored by CPCU Society (2009), p. 8.

[4]Jack Hungelmann, "Risk Management: Protecting Assets When Home Ownership is Transferred to a Trust," www.IRMI.com Expert Commentary (Dallas, TX: International Risk Management Institute, Inc., December 2007).

This endorsement allows the policy to be issued in the name of the grantor of the trust instead of in the name of the trust. Research into trusts indicates that the party establishing the trust (i.e., grantor) is often (a) the party requesting the policy and the party who formerly owned the property now being held in trust, (b) the party who continues to reside in the home, and (c) the party designated as the trustee. As a result, the policy could be issued in the name of the grantor of the trust (who would be the named insured) rather than in the name of the trust.

A scenario will illustrate how this endorsement works. Let us return to the above scenario of John and Mary Doe, who are the grantors of the trust. Further assume that John and Mary are also the trustees. With the HO 06 15 endorsement attached, John and Mary will still be listed as the named insured under their homeowners policy as the grantor. The trustee (John and Mary) holds the legal ownership or legal title to the home, and John and Mary (as the grantors) hold the equitable/beneficial ownership. But John and Mary are still fully protected under their homeowners policy, as they are still listed as the named insured.

The endorsement amends the definition of an "insured" to include the trust (but only if it is recognized under the applicable state law as a legal entity with the right to sue or be sued in a court of law) and if named in the schedule as an insured. Note, however, that the trust itself is an insured only for the following coverages.

- Coverage A—dwelling
- Coverage B—other structures
- Coverage E—personal liability/Coverage F—medical payments but only for bodily injury and property damage arising out of the ownership, maintenance, or use of an insured location

The trustee designated in the endorsement schedule is an insured for the same coverages, but this status is limited only with respect to the trustee's duties as a trustee. For example, assume the grantor's bank is listed as the trustee. This endorsement would not provide any property or liability coverage for any of the bank's other loss exposures; coverage would apply only to its duties as a trustee for the house being covered under the policy.

The "business" definition under the endorsement is amended to stipulate that any of the trustee's activities in connection with this trust are not considered "business" activities in this policy and are thus covered. In contrast, the "business" definition does encompass home sharing host activities.

There is no consensus on this complex issue. What complicates matters is that there is no "standard" trust agreement. An underwriter would find it difficult to analyze every trust agreement to fully understand exactly who has what insurable interests and liability exposures. The growing popularity of trusts, however, means that insurers should anticipate the day when the use of trusts will spread throughout their homeowners book of business.

To systematically handle these potential trust exposures, insurers should develop a series of questions that will efficiently identify trust arrangements that pose extraordinary risks. With this approach, these risks can be reviewed for special underwriting attention.

Examples of pertinent questions include the following.

- Who are the parties to the trust (grantor, trustee, beneficiary)? What is their relationship to each other?
- Who is living in the home?
- How is the trust worded? Is it a personal trust?
- What tangible property does the trust hold (house, jewelry, boats, autos)?
- Is there any business use of any property held by the trust?
- What rights has the grantor reserved regarding the property held in trust?[5]

The bottom line is that if an insurer plans to dispute any claims for homeowners losses because the named insured in the declarations is a person, but the home (or personal property) is titled in the name of the trust, this concern should be proactively and clearly communicated to its agency force along with a logical plan to properly cover any potential coverage gaps through a specialized policy or an endorsement. In addition, agents should work with their underwriter to find the best method of insuring this risk and properly document this agreed approach.

Inadequate Dwelling Limits

The California wildfires in 2018 vividly illustrate the major problems of underinsurance in the homeowners line of business. In some fire-ravaged communities in the state, almost 70 percent of home owners contended that they did not have enough insurance to replace or rebuild their homes, according to a survey by United Policyholders.[6] Nationwide Insurance Company reported that about two out of every three homes in the country are underinsured. It estimated that the average underinsurance amount is about 22 percent, though some homes are underinsured by 60 percent or more.[7] CoreLogic, a leading property analytics company, identified 110,000 Southern California properties in very high to extreme risk of wildfire. With average reconstruction costs at approximately $400,000, the risk is more than $46 billion. CoreLogic reported that this amount is much higher than in years past because of significant increases in labor and building material costs. If just 1 percent of the at-risk homes suffered a total loss, the undervaluation of that 1 percent could be $25 million if insurance limits were not kept current.[8]

There are numerous reasons why so many home owners are perilously underinsured. First, insurance agents and brokers are involved in a downward spiral race to be ultra-competitive in order to win accounts. In some cases, agents have admitted under oath that they decreased insurance limits to reduce

[5]Tim O'Brien and Michael Markiewicz, "Property and Casualty Insurance Solutions for Entity Owners," www.markspaneth.com/assets/images/insights/420.292.Finance_Markiewicz.pdf (July 16, 2019).

[6]Swindell, Bill, "Insurance Shortfalls Hamper Sonoma County Fire Victims' Ability to Rebuild," The Press Democrat, www.pressdemocrat.com/business/8117171-181/insurance-shortfalls-hamper-sonoma-county (March 24, 2018).

[7]Nationwide Insurance, "Make Sure Your Home is Covered for All It's Worth," www.nationwide.com/underinsurance.jsp (2018).

[8]Olick, Diana, "Millions of Homes are Underinsured Against Natural Disasters as Construction Costs Keep Rising," *CNBC Markets,* www.cnbc.com/2019/05/03/millions-of-homes-are-underinsured-against-natural-disasters.html (May 3, 2019).

premium quotes in order to win business.[9] Writing a new client's homeowners insurance with $400,000 limits versus $480,000 may be just enough of a premium credit to earn the business. Home owners share in the blame since they often place too much emphasis on the lowest premium and look past the possible underinsured values and other coverage gaps.

Second, many agents and brokers use basic or low-cost appraisal software, often allowed by the insurer. In fact, some insurers that offer homeowners quotes online use a simple replacement cost calculator that asks only a few questions about the home and then provide a bare-bones estimate of the home's replacement cost. One online insurer's calculator asks, "What is your risk tolerance?" It then throws that response into the mix. Even larger home valuation companies such as CoreLogic's Marshall Swift products and e2Value offer lower-cost replacement cost estimators. Some of these products are virtual only, with no in-person or drive-by property inspection and relatively few questions about the intricacies of the home. Many of these products promote themselves by advertising how quick and easy the product is. That sounds good on the surface, but what happens when a total loss occurs? Based on past studies, these are the types of scenarios in which huge underinsurance gaps become apparent.

In fairness to CoreLogic and e2Value, these companies also offer more in-depth home replacement cost calculators. These expansive products utilize component-based replacement cost techniques to improve valuations of homes. In contrast to the simpler "cost per square foot" techniques, component-based techniques work the way a contractor builds a home, from the ground up, taking into consideration all the individual characteristics of each unique home.

According to e2Value, an evaluation of the home's architectural style and shape is essential. For example, a home with a Victorian style may require specialized lumber with a customized approach. A Frank Lloyd Wright-style home would be an example of even greater customized materials and workmanship and thus higher per-square-foot replacement cost considerations. In contrast, a ranch-style home will require less specialized knowledge and require fewer custom-building materials. E2Value's sophisticated software program contains over 150 distinct architectural styles.[10]

The e2Value software package also delves into very specific aspects of the home, such as the types, manufacturers, and number of lights, and detailed information on kitchen appliances. Fortunately, many property valuation companies such as e2Value and Marshall Swift have more questions and require more information on higher-value homes. This detailed approach is necessary to avoid some of the major insurance-to-value (ITV) problems associated with large catastrophes. A cookie-cutter approach to developing proper ITV is a recipe for failure, particularly when it comes to high-end homes.

Third, stricter ordinances or laws pertaining to residential building codes are growing more

[9]Adriano, Lyle, "Wildfire Victims are Largely Underinsured," *Insurance Business,* www.insurancebusinessmag.com/us/news/catastrophe/wildfire-victims-are-largely-underinsured-116580.aspx (November 19, 2018).

[10]E2Value, "Architectural Styles," https://evs.e2value.com/evs/est/InteractiveHelpAdmin/content.aspx?groupid=12 (July 2019).

common. If a home is badly damaged, the insured may be required to rebuild the structure to meet new (and nearly always stricter) building codes. Building codes are sets of regulations governing the design, construction, alteration, and maintenance of structures. Electrical codes are ones that are regularly updated. For example, older homes often do not have ground fault circuit interrupters (GFCIs) in areas where there are likely to be small appliances and where water is present. If a kitchen fire results, the municipal building code would likely require new GFCIs in the kitchen when the rebuilding begins.

Often, a municipality may change codes following significant catastrophes, such as hurricanes, earthquakes, and fires. At times, the cost of code upgrades can run 15 to 20 percent or more of the underlying loss. Yet the ISO ordinance or law coverage limit in its homeowners policy is only 10 percent of the dwelling limit; thus, coverage gaps in this area can arise. ISO does allow this limit to be increased via its **ordinance or law increased amount of coverage (HO 04 77)** endorsement up to 100 percent of the dwelling limit.

Thus, insurers and agents should be aware of the building code requirements in the cities in which they write business. Although electrical upgrades (e.g., out-of-date electrical breaker boxes) are the most common, other upgrade examples include plumbing fixtures and materials, sprinkler systems, insulation, mechanical devices, roofing materials, and smoke alarms. Often, this information is available through remodeling associations. Learning the building codes will provide insurers and agents good clues as to the minimum ordinance and law coverage limits to provide their customers to reduce coverage gaps.

Fourth, some communities have demolition codes, requiring a home to be demolished and rebuilt if, say, 50 or 75 percent of the home is destroyed.[11] In some coastal communities, the elevation of the home has to be raised before rebuilding can begin. This type of building or ordinance law could result in a painful coverage gap for the insured.

Fifth, construction costs often "surge" following large catastrophes, such as hurricanes and wildfires, often exacerbating this underinsurance problem. "Demand surge" is the "increase in the cost of repair or replacement of damaged property that may occur following a large-scale disaster when many individuals and organizations vie for a limited supply of labor and materials needed for repair."[12] This phenomenon should encourage insurers to develop an endorsement that would increase the dwelling limit by a certain percentage in the event of a catastrophe-related loss. This is often referred to as extended replacement cost coverage.

Guaranteed replacement cost is another option to consider. Under this property insurance valuation option, the policy pays the full cost of replacing the home even if this amount exceeds the policy limits. This valuation method fully indemnifies the insured without any depreciation and without a maximum reconstruction payment. The provision helps the insured avoid being underinsured in the event of a total loss. An important caveat typically applies to this provision—the home owner must allow the insurer to set the replacement cost and automatically increase it

[11] *Mierzwa v. Florida Windstorm Underwriting*, 877 So. 2d 774 (Fla. 2004).

[12] International Risk Management Institute, Inc., "Demand Surge," *IRMI Glossary of Insurance and Risk Management,* www.irmi.com/glossary (2019).

as needed. Note that guaranteed replacement cost coverage approaches can vary by state and are not available in every state or from every insurer.

Obviously, greater effort is needed to better gauge the replacement cost value of homes to avoid these types of situations in the future. The question as to who is ultimately responsible for selecting the correct limit has been an issue in many legal disputes. In most cases, the California courts have ruled that the home owner has the primary responsibility for ensuring that he or she has the proper dwelling limits, with some exceptions.

Insurers that do not provide guaranteed replacement cost coverage (the majority does not) and that encourage or allow their agents to use short and quick versions of residential replacement cost estimators may have a large swath of insureds with underinsured homes. This situation is particularly onerous in the case for higher value dwellings.

Following are some general tips for agents and insurers to reduce the problem of underinsured homes.

- Avoid quick and easy replacement cost calculators, especially for mid- to high-value homes. The more sophisticated component-based replacement cost estimators should be used for homes near or in the high-end range. A physical inspection of these homes is essential.

- Offer guaranteed replacement cost (or guaranteed rebuild) coverage; an alternative would be to offer a 30 to 50 percent cushion above the dwelling limit (extended replacement cost coverage).

- Develop an endorsement increasing the dwelling limit in the event of a catastrophe due to ensuing spikes in building costs.

- Increase the ordinance or law coverage (10 percent of Coverage A under the ISO HO 3) to a higher percentage of coverage. Note that this recommendation is particularly important for older homes.

- Proactively communicate with insureds about the need to keep their insurance agent informed about any remodeling, since remodeling can dramatically increase the need for higher dwelling limits.

- Periodically reinspect existing homes (particularly high-end ones) to ascertain if dwelling limits are adequate.

- Insurance agents, customer service representatives, and underwriters should understand construction value concepts. California state regulators now require insurance agents to take a course in construction value concepts to better advise policyholders.

Some advocates believe that a better approach in the future would be the elimination of dwelling and personal property limits entirely with a pure replacement cost clause in which the policy would guarantee that the destroyed structure and personal property would be replaced as it was before the loss with appropriate code updates.[13] This approach would mean the home owner would be truly protected, and the insurers could get adequate premium. Of course, this idea could only work if accurate component-based valuation methods of replacement cost were used in conjunction with a thorough physical inspection of the property. This approach would help ensure adequate rates for the insurer and good protection for the insured. Efforts to improve these valuations may entail large upfront costs, but the long-term benefits may outweigh these expenses.

One final idea to reduce coverage gaps for home owners suffering major losses concerns the loss settlement provision of the homeowners policy. Some homeowners policies agree to rebuild the home using “materials and workmanship of similar quality.” This language contrasts unfavorably to policies whose loss settlement provisions agree to rebuild using “like kind and quality” materials and workmanship. The difference in these two approaches found in this often-neglected policy provision is immense. To reduce coverage gaps, agents should seek out (and insurers should provide) coverage granting the “like kind and quality” provisions, particularly for older homes.

Inadequate Condominium Coverage

A condominium can be defined as a single real estate unit in a multiunit development in which a person has both separate ownership of a unit and a common interest, along with the development’s other owners, in the common areas.[14] Although this definition is fairly straightforward, arranging the insurance for condos is often not so easy. In fact, properly placing the insurance for a personal lines client who owns a condominium is like completing a large and complex puzzle—it takes some diligent work and effort. And, it starts by closely reviewing the condominium association’s “declaration” document, which details what real property the unit owner is responsible for insuring separately.

Condominium association rules and covenants affect insurance loss exposures by determining what categories of building property are owned by the association—and thus are insured under the association’s master policy—and what property is individually owned by the unit owners—and thus should be insured under the unit owners’ policy, such as the ISO H0 6 form.

During the last 30 years, there was a trend away from insuring associations’ real property under a “bare walls” basis to a “single entity” basis.[15]

[13]Paul Nielander, “Valuing a Home Correctly: How to Avoid Underinsurance,” *Personal Risk Management and Insurance*, www.irmi.com/online/prmi/ch016/1l16g000.aspx (Dallas, TX: International Risk Management Institute, Inc., August 2017).

[14]*Black’s Law Dictionary,* 9th ed. (St. Paul, MN: West Group, 2009).

[15]Investopedia, “All-In Coverage,” https://www.investopedia.com/terms/a/allin-coverage.asp (March 2018).

Under a "bare walls" approach, the condominium association insures only the bare structure(s) of the individual condo building(s); the structure, fixtures, and furnishings of collectively owned areas; and the collectively owned personal property of the association. Under this methodology, individual unit owners are responsible for insuring building property they own and use exclusively, such as sinks, built-in cabinets, appliances, flooring, and wallpaper in their individual units.

In certain parts of the country, the more common insuring approach now is the "single entity" basis, in which the condominium association master policy covers virtually all real property in a residential condo structure, including fixtures in individual units. One way to look at it is that, if the individual unit owner could turn the condo upside down and shake it, he or she would need to insure under a unit owners policy whatever property would fall out.

While this trend has the effect of shifting loss exposures from the personal unit owner policy to the association master policy, there is one noteworthy countertrend: the ever-increasing association master policy deductible. This development causes many coverage gaps to develop for the unit owner since policies such as the unendorsed ISO Homeowners 6—Unit-Owners Form (HO 6) only provide $1,000 in loss assessment limits.

Association master policies often are written with $5,000, $10,000, or $25,000 deductibles, but condos in hurricane-exposed coastal areas may have deductibles ranging from $50,000 to $100,000. Some deductibles are a set percentage (e.g., 1 or 2 percent of the dwelling limit).

Association documents usually include provisions allowing the association to allocate the deductible in various ways, and it is possible that the entire deductible could be assigned to a single unit owner that the association believes is responsible for the loss. Assume this latter example is the case, and further assume the association deductible is $10,000. If the condo unit owner negligently starts a kitchen fire, and the loss is $27,000, the condominium association policy would pay $17,000 ($27,000 less the $10,000 deductible). The negligent unit owner might be assessed the entire $10,000 deductible.

The HO 6 only provides $1,000 for loss assessments arising out of a master policy deductible unless the **supplemental loss assessment coverage (HO 04 35)** endorsement is attached. Thus, agents should recommend this endorsement (or a similar one) for their condominium clients.

Agents and brokers should carefully review the insurance specifications in the association's "declarations" document, obtain an accurate estimate of the replacement cost of the real property for which the unit owner is responsible (often including any improvements and betterments), and select this amount as the dwelling limit. Bumping up the standard assessment limit, including assessments arising from a high master policy deductible (the latter often requiring a negotiated manuscript endorsement) and expanding coverage from named perils to all risks, are highly recommended actions. Another possible solution concerning the high association deductibles may be found in the association documents. If these documents make the unit owner responsible for the deductible, many insurers will use the dwelling limit to pay the deductible. As a result, the dwelling limit would need to be increased in the amount of the deductible.

Because of these complexities and the chance of coverage gaps, some agents will not write condominium policies except on an accommodation basis for valued clients. In addition, they may only issue a unit owners policy with dwelling limits and personal property limits of at least, say, $40,000 each, both with replacement cost coverage.

The following are some tips for insurance professionals to improve the insurance protection for individual condominium unit owners to avoid any large coverage gaps.

- The insured should request a copy of the association's "declaration" document and provide it to his or her personal lines agent. This document will indicate what coverages the unit owner is responsible for individually insuring. This will help the agent determine the correct insurance limit for the condo.

- The insured and insurance agent should work together to evaluate the property insurance limit appropriate for the condominium. For example, if the insured has performed any remodeling work, damage to these updates will typically not be covered under the condominium master policy, and the dwelling limits under the unit owners policy may be inadequate as a result. Replacement cost estimator software packages are often helpful in this area.

- Insurance agents should consider potential assessments from the association to individual unit owners designed to reimburse the association for deductibles it incurs following a loss covered by the association's master policy. This situation is particularly problematic for unit owners when the assessment is due to high property deductibles increasingly found under associations' master policies. A review of the association's declaration document will indicate the amount of the deductible. The unit owners policy probably provides a limited amount of coverage for this assessment, but this limit can usually be increased if there is a possibility of being assessed more than the assessment coverage limit.

- Another area in which coverage gaps often appear (e.g., water damage from a leaky roof) concerns the perils covered by the unit owners policy. Depending on the form currently in place, it may be beneficial to expand named perils coverage to an open perils or "risk of direct physical loss" basis.

- The agent and insured should review the personal property limit under the unit owner's policy. This limit may need to be adjusted based on any major purchases made since the last review.

- Loss of use coverage is often inadequate because this coverage is often based on a percentage of the personal property limit. Agents should pursue loss of use coverage that contains no dollar limitation, particularly for clients with high-end condominiums.[16]

[16] Hess, Allison, "Understanding Condo Insurance; Loss of Use Coverage," Insuramatch, www.insuramatch.com/learning-center/understanding-condo-insurance-loss-use-coverage (November 8, 2018).

- Sewer backup coverage is highly recommended for the unit owners policy to (a) provide coverage for direct damage to the unit and (b) broaden loss assessment coverage to include assessments from this peril.

Sewer Backup Losses

The danger of sewage backup and sewage overflow is one that becomes a nightmarish reality for many home owners every year. A community in Florida was impacted, with about 26 sewage spills in Pinellas county causing damage to hundreds of homes in the aftermath of Hurricane Irma. Large swaths of these property owners were unprotected due to unendorsed homeowners policies.[17] These types of nonindemnified losses have occurred throughout the country, with insurers often refusing to pay due to exclusions and restrictions in the homeowners policy.

These losses are often caused by the city's sewage system. Typically, these losses cause tens of thousands of dollars (or even six-figure losses) in damage and make the house unlivable. A common culprit is a blockage in a city sanitary main. What often makes the matter worse is that water backup losses caused by a city-owned and maintained sewage system are often not even recoverable from the city. Many cities and/or states have laws granting them governmental immunity from reimbursing home owners for city-caused sewer backup damage into residents' homes. There is also no coverage for this loss under a flood policy.

[17] SWTSP Staff, "Homes Flooded with Sewage During IRMA," www.wtsp.com/article/weather/irma/home-flooded-with-neighbors-sewage-during-irma/477982444 (September 22, 2017).

The home owner would have to rely on his or her own homeowners policy with the **limited water back-up and sump discharge or overflow coverage (HO 04 95)** or related endorsement for water backup coverage. The basic limit under this endorsement is $5,000, which can be increased to $10,000, $15,000, $20,000, or $25,000. Unfortunately, in many cases , even the $25,000 limit may be inadequate, particularly with extensive damage to high-end homes.

Other cities may not be so strict concerning total immunity, but beware of other laws that limit their responsibility. For example, some cities will only reimburse home owners for losses caused by city-owned sewer lines if the city was aware of a problem and failed to take proper steps to resolve it in a reasonable period of time. In other words, if the municipality were unaware of the problem, it could legally deny liability. Or, if it is determined that a combination of city-owned and home owner-owned tree roots caused the sewer backup, the city may only be willing to pay part of the loss.

In addition, most home owners do not realize that they are typically responsible for maintaining their house or sewer lateral, which is the main pipeline between the city sanitary sewer main (located under the street) and the home. In effect, the property owner may own the sewer lateral, including any part that may extend into the street or alleyway.

Unfortunately, most home owners are not aware that their homeowners insurance policy does not cover such damage. Just as coastal home owners learned after hurricanes that their policies did not cover flood damage, others are learning that the policy on which they have relied on for so long does not cover damage from sewer backup. For these reasons, insurers should either build this coverage into the homeowners form or make available a water backup or overflow endorsement (with high limits) to the homeowners or dwelling policy. The endorsement should cover water damage, including remediation and cleanup costs.

One of the common problems is that the insurer endorsements often contain a fairly low limit, such as $10,000, although some insurers may provide higher limits for a higher premium. Sewer backup damage typically costs a home owner anywhere from $20,000 to $50,000. To reduce coverage gaps, insureds should procure protection of at least $50,000. Some insurers catering to high-end homes provide this coverage with no limit as part of their standard policy.

In addition, agents should recommend that their homeowners clients adopt several loss control techniques concerning this loss exposure, such as the following.

- People should not put grease, paper towels, diapers, or other refuse down toilets or sinks. Avoiding this action will help prevent clogs in the pipes that connect the home to the sewer. Note that grease buildup in the lines is a common cause of water and sewage backup losses.

- If a sump pump, French drain, or other flood control system is connected to the sewer main, a licensed plumber should remove that connection. Typically, such an arrangement is illegal.

- Insureds should consider getting a licensed plumber to install a backflow prevention device. This valve allows sewage to go out but not to come back in. The investment of between $500 and $5,000 will go a long way toward protecting the home.

- If there is a major sewer or drain backup into the home, a specialist should be called in to deal with the aftermath of this type of loss. The use of an experienced professional will help to prevent disease and reduce further damage from mold and mildew.

Domestic Workers

There are more than 2.5 million domestic workers across the United States, and this figure is expected to grow over the next decade.[18] But a definitive count is nearly impossible since many of these workers are in the country illegally, and many collect income that goes unreported on taxes. Thus, this number may be on the low end. There are many insurance implications for home owners in the hiring of domestic workers. So, what are the chief homeowners coverage gaps associated with this exposure for the home owner/employer?

Standard homeowners policies typically exclude bodily injury losses under the personal liability and medical payments sections to any persons eligible to receive any benefits voluntarily provided, or required to be provided, by an "insured" under the Workers Compensation Act. State workers compensation laws can vary on this requirement. In many states, domestic employees are not covered by the Act. However, in a number of

[18]Calfas, Jennifer, "There is a Real Crisis: Domestic Workers are in High Demand, but the Jobs have Few Protections and Little Pay," *Money Magazine,* http://money.com/money/longform/domestic-workers-crisis/ (April 4, 2019).

states, employers of domestic employees are subject to the Act if they employ these workers for more than a specified number of hours per week or if the employee is paid more than a specified sum over a certain period of time. In two states, New Hampshire and New Jersey, not only are domestic employees covered under the Act, regardless of the pay or the number of hours worked, but all homeowners policies must provide workers compensation coverage for these workers.[19]

Insurers and agents need to be aware of these laws for their clients who are apt to hire domestic workers. For example, assume John and Mary Wilson, residents of the wealthy suburb of Chevy Chase, Maryland, directly employ a domestic worker who works 8 hours every Monday for $12 per hour. The worker, who has no health insurance, suffers a serious head injury when she falls from a ladder she is using to clean the top shelf of a bookcase at the Wilsons' home.

Assume further that the Wilsons have a homeowners policy but no workers compensation policy for this worker. Maryland law stipulates that domestic workers who earn less than $1,000 per quarter are excluded from the Act but the worker in this loss scenario earns about $1,200 per quarter. Thus, the Wilsons are required by law to procure workers compensation for this worker but fail to do so—perhaps because they are unaware of this law.

The Wilsons' homeowners policy, however, excludes bodily injury to domestic employees if the insured is required to procure workers compensation (which is the case in this example). As a result of this serious injury, the domestic worker's husband files a lawsuit against the Wilsons. Unfortunately, the Wilsons are now looking at a huge liability coverage gap.

Insurance agents and home owners should become knowledgeable about workers compensation laws concerning domestics in their state and any other pertinent states. Equipped with this information, agents should then properly educate their staff and clients about any potential gaps in homeowners coverage. In some cases, agents should recommend that their clients purchase a separate workers compensation policy.

The following tips can assist home owners in mitigating the risks of employing domestic workers and for ensuring that these workers have the proper protection.

- If hiring a domestic worker directly, the home owner should order a background check on potential domestics to see if they (a) are U.S. citizens, (b) have a history of filing lawsuits, (c) have credit problems, or (d) have criminal records. If using an employment agency, the insured should verify the above steps are performed. Prospective domestics with major concerns of these types should not be hired.

- Insurance agents should work closely with home owners to see if workers compensation insurance should be procured for domestic workers. Agents need to be familiar with state laws concerning domestic employees. In many cases, home owners may choose to voluntarily provide workers compensation coverage.

[19] Robin Olson, "State Workers Compensation Laws and Domestic Workers," *Personal Risk Management and Insurance*, www.irmi.com/online/prmi/ch016/1l16f000.aspx (Dallas, TX: International Risk Management Institute, Inc., December 2018).

Although the homeowners policy covers injuries to domestic employees in many cases, the policy limit could be grossly inadequate in the event of serious injury, permanent disability, or death. The advantage of workers compensation coverage is that it provides broader protection (e.g., disability payments) than the typical homeowners policy, including unlimited medical expenses in most states. So, even if not required by law, it is a good idea to consider voluntarily providing this important coverage.

- If an outside firm or agency is used to hire the domestic, the employer/home owner should verify that the worker has workers compensation coverage. The home owner should obtain a certificate of insurance from the employment agency on an annual basis showing this coverage.

- The home owners should prepare a well-organized and documented human resource file for every domestic employee. In addition, an employment application should be completed and the employee should be given an employment manual or handbook. This manual will reduce the chances of an employment-related lawsuit because it can include protective provisions detailing the home owner's opposition to any employee mistreatment. An employee manual written or revised by an experienced attorney is an even more effective risk control recommendation.

- An employment practices liability policy should be strongly considered. This coverage can protect the home owner from a wide variety of lawsuits, including allegations of discrimination, wrongful termination, harassment, and slander. Many insurers serving the high-end marketplace often provide this coverage as an endorsement to their umbrella or excess liability policy. A personal injury endorsement attached to the homeowners policy is also recommended.

- The insurance agent should discuss with the home owner the possibility of increasing the personal liability and medical payments limits under the homeowners policy to the highest available limits, particularly if workers compensation benefits are not required or purchased. A personal umbrella policy is also recommended.

- The home owner should verify that his or her employment practices comply with federal requirements, such as the withholding of payroll taxes and proof of citizenship. Home owners should avoid paying domestics "under the table" due to the potentially burdensome legal/tax implications of taking this risk.

Contractor's Injuries at Insured's Home

A Chartered Property Casualty Underwriter (CPCU) friend of mine from the Southwest told me of a liability-related loss a few years ago at his home. He hired a general contractor (GC) to remodel his home. He obtained the necessary certificates of insurance (COIs) indicating the GC had current general liability and workers compensation coverage. He also thoroughly read and understood the construction contract. (It helped that he was in the insurance business.)

After the remodeling began, he received a call from his GC who said that a hired electrical subcontractor's employee had collapsed and died in my friend's attic. The GC later found out that the subcontractor did not have a workers compensation policy. The GC procured this coverage for his own 10 employees but did not require COIs proving this coverage for any of his subcontractors. More recently, my friend has received inquiries from the deceased family's attorney about this death.

There are typically two homeowners liability exclusions that could pertain to this situation. The first is the contractual liability exclusion that provides a broad exception granting coverage for a loss concerning an "insured location." So, this exclusion does not apply to the loss described above. The other exclusion pertains to bodily injury to any person eligible to receive any benefits voluntarily provided, or required to be provided, by an "insured" under any workers compensation law. Since the subcontractor is not an "insured" under my friend's homeowners policy, this exclusion would not apply either. Thus, it is pretty clear that the homeowners liability coverage would apply.

But what if my friend was in fact considered an employer? In a California case, the insured home owner hired a neighbor (an unlicensed and uninsured roofer) to replace the roof on his house.[20] On the first day of the job, the neighbor fell from the roof and broke his leg. He later sued the home owner, seeking damages. The California appellate court ruled that the home owner was indeed an employer, stating that any person who hires an unlicensed person to perform duties that required a license is, in fact, an "employer." The court further ruled that, once an employment relationship is created, the hiring individual may be sued for any injuries sustained on the job. My friend clearly would not be viewed as an employer since the GC he hired was both licensed and insured.

The issue often comes up as to whether a worker is a "casual" employee or not. If a worker is casual, many states do not require the employer to procure workers compensation. However, in one New Jersey case, the court found the employment was not casual because the work was not, in the court's decision, by "accident or by chance."[21] There, a worker, without a formal contract, had painted a summer cottage, later applied a water sealant to another part of the residence, and was subsequently injured. Although this ruling was later reversed by the appellate court, it points to the need for home owners to be careful in their hiring of uninsured contractors to work on their homes.

Thus, several factors come into play as to whether or not a homeowners policy would cover or exclude a contractor-related loss in the home.

- The wording of various homeowners liability exclusions and the court's interpretation

- State workers compensation laws concerning independent contractors and covered employments

- Whether or not the worker is considered an "independent contractor" or an "employee"

[20] *Mendoza v. Brodeur*, 142 Cal. App.4th 72, 8 WCAB Rptr. 10255 (2006).

[21] *Martin v. Pollard,* 638 A.2d 1380, 271 N.J. Super. 551 (N.J. Super. App. Div. 1994).

- Whether or not the "employee" is considered a "casual" employee

This potentially explosive liability situation can be avoided through several key steps, which are particularly important if a major home renovation or the building of a swimming pool is imminent.

1. Some home owners may inadvertently become a de-facto GC by hiring "construction managers" instead of a GC. The construction manager typically subcontracts out 100 percent of the work and often carries less insurance (or no insurance), relying instead on the subs providing the liability and workers compensation insurance. Utilizing a GC rather than a construction manager will typically result in better insurance protection for the project.

2. The home owner should verify that the contractor is licensed for the work and is bonded. In addition, he or she should ask for COIs from the contractor for workers compensation and general liability. (Contractors who cannot provide evidence of this coverage should be avoided.) If the GC uses subcontractors, COIs for these subs should also be provided.

3. The home owner should obtain a copy of the proposed contract. (This is vital for larger projects, such as major home renovations.) The written agreement should confirm an independent contractor relationship. Ideally, it should include a hold harmless clause in the insured's favor, particularly for major work, such as when heavy equipment will be used to construct a swimming pool.

4. The insured should also secure additional insured status for himself or herself in the contractor's general liability policy.

5. An experienced attorney should review the more complex contracts for major renovations or projects.

Proper Coordination of Overall Insurance Program

As society grows more complex, personal lines loss exposures grow more complex as well. This phenomenon is particularly true for wealthier individuals with many unique loss exposures. A recent court case points to this growing complexity. This case provides a worrisome example of what can happen when an insured (the owner of many small businesses with a variety of business names) attempts to insure multifaceted personal and business risks under a discordant group of policies from multiple insurers and multiple brokers.

This New York court case concerned a liability loss suffered by a wealthy insured/entrepreneur with a patchwork of uncoordinated insurance policies.[22] There, the insured's guest was injured on a vacant, undeveloped piece of land owned by one of the insured's businesses. The insured notified numerous insurers of the loss, and all declined coverage. As a result, the insured and two of his businesses sued five different insurers and three different brokers. The insurers prevailed in nearly all of the

[22] *Picone v. Great Northern Ins. Co.*, 2008 N.Y. Slip Op. 33029 (N.Y. Sup. Ct., Nov. 3, 2008).

motions to dismiss the case, leaving the insured with no insurance coverage.

This case points to the need for insurance agents and brokers to gravitate from being simply insurance salespersons into risk managers, particularly for their more affluent personal lines clients. One of the important ways to do this is for agents to make sure all their clients' policies are properly harmonized. The following tips for insurance professionals are designed to assist insureds in properly coordinating their various exposures and policies, thus mitigating many potential coverage gaps.

- The named insured including spouse, along with any trusts or similar interests, should be specifically and consistently co-named in all of the insurance policies. Consistency is necessary for all insurance policies covering these parties. If married, both spouses should be listed as named insureds under all of their insurance policies. If a trust owns the home, make sure that all applicable parties are listed as co-named insureds on both the underlying and umbrella policies. This approach helps to eliminate coverage gaps. Alternatively, consider attaching the **trust endorsement (HO 06 15)** or a similar one, particularly if the grantor of the trust lives in the home and is also the trustee.[23] If an LLC owns property for which the insured has a financial interest, the insured should work with a skilled attorney experienced in business organizations on this matter.
- Selecting the proper umbrella policy is important since these policies may cover important gaps in the underlying coverage. Ideally, the same insurer should provide the underlying coverage and the excess coverage—again to reduce any gaps and to avoid bickering between two separate insurers in the event of a major liability loss.
- Insureds should retain proposals for insurance that outline exposures and recommended coverage. These proposals should be kept for at least 3 years. If changes are made to these proposals or reviews, the insured should receive the updates.
- Insureds should keep old copies of insurance policies indefinitely, particularly those with liability coverages. The insured should scan these documents and retain them electronically with duplicates stored at a different location.
- Insurance agents should provide an annual review of coverage afforded or areas that may be uninsured or underinsured, particularly for wealthier clients with myriad loss exposures. As changes are discussed and implemented, the agent should provide the insured a revised review.
- Agents should regularly provide loss control and contractual risk transfer recommendations to their clients. This process should also be part of the annual review of coverage for new exposures. Various other risk management techniques, as necessary, should be explained to the insured as well.

[23] International Risk Management Institute, Inc., "Trust Endorsement," *Personal Risk Management and Insurance*, www.irmi.com/online/prmi/ch013/1l13f100/al004070.aspx (Dallas, TX: International Risk Management Institute, Inc., 2017).

- If the insured is also an owner of one or more businesses, the agent should verify that proper coverage is in place for these businesses. The insured should work with a minimal number of agents and brokers to ensure that all the loss exposures of each business are properly covered, within either a combined insurance program or separate ones. Careful attention should be paid to the specific names of each business and the specific parties who are listed as named insured and additional insureds under the policies covering the businesses. Coverage gaps between personal versus corporate activities should be thoroughly explored and resolved after considering a variety of risk management techniques. For example, special attention should be paid to company cars, excess liability limits over company cars, and restrictions on family members (e.g., teenagers) driving a company car.

- Insurance agents should explain the suability factor to their clients. Suability is determined by the size of any savings account and stock portfolio, real estate holdings, the insured's profile in the community, and current and potential family income. Agents and brokers should recommend a personal umbrella policy for their clients with moderate suability factors ($1 million to $2 million limits) and high suability factors ($5 million to $10 million limits). A strong argument could be made that even middle- or lower-income persons should procure such a policy.

- Agents should advise their insureds to be wary of purchasing some of their coverage (e.g., personal auto policy) from the Internet and the rest through a traditional agent. The insured may unknowingly procure auto liability limits (or boat or motorcycle liability limits) well below the minimum limits required by their umbrella policy. Gaps of $100,000 or beyond are not uncommon in these scenarios.[24]

The bottom line is that forward-thinking personal lines insurance agents and brokers need to evolve into risk managers, particularly with the growing complexity of personal loss exposures and the array of risk management techniques to consider. This value-added activity will surely pay big dividends for agents and brokers down the road, particularly in their client satisfaction and retention rates.

Conclusion—Personal Risk Management

The premise of the best-selling book *Freakonomics* is that people should challenge conventional wisdom when making day-to-day decisions and try to analyze the hidden side of the various options in life.[25] For example, one chapter concerns the issue of parents' ability to assess the various risks facing their children. The authors claim that parents are often afraid of the wrong perils. In one example, an 8-year-old girl named Molly has two close friends. Molly's parents learned that one friend's parents owned a gun. Thus, they have forbidden Molly to play there. Instead, Molly spends a great deal of time at the other friend's house, which has a swimming pool in the backyard.

[24] O'Brien, peer review comment (Oct. 18, 2009).

[25] Steven Levitt and Stephen Dubner, *Freakonomics* (New York: HarperCollins Books, 2006), pp. 149–154.

Molly's parents believe they have made good decisions about where Molly spends her time.

But is this truly a wise decision? Not according to the data in the book. The authors argue that this is actually a poor decision. On an annual basis, there is one drowning of a child for every 11,000 residential pools in this country. Thus, about 550 children under age 10 drown each year. Conversely, there is one child killed by a gun for every 1 million-plus guns. Since the United States has roughly 200 million guns, this means approximately 175 children under age 10 die each year from guns. The chance of death by drowning (1 out of 11,000) versus death by gun (1 in 1 million-plus) is not even close.

Another theory behind this phenomenon concerns the immediacy of a potential loss. Thus, many people fear terrorist attacks much more than developing high cholesterol and resulting heart disease. Fear seems to thrive best in the present tense. While a terrorist attack is viewed as a distinct possibility now, death by heart disease (annual U.S. deaths exceeding 600,000) is often seen as a slowly evolving, distant, and quiet catastrophe. As Levitt and Dubner describe it, "terrorist acts lie beyond our control; French fries do not."[26]

Insurance and risk management professionals also need to challenge the conventional wisdom concerning risk assessment for their clients. A detailed exposure survey, particularly for their wealthier clients with myriad loss exposures, is the first step in this process. In addition, the conventional wisdom that personal lines agents and brokers focus on selling more insurance, rather than serving their clients as forward-thinking risk managers, should also be challenged and changed.

Agents have a smorgasbord of techniques at their disposal to deal with these assorted risks, such as contractual risk transfer, risk avoidance, and loss control. With agents serving as risk managers rather than simply as insurance salespeople, clients will be better served and better protected. This risk management approach will result in fewer coverage gaps—gaps that can wreak financial havoc on personal lines insurance consumers and gaps that can give insurers and agents alike a black eye in the public's mind.

[26]Ibid, p. 152.

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