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## **Excuse Me - Do You Speak Fluent Insurance?**

### **I. The Policy**

#### **Understanding the Simple Complexity**

The insurance world has many nuances and complexities. When the first official commercial insurance policy in the United States was issued it was 165 lines of explanation. Total. The idea was that a policy was to be readily understood by the average person. Today that holds little to the intention ascribed to by the original thought. In exchange for an initial payment, known as the premium, the insurer promises to pay for loss caused by perils covered under the policy language. By definition the policy is a contract (primarily in a standard form) between the insurer and the insured, which determines the claims that an insurer is legally bound and required to pay. However, insurance companies write policy contracts to protect themselves from taking on too much exposure and concentration of risk. This leads to legalese in the policy and a tight rope walk between carrier and customer. And to make it more complex, the legislation (state and federal) and the judicial system add their own requirements to policy wording and the claims process. Thus, rarely does anyone desire or want to read a policy, let alone understand the nuances and complexities in the policy wording.

#### **Have to Read in Legal Terms to know What is In It**

In most instances, clients do not understand that insurance policies are not standard business contracts. Rarely will a client read their policies and only after a claim do they really understand what the contractual policy provides or omits for them in legal terms. Insurance policies have inherent elements including but not limited to:

- Insurance policies are aleatory, meaning that the amounts exchanged by the insured and insurer are unequal because they depend upon uncertain and risky future events. In comparison, standard non-insurance contracts are commutative. This means the values exchanged are usually intended by the parties to be approximately equal. This distinction is particularly important in the circumstance of finite risk insurance which contain "commutation" provisions.

- Insurance contracts are unilateral. The legal meaning of unilateral as it applies to insurance policies is that only the insurer and not the client makes legally obligated capacities in the contract. The insurer is required to pay the benefits under the contract if the insured has paid the premiums and met specific basic requirements.
- Policies are generally considered contracts of adhesion because the insurer draws up the contract and the insured has limited ability to make significant changes to it. This is interpreted to mean that the insurer bears the burden if there is any vagueness in any terms of the contract. In several jurisdictions, including California, Wyoming, and Pennsylvania, the insured is bound by clear and conspicuous terms in the contract even if the evidence suggests that the insured did not read or understand them.
- Insurance contracts are governed by the principle of “utmost good faith” which requires both parties to deal in good faith and specifically if it imparts on the insured a duty to disclose all material facts which relate to the risk to be covered. Underwriting has to be made aware of all the risks. This is dissimilar to standard legal doctrine that covers most other types of contracts. Due to utmost good faith approach the insured can sue an insurer in tort for acting in bad faith.

Understanding the concept of a legal document is the foundation for understanding the insurance policy but there are major differences. Clients rarely understand those differences until a claim occurs.

### **The Drafters**

Property and casualty insurance companies characteristically use identical language in their standard insurance policies. These are drafted by advisory groups. Two of the most frequently recognized associations are the Insurance Services Office (ISO) and the American Association of Insurance Services. The reason for using similar language drafted by advisory establishments for the policy wording is that it reduces the regulatory burden for insurers. Policy forms must be approved by each individual state. This permits insurance buyers to match policies with similar standard language and definitions. Also from a judicial standpoint, as policy forms are reviewed by judges, the understandings convert to ease of reading and are further predictable. Courts having the standard language can elaborate upon the interpretation of the same clauses in the same policy forms, rather than different policies from different insurers. It makes their jobs easier.

Several carriers have begun to deviate against the standard policy wording in the past several years. These insurers have increasingly modified the standard form language to their own company-specific wording, to in their view better protect themselves. Some have also failed to adopt changes to standard forms as set by the organizations. Auto and many homeowners’ policies vary tremendously in the scope and language provided to the insureds. Commercially, Directors and Officers (D&O) policies have the same standard wording and language but vary via endorsements and manuscripts. Part of the move away from standardization is that the drafting of standard policies consumes a large amount of time and carriers feel that they are more quickly able to respond to market changes and emerging exposures than the organizations drafting the new policy wording. Lawyers engaged in bringing litigation against insurers have also been part of the issue as carriers defend their language with their interpretation and not that of the standard agencies.

This divergence has begun to force risk and claims managers to read the policies before the claim occurs and ask for explanations more often especially when changing from one carrier to another.

## **II. Policy Line Up**

### **Policy Di-Sections**

Reading an insurance policy isn't exactly like curling up on a cold evening with warm hot chocolate and the latest best seller book. However, just like a book, there are is a road map known as a table of contents and is divided into chapters. The plot is not always the best, but the chapters do create the story. So, what are the chapters from beginning to end in most policies? The general parts of an insurance policy include:

#### **Declarations page**

The policy declarations page often called the "dec(k) page" is fundamentally the first page of the policy. It identifies who is an insured, the insured's address, the insuring company, what risks or property are covered, the policy limits, any applicable deductibles, the policy period and premium amount. This page is where errors can occur and should be evaluated closely.

#### **Definitions**

This section gives you the definitions of words and phrases that will be used throughout the insurance policy. Many times important defined words appear in bold print through the policy. Understanding the definitions is where many policyholders and the carriers divide only to be settled by a judge.

#### **Coverages or the Insuring Agreement**

This segment of the policy describes the specific insurance provided. In the language it provides what are the covered perils, or risks/exposures that are assumed, and/or nature of coverage. It lists what property is covered and for what damages. The Coverages section is where indemnity resides.

#### **Exclusions**

These describe the coverage limitations or how coverage may be reduced or even eliminated depending on how a loss occurs. In simple terms, this chapter of the contract takes coverage away from the insuring agreement by describing property, perils, hazards or losses arising from specific causes which are not covered by the policy. Insurance companies may allow policyholders to buy back coverage for some exclusions for additional premium or as a concession (see endorsements below). For example, windstorm coverage may be excluded for people who live in an area where windstorms are unlikely to happen. However, if an insured wants the coverage, they could buy it back for additional premium. Claims and risk professionals MUST review this chapter first and thoroughly when receiving the policy.

#### **Conditions**

These are specific provisions, rules of conduct, duties, and obligations which the insured must comply with in order for coverage to trigger. These also outline what the insured is required to stay in compliance with in order to keep coverage in effect. If policy conditions are not met, the insurer can deny the claim. This section tells the insured what the insurer's responsibilities are, and what the insured's responsibilities are. This section also includes how to cancel a policy, transfer of rights or duties, and payment plans, if any.

### **Limits and special limits**

This section explains how much the insurer pays for specific losses or types of property. This section indicates that while there is coverage, the loss may only be covered up to a specific dollar amount or for a percentage of the entire loss and not the whole loss amount. Many policy owners skim over this section until it is time for the claim. Then the realization sinks in that there were limits to the policy amount and that these should have been addressed prior to the loss.

### **Duties after a loss**

This part of the insurance policy gives direction on timelines and action plans when a loss occurs. It includes notifying the insurer as soon as reasonably feasible, notifying the police or authority having jurisdiction, protecting the insureds property from further damage. Mitigation clauses and guidance are provided to prevent moral hazard.

### **Endorsements**

In short, these additional forms are attached to the policy that amend the language, either unconditionally or when the actuality of some condition or action defines optional coverages available for additional premium. An insurance endorsement may change the policy so that it better fits the insureds specific needs. Amendatory endorsements may also be added by the insurer, with no additional premium. These are specially added to clarify policy terms and language. They may revise, expand, or delete clauses previously defined or explained in one or more coverage forms, or the endorsements may even transform each other. The underlying warning red flag of endorsements are they make policies even more challenging to read for non-policyholder legal professionals. Claims professionals and risk managers have to assure that what was deleted is now added back and what was in the policy agreement is not limited with endorsements.

## **III. An Educated Policyholder is the Our Best Experienced Consumer**

Policyholders need to be smart shoppers, using their brokers and underwriting meetings not only to find the best premium quotes, but also to find the best terms of coverage. Insurance policies are not created equal and thus smart risk and claims management professionals have to secure quality coverage that is both protective and understandable. It is axiomatic that insurance can protect against a range of serious threats. The perils for most organizations are abundant: employment related claims, external theft, long-tail claims, customer/patient/guest claims, regulator investigations and enforcement proceedings, natural perils, and cyber claims are but a number of exposures that many policyholders confront.

### **What to Do**

Insurance purchasers can do much to mitigate risk by considering factors other than price when purchasing their insurance coverage. Below is a check-list of measures that can give policyholders an advantage when dealing with potentially major loss scenarios.

### **1. Purchase Tailored Insurance Coverage on an all-risk basis where available.**

That does not necessarily mean buying a new specialty policy every month. Some insurance companies are actively soliciting policyholders for the 'Policy of the Month Club', and they want you to be a member. It now seems that every risk is met with a new, specialty stand-alone insurance policy (with a new insurance premium to match). While policyholders should seek to buy insurance coverage tailored to protect against risks unique to their business, they should look to do so with all risk coverage rather than adding a whole new insurance product line. Every time a new policy is added to a program, new exclusions and supposedly new underwriting "intent" is added to your insurance programs. This may cause an opportunity for some insurance companies to argue that a new gap in coverage exists as claims fall between new exclusions and narrower coverage grants.

### **2. Avoid Onerous Insurance Policy Terms**

While shopping for the provisions outlined above, seek out policies containing the fewest escape clauses that might enable the insurance company to avoid coverage for a large claim. What the big print gives, the fine print can undermine. For example, policyholders should insist upon policies that do not tie the calculation of time element coverage to the performance of other properties owned by the policyholder. Some insurance companies insert language that they argue entitles them to offset losses at one location with profits earned at another.

Another common example involves policies that are ambiguous (or worse) as to whether business income protection "requires" a complete cessation of business to trigger time element coverage. Some insurance companies have argued that there is no time element coverage unless the policyholder's business has completely ceased. This can be a devastating position when a policyholder operates numerous business activities at a location and an insured peril only affects some of them. Even a partial interruption of activities can have dire consequences for profitability. Avoiding such policy traps is worth both time and money; policyholders are wise to shop for the most favorable terms available. Shopping by price alone is usually a mistake.

### **3. Avoid Incongruities In your Insurance Program**

Many organizations need to purchase excess insurance in addition to primary coverage. While it can be painstaking, policyholders should take care to ensure that their excess policies track the language of their primary policies to avoid gaps in coverage and other potentially unpleasant surprises. Just because an excess insurance policy is described in the insurance binder or declarations page as "follow form" does not mean that it really is.

The key to making the policy understood is reading and that takes work for both attorneys and clients.