



Essential Protections for Policyholders



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Essential Protections for Policyholders
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Homeowners insurance is not “one size fits all;” homeowners differ in what kind of insurance they need, want, or are willing to pay for. But all homeowners need certain basic coverage and should have the opportunity to purchase other coverage that is best suited to them. That way, homeowners can be informed about the choices available and can make better decisions about how much insurance of what kind to buy.

The most important element of coverage is a homeowner’s ability to use the coverage when it is needed. An Essential Protection is to make sure that policyholders are not discouraged from filing claims or punished for doing so by having their policies canceled or not renewed because they have asked about a potential claim or filed a claim.



Homeowners’ insurance policies should contain minimum guarantees of protection and insurance companies should offer essential additional coverages.

- **Every homeowner’s insurance policy should contain essential terms and coverage, and policyholders at the time of purchase or renewal should be able to purchase additional important coverage.**

Homeowners’ insurance policies vary greatly and insurance consumers reasonably can choose to buy different types of coverage depending on their economic circumstances and their willingness and ability to accept risk. But for homeowners’ insurance to serve its purpose of providing basic financial security, every homeowners’ policy should

include minimum essential terms, and consumers should be offered additional terms that address risks that are commonly encountered if a loss occurs.

Homeowners' policies typically include coverage for loss of use of the property, of which the most important component is Additional Living Expense (ALE). ALE coverage reimburses the homeowner for losses caused by the primary residence being uninhabitable, such as the cost of renting a comparable property. Because repairs can take time, policies should provide a minimum time period of twelve months during which ALE may be incurred; homeowners who wish additional protection should be able to purchase ALE coverage that extends for an additional twelve months.

Replacement cost coverage pays for the cost to repair or replace damaged property. If a homeowner chooses to rebuild or relocate at another location, the benefits of the policy still should be available, limited to the cost of replacement at the original location.

Replacement cost coverage typically is capped at a dollar amount stated in the policy limit. Extended Replacement Cost coverage provides an additional percentage that may be recovered. This protection is necessary if the estimate of the cost to repair that is the basis for the policy limit—often provided by the insurance company—is too low, and is especially important after catastrophes, when the cost of labor and materials typically rises.

Repair or rebuilding of damaged property often requires that the property be improved from its prior condition because building codes have changed since the original construction. A damaged property must be repaired or rebuilt to conform to the current building code which may require additional expense. Policyholders with Replacement Cost coverage reasonably expect that this additional cost will be part of their policy, and policyholders with Actual Cash Value coverage should be made aware of the need for so-called "Law and Ordinance Upgrade" coverage.

The Essential Protections apply to every homeowners' insurance policy. Individual states may have special situations that call for other essential terms or the offer of other additional coverage.

Recommended action:

States should require that every homeowners insurance policy contain essential terms and coverage and that insurance companies at the time of purchase or renewal offer additional coverage. These terms include:

- Minimum coverage for Additional Living Expense and the opportunity to purchase greater coverage.

- In a Replacement Cost policy, the opportunity to purchase coverage for Extended Replacement Cost, or the cost of replacement beyond the stated policy limit.
- In a Replacement Cost policy, Law and Ordinance coverage, or coverage for repair or replacement upgrades required by law.
- In an Actual Cash Value policy, the opportunity to purchase Law and Ordinance coverage, or coverage for repair or replacement upgrades required by law.

Recommended statutory language:

(1) Every homeowners insurance policy must include additional living expense coverage. This coverage must be available for a period of at least twelve months and is subject to other policy provisions. Insurers shall offer policyholders the opportunity to purchase a total of at least twenty-four months of additional living expense coverage.

(2) In the event of a total loss of a structure insured under a homeowners insurance policy that provides for replacement cost, the insured may rebuild or replace the property at a location other than the insured premises. In that case, the measure of indemnity shall be based upon the replacement cost of the insured property and shall not be based upon the cost to repair, rebuild, or replace at a location other than the insured premises.

(3) Before issuing or renewing a replacement cost homeowners insurance policy whose dwelling limit is equal to or greater than the estimated replacement cost of the residence, the insurer shall make available to an applicant the opportunity to obtain extended replacement-cost in an amount of insurance that is at least twenty percent of the limit of the insurance for the dwelling.

(4) Every homeowners insurance policy that provides for replacement cost shall include law and ordinance coverage for costs necessary to meet applicable laws and ordinances regulating the construction, use, or repair of any property or requiring the tearing down of any property, including the costs of removing debris. However, additional costs necessary to meet applicable laws and ordinances may be limited to 25 percent or 50 percent of the dwelling limit, as selected by the policyholder, and such coverage applies only to repairs of the damaged portion of the structure unless the total damage to the structure exceeds 50 percent of the replacement cost of the structure.

(5) Before issuing or renewing a homeowners insurance policy that provides for payment of losses at actual cash value, the insurer shall offer law and ordinance

coverage for costs necessary to meet applicable laws and ordinances regulating the construction, use, or repair of any property or requiring the tearing down of any property, including the costs of removing debris. However, additional costs necessary to meet applicable laws and ordinances may be limited to 25 percent or 50 percent of the dwelling limit, as selected by the policyholder, and such coverage applies only to repairs of the damaged portion of the structure unless the total damage to the structure exceeds 50 percent of the replacement cost of the structure.

Current law:

A few states specify by statute required ALE coverage.¹ The ability to replace property at a different location is specified by statute in California² and by judicial interpretation of the insurance policy in other states.³ Several states require insurers to offer extended replacement cost and law and ordinance coverage.⁴

Insurance companies must observe reasonable standards for canceling and renewing policies and reporting claims.

- **Insurance companies may not use an inquiry about a loss or a single claim as the basis for cancellation, nonrenewal or premium increase of a policy.**

Insurance companies legitimately can use some elements of policyholders' claims experience in deciding whether to issue or renew policies and how to price them. However, companies should not be able to use elements that are not strongly correlated with future risk or that discourage policyholders from pursuing legitimate claims. This practice—"use it and lose it"—makes some consumers uninsurable and, as knowledge of the practice becomes widespread, deters many others from asserting their rights. The most extreme version of this practice occurs when companies refuse to insure or renew or impose a premium increase or surcharge on policies merely because policyholders

¹ E.g., Colo. Rev. Stat. Ann. § 10-4-110.8; Md. Code, Insurance § 19-208.

² Cal. Ins. Code § 2051.5(c).

³ E.g., Huggins v. Hanover Ins. Co., 423 So. 2d 147 (1982); Blanchette v. York Mutual Ins. Co., 455 A.2d 426 (Me. 1983).

⁴ Colo. Rev. Stat. § 10-4-110.8(6)(a); Fla. Stat. Ann. § 627.7011.

have inquired about coverage without actually filing a claim. The problem is made worse by companies' reliance on centralized databases about policyholders, so the fact that policyholders made inquiries are reported to all companies, even if the inquiries were unrelated to actual losses.

Recommended action:

States should prohibit insurance companies from refusing to issue, cancelling, surcharging increasing premiums, or refusing to renew policies because policyholders have made inquiries about coverage or potential claims or have filed one or a small number of claims.

Recommended statutory language:

- (1) An insurer shall not refuse to issue, refuse to renew, or cancel an insurance policy, establish rates for coverage, or impose a surcharge based in whole or in part on one or more inquiries made by any consumer to an insurer, regardless of the source of the information that inquiries were made.
- (2) An insurer shall not submit to any insurance support organization or consumer reporting agency that an inquiry was made to the insurer.
- (3) An "inquiry" means any communication to an insurance company by an insured, or by an insurance producer on behalf of an insured, regarding terms and conditions of a homeowners insurance policy, including a communication concerning whether a homeowners insurance policy provides coverage for a type of loss or the process for filing a claim, that does not result in the filing of a claim.
- (4) An insurer shall not cancel, refuse to renew, impose a surcharge on, or increase the premium of a homeowners insurance policy solely on the basis of
 - (a) claims made for coverage under the policy, unless two or more such claims have been made against the policy during the 36 months immediately preceding the expiration of the current policy period; or
 - (b) claims closed without payment, notwithstanding any other provision of this section.
- (5) An insurer shall not cancel a homeowner's policy of insurance or increase the policy deductible except for any of the following reasons:
 - (a) Nonpayment of premium.
 - (b) Conviction of the named insured of a crime having as one of its necessary elements an act increasing any hazard insured.

(c) Discovery of fraud or material misrepresentation by the named insured or his representative in obtaining the insurance or pursuing a claim under the policy.

(d) Discovery of grossly negligent acts or omissions by the insured or his or her representative substantially increasing any of the hazards insured against.

(6) An insurer shall not cancel or refuse to renew a policy except by notice to the insured. A notice of intention not to renew is not effective unless received by the named insured at least 30 days prior to the expiration date of the policy. Like notice must also be given to any party named as mortgagee on the policy. The notice must include the insurer's actual reason for refusing to renew the policy. The statement of reason must be explicit and sufficiently specific to convey, clearly and without further inquiry, the basis for the insurer's cancellation or failure to renew. Explanations such as "underwriting reasons," "underwriting experience," "loss record," "location of risk," "credit report" and similar terms are not by themselves acceptable explanations.

Current law:

A number of states have adopted statutes that limit insurance companies' ability to use inquiries as the basis of underwriting decisions.⁵ The statutes typically are limited to homeowners' or other property insurance.⁶ The definitions of "inquiry" vary modestly, usually including the two elements of "a request for information regarding the terms, conditions, or coverages offered under a property and casualty insurance policy" and that the inquiry "does not result in a claim."⁷ The statutes prohibit the use of inquiries in specific situations, such as canceling or nonrenewing policies;⁸ issuing or declining to issue, nonrenewing, or canceling;⁹ imposing surcharges or higher premiums;¹⁰ or, most

⁵ E.g., Ariz. Rev. Stat. Ann. § 20-1652; Colo. Rev. Stat. Ann. § 10-4-110.8; Del. Code Ann. tit. 18, § 4131;

Haw. Rev. Stat. § 431:10E-124; Minn. Stat. Ann. § 65A.285; Mont. Code Ann. § 33-15-1105; N.J. Stat. Ann. § 17:29B-4.1; Tenn. Code Ann. § 56-7-113; Tex. Ins. Code Ann. § 544.553; Tex. Ins. Code Ann. § 551.113; Wyo. Stat. Ann. § 26-23-108.

⁶ E.g., Haw. Rev. Stat. § 431:10E-124; N.J. Stat. Ann. § 17:29B-4; Tex. Ins. Code Ann. § 551.113.

⁷ E.g., Mont. Code Ann. § 33-15-1105. At least one state, Hawaii, narrows the definition by excluding inquiries where "the inquiry provides information not previously disclosed by the insured." Haw. Rev. Stat. § 431:10E-124.

⁸ E.g., Colo. Rev. Stat. Ann. § 10-4-110.8.

⁹ E.g., Tex. Ins. Code Ann. § 551.113.

¹⁰ E.g., Minn. Stat. Ann. § 65A.285; Wyo. Stat. Ann. § 26-23-108.

generally, “for purposes of making underwriting decisions.”¹¹ Some states also specifically prohibit insurance companies from reporting inquiries to national databases such as CLUE.¹²

A number of states limit insurance companies’ ability to cancel or refuse to renew policies except for the reasons stated in paragraph (5) of the recommended statutory language.¹³ With reference to the “use it and lose it” concept, the most relevant language prohibits adverse action unless there is an event such as “a material change in the risk being insured”¹⁴ or “increased hazard or material change in the risk assumed that could not have been reasonably contemplated by the parties at the time of assumption of the risk.”¹⁵ Some states specify a minimum number of claims that may trigger cancellation or nonrenewal.¹⁶

Many states also have related provisions limiting the use of losses due to catastrophes or other weather-related events as a basis for cancellation, nonrenewal, or other underwriting decisions. Refer to the discussion under Essential Protections for Disaster Victims.

¹¹ Del. Code Ann. tit. 18, § 4131.

¹² E.g., Ariz. Rev. Stat. Ann. § 20-1652; Colo. Rev. Stat. Ann. § 10-4-110.8; Mont. Code Ann. § 33-15-1105.

¹³ E.g., Okla. Stat. Ann. tit. 36, § 3639.1; La. Rev. Stat. Ann. 22:1333; La. Rev. Stat. Ann. 22:1265; Tex. Ins. Code Ann. § 551.107 nonrenewal only if three or more claims in any three-year period); N.C. Gen. Stat. Ann. § 58-41-15; Ark. Code Ann. § 23-66-206); Wyo. Stat. Ann. § 26-35-202.

¹⁴ La. Rev. Stat. Ann. 22:1265(D).

¹⁵ N.C. Gen. Stat. Ann. § 58-41-15(a)(3).

¹⁶ E.g., La. Rev. Stat. Ann. 22:1265; Tex. Ins. Code Ann. § 551.107(d).

About Essential Protections for Policyholders

Essential Protections for Policyholders is a project of the Rutgers Center for Risk and Responsibility in cooperation with United Policyholders.

The Rutgers Center for Risk and Responsibility at Rutgers Law School explores the ways in which society makes choices about risk, its proper allocation, and compensation for the harm caused when risks materialize.

United Policyholders is a non-profit 501(c)(3) organization whose mission is to be a trustworthy and useful information resource and a respected voice for consumers of all types of insurance in all fifty states.

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Contact:

Professor Jay Feinman
Rutgers Law School
Co-Director,
Rutgers Center for Risk and Responsibility
feinman@law.rutgers.edu
856-225-6367

Amy Bach
Executive Director
United Policyholders
amy.bach@uphelp.org
415-393-9990 ext. 101

Rutgers, The State University of New Jersey
217 N. 5th Street
Camden, NJ 08102

381 Bush St., 8th Floor
San Francisco, CA 94104