Coinsurance in the Residual Market

Why Coinsurance Exists in the marketplace.

- The purpose of coinsurance is to seek equity in rating.
- Ensures that policyholders insure their property to an appropriate value and that the insurer receives a fair premium for the risk.
- Allow companies to remain competitive in the for-profit market. When the majority of policyholders are purchasing full limits of insurance, more premium dollars are exchanged, and insurers can lower rates for those policyholders to an equitable level.
- A coinsurance clause for standard property insurance policies will dictate the limit that the policyholder needs to obtain to avoid becoming a co-insurer with their carrier in the event of a loss.
- Encourages accurate assessment and underwriting.

What role does the industry want or need FAIR Plans to play?

- As a market of last resort, FAIR Plans were established to provide basic insurance to those who would not qualify elsewhere.
- FAIR Plans were not established to compete with the standard market.
- Serve as temporary sanctuary for a small segment of the insured market, with an additional mandate to rehabilitate and return that segment to the standard market, if possible.
- FAIR Plans were not created to make profit, nor are they mandated to make whole the market segment they serve.

Hinderances to FAIR Plans that require thinking outside the normal market context.

- Coverage limits are restrictively capped, and perils insured against are typically limited to named perils.
- Due to the above, FAIR Plans often cannot establish, assert, or maintain the requirement that applicants insure their property to a certain percentage of its value.
- Losses are typically settled at actual cash value.
- Rate structures are typically inadequate due to smaller pools and coverage limitations as described above.
- Given their smaller size, FAIR Plans should strive to adequately balance the level of risks insured with appropriate rating mechanisms in place to insure that earned premiums are adequate to serve their small segment pools.
- Due to escalating construction costs, determining the valuation of property at the time of loss to reconstructive replacement cost, which is necessary to apply coinsurance in the settlement of losses, is a highly disputable endeavor.
- There are many examples of case law where the appraisal clause has been invoked due to disputes that arise while establishing a true valuation of damages.
- Valuations conducted at the time of a loss slow the claim resolution process, while also increasing the labor resources needed, and overall loss expense.
- Most insureds are unlikely to willingly concede to the application of coinsurance to their insurance settlement without pursuing all avenues available to them to mitigate their self-insured exposures.
- Disputes arising from the valuation process are likely to lead to a significantly increased percentage of coinsurance claimants invoking the policy Appraisal Clause and/or seeking counsel.
- Appraisal and litigation take time, require additional resources, and increase overall costs.

Do Courts Enforce Coinsurance Clauses?

- Courts can invalidate coinsurance clauses for many reasons.

- Some states have passed statutes voiding coinsurance clauses in property insurance policies which insure risks associated with fire or storm damage on real property.
- There are instances where courts have ruled that in case of a total loss, the insurer is liable for the amount named in the policy.
- Multiple cases exist where coinsurance clauses were voided due to the insurer's failure to comply with statutory requirement that it print or stamp on the face of the policy, with the consent of the insured, or other similar statutory provisions speaking to the replacement cost provision.
- Due to challenges previously stated, many FAIR Plans often waive the application of coinsurance percentages during settlement of losses, leaving them to give up rate prior to the loss, while also conceding any savings that may have been gained during settlement.

Conclusion

Eliminating coinsurance can benefit FAIR Plans, policyholders, and producers by:

- Clearly defining the limit of coverage that can be paid for a loss caused by a covered peril, as well as the cost that is to be incurred by the customer.
- Reducing the potential for dispute and litigation, which saves both time and money for both the insured and industry.
- Provides cost and time savings by reducing the need for detailed valuations when coverage is being obtained as well as afterwards, when losses have occurred.
- Ensuring proper rate for risk.
- Eliminates instances where establishing and/or maintaining insurance to value is not possible or feasible.
- Aligns with the FAIR Plan mandate to provide basic coverage, limited in nature, without competing with the standard market.
- Aligns with the FAIR Plan mandate to be good stewards of both the industry and insured funds appropriated to manage them.
- Follows proven underwriting principles toward achieving and maintaining a true balance of shared risk between the market and consumers.
- The strategy outlined aligns with the FAIR Plan mandate to rehabilitate and, as promptly as possible, return high risk business to the standard/for profit marketplace.

Explaining limited coinsurance options to producers & consumers.

Internally, utilize a pop-up box when a producer starts a new business commercial application:

This FAIR Plan may not allow coinsurance on new underinsured commercial applications. As a small reinsurer of last resort, the commercial policy limits are capped, and perils insured against are limited. Additionally, all losses are settled at actual cash value. As such, we do not wish to enter into any agreement that may require either party to determine, maintain and/or insure property to a certain percentage of its reconstructive value. As the non-standard market provider of last resort, we do not compete with the standard market, but do strive to adequately balance the level of risks insured with rating that is adequate for the diminished pool size that we serve.

Any applications submitted with a request for coinsurance must contain a minimum of:

- *Two standard market declinations or a current non-renewal notice.*
- *An additional declination from at least one E & S carrier.*
- *A current full replacement cost valuation with photos of all sides of each structure.*
- *Additional primary or supplemental underwriting information as requested by the facility.*

Our Mission is to make basic property insurance available to qualified applicants who have not been able to obtain property insurance through the standard insurance market. It is understood that applicants, as well as policyholders, will seek insurance in the standard insurance marketplace before applying to the FAIR Plan.

Externally, add a message to the Plan website:

> *As a residual market mechanism, the FAIR Plan strives to provide basic property insurance to qualified applicants who are unable to obtain insurance through the standard market. The Plan balances the level of risks we insure with rating that is adequate for the diminished pool size that we serve. As such, we do not wish to enter into any agreement that may require either party to determine, maintain and/or insure property to a certain percentage of its reconstructive value. All claims are settled on an actual cash value basis. Any application for commercial property coverage must include two standard market and/or excess surplus carrier declinations in addition to other Plan requirements.*