# INSURANCE INDUSTRY/
# RISK OF INVESTMENTS/
# INSURANCE RATES/
# FRAUD/
# TERRORISM


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This text is designed to provide accurate information in regard to the subject matter covered. The readers of this book understand that the author is not engaged in rendering legal or financial services. You should seek competent tax or legal advice with respect to any and all matters pertaining to the subject covered in this book.

This book is updated periodically to reflect changes in laws and regulations. You can call the author at 410-989-0559 to verify that you have the most recent update.

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The insurance industry has changed quite a bit in the last ten years. During the 90’s and into 2000, premiums were fairly stable. There were many carriers. Then, a lot of factors came together and changed the industry forever.

In 2000 things began to happen. It included claims resulting from catastrophic weather, mold damage payouts, general investment losses, and the terrorist attacks of September 11$^{th}$. The result was property and casualty under writing losses of $53 billion.

For homeowner’s insurance, which is in the property-casualty category, losses and expenses exceeded premiums by $8.9 billion in 2001. The industry incurred $1.18 in losses and expenses for every dollar earned that year. It was one of the worse years on record.

For the homeowner, who pays an average of $500 a year for coverage, those loses will mean an increase in premiums of eight percent to nine percent, stricter writing requirements, lower insurance payouts and few companies from which to choose, especially for first time buyers. Older homes might be harder to insure because they pose bigger risks to insurers.

Some insurers have stopped writing insurance in some areas in the United States. Some insurers believe that the country has too many anti-insurance laws. Many insurance companies are requesting double-digit rate increases to cope with the unexpected losses. Some insurers have suspended writing new homeowner's policies in several states. They don't want to take on new business at low rates, and if they raise the rates too high then they fear losing their existing customers. Insurers believe that new customers are more likely to have claims; therefore some insurers have slowed expanding in some insurance lines.

## What is Homeowner's Insurance?

Homeowner's insurance protects the policy owner from financial loss if his house is damaged by "perils" such as fire, water, hail, lightning, theft or lawsuits resulting from an injury on the property. Coverage comes in two basic forms, insurance on the structure only and coverage for the house and the valuables inside.

The basic policy, usually the only one required by lenders, covers only the house. It is often called fire insurance or hazard insurance. The policy, is written to cover only replacement cost of the house at the time it is damaged or destroyed. It does not include valuables inside the house. Basically, the fire policy protects the lender from losing its investment in the house.

Most homeowners pay for additional coverage to replace valuables such as jewelry, art, satellite dishes, computers, furniture and expensive collections. In the past, replacement insurance has been very affordable.

Most of the time, insurers figure the replacement cost of the valuables as a percentage of the home's value, typically 70 to 75 percent. So an insurer would pay $70,000 to $75,000 to replace possessions in a $100,000 home. Most standard policies (above the basic-structure policy) also include $100,000 of liability coverage.

Agents should warn their clients to watch for exclusions, which are more common in today's market. Two common exclusions are sewer and water backup in basements, toilets and other basement plumbing. For an extra $25 or so, it's covered.

Hazard policies and the more extensive policies are designated "all peril". The policy will spell out what they cover-hail, lightning, wind, tree damage and fire damage and what they don't-normal wear and tear, earthquakes, nuclear disasters, terrorism, vermin, and acts of war.

Land is also excluded from most policies. Floods also are not covered by a standard homeowner's policy. The buyer of a house in a flood-prone area has to pay about $400 for coverage through the Federal Emergency Management Agency. Regional hazards such as tornadoes and earthquakes usually require supplemental insurance that is sold by insurance companies. Premiums can vary sharply by region, right down to the zip code. Many factors go into the rating, but one of the most important is an area's risk of fire damage. Underwriters use a 1-10 scale based on the type, size and number of local fire departments.

An important factor today is the deductible – premium relationship. The more the deductible (what the policy owner pays before the insurer pays), the lower the monthly or annual premium. Many policy owners bump their policies from a $250 deductible to a $500 deductible to save 15 percent on their premiums.

Agents should remind clients that insurance is not a home warranty and should be used only when necessary to keep the insurance premiums down, policy owners should consider fixing it themselves if they can.

## Credit Scoring

One of the hottest issues in the insurance market today is “credit scoring,” which means that an insurance company can or refuses to renew someone based on a poor credit history.

Some insurers claim that the credit score is a useful, accurate and fair measure of someone’s risk factor. Many legislators and consumer groups believe credit scoring unfairly discriminates against poor and lower income groups. Credit scoring is used in many states. In Maryland for example, credit scoring can be used as an underwriting tool for auto insurance but not for homeowner’s insurance. Insurers believe that credit scoring is a very good predictor of future loss. Consumer groups are concerned that it is a surrogate for discriminating against race and the poor.

Insurance companies have sampled people and ranked them based on credit scores. When they compare claims of people with the same background, those with the worst credit filed the most claims.

Opponents of credit scoring state that the insurers have not shown evidence that establishes a relationship between scores and insurance risk. They also believe credit scoring would improve long-term penalties on those going through temporary hard times such as sickness, marital separation and divorce.

## FICO SCORE

Most lenders and every credit agency calculate borrower's credit scores using the FICO software. FICO stands for Fair, Isaac and Company, a San Rafael California company. It was founded by Bill Fair and Earl Isaac in 1956. This complex rating system is used by lenders to predict the likelihood of the borrower to successfully repay the loan. It takes into consideration account inquires, payment history, credit balances, and other important factors in determining a person's 3-digit credit score. Once the score has been determined, the borrower is then placed in one of 3 main categories. A person with a credit score of 680 and above is considered a category I. Borrowers in this category will have no problem getting a good interest rate on a home loan, car loan, or credit card. Credit scores between 680 and 560 are considered to be a category II, and borrowers in this group will likely have to pay a much higher interest rate on a loan. Scores below 560 are category III. People in category III will most likely have to pay interest rates between 22 and 23% and may even have to pay more for insurance. A very low credit score can even prevent a person from getting a job with many companies.

Many insurers, healthcare providers, banks, credit card companies, telecommunication organizations, and government agencies rely on the FICO software. Consumers can get their FICO score and other credit information through www.myfico.com.

Fair Isaac has offices located in 9 countries. It services over 80% of the top personal lines insurers in the United States, and most of the major credit card companies in America. The FICO score is the most used credit bureau score in the world. More than 40 billion have been sold since 1985.

# Checking the Credit Report

At least once a year, consumers should check their credit report with the three major reporting agencies, Equifax, Experian, and TransUnion. People can get a copy of their credit report by contacting the credit reporting agencies directly at:

* Equifax 1-800-685-1111 www.equifax.com

* Experian 1-888-397-3742 www.experian.com

* TransUnion 1-800-888-4213 www.Transunion.com

If a person finds erroneous information on his credit report, he should notify that agency immediately. Credit reporting agencies must investigate the matter and respond within 30 days after receiving notification.

## Clue Report

When considering a persons application for insurance, insurers will review claims filed against the home the person wants to insure. If the owners filed a lot of claims in the past five years, the person may be rejected, particularly if the claims were for water damage. Insurers view those as a harbinger of mold claims.

Insurance agents should tell their customers to get a copy of the home's Comprehensive Loss Underwriting Exchange (CLUE) report, which shows the history of claims against the property. Only the owners of a home can get its CLUE report. The buyer of the home should ask the seller to get a copy of the CLUE report.

When reviewing a home's CLUE report insurers try to determine whether the problem that caused a claim has been repaired. They also look for patterns that suggest a risk of future claims. A history of break-ins, for example, may indicate the home is in a high-crime area. Some insurers will charge higher premiums for that home, or refuse to cover it.

If the person can't get insurance, the agent should consider advising the person about looking into the state's Fair Access to Insurance Requirement Plan. Many states offer FAIR plans to homeowners who can't buy insurance from private insurers. The plans cost more than private insurance, and coverage may be limited.

A list of state FAIR plans, along with their phone numbers can be found at the Insurance Information Institute's internet site, www.iii.org.

## Mold Damage

In Texas, Louisiana, and California, mold-claims soared to 1,300 percent in 2001. In these three states, mold payouts cost insurers $ 1.3 billion in 2001, and many claims were still pending.

Major insurers have cut out coverage for mold damage in many states. Some insurers do not cover mold fungus, wet rot, dry rot or bacteria unless these problems arise from events covered under the policy. Some insurers have put $ 5,000 to $ 10,000 limits on how much they'll pay to repair damage.

Need for Federal Aide

Many professionals in the insurance industry believe that the federal government should provide financial back-up to the private insurance market. The purpose is to assure that the nation's economy does not falter due to a lack of insurance coverage for terrorism.

The federal assistance should be for a short period of time to help stabilize the commercial marketplace. This will allow the private insurers to be able to assess risk and to determine the proper price for underwriting terrorist coverage.

Insurance experts believe the insurance industry is will capitalized and financially able to withstand the pressures created by the September 11th terrorist attacks.

The United States insurance industry collects over $ 1 trillion in annual premiums and has over $ 3 trillion in assets. It is estimated that the total insurance loss from September 11, 2001 will ultimately be about $ 41 billion. This amount represents just 3 to 4 percent of the premiums written in 2000.

In the past, America's insurance companies have time and again shown their ability to respond to huge disasters and successfully recovered. Adjusted for inflation, Hurricane Andrew in 1992 caused $ 19.7 billion in insured losses, and California's Northridge Earthquake in 1994 cost $ 16.3 billion in insured losses.

**Hurricane Andrew**

Until September 11, 2001, Hurricane Andrew was the world's worst disaster of record. The devastation included the following:

1. 23 deaths directly attributed to the storm
2. 28,066 homes destroyed
3. 107,380 homes damaged
4. 82,000 businesses destroyed
5. 7,800 businesses closed as of September 1992
6. 86,000 people out of work as of September 1992

By comparison, nearly 3,000 people died as a result of Sept. 11 attack and insured losses from the event are currently estimated at $ 20 billion in insured losses. Still, Andrew tops Sept. 11 for the sheer number of insurance claims it produced.

Insurers handled more than 700,000 claims compared to just 31,000 claims as a result of Sept. 11. After hurricane Andrew, 10 insurers became insolvent and the remaining insurers were reluctant to stay.

As more insurers announced cutbacks, the state of Florida imposed a moratorium forbidding insurance companies from abandoning policyholders. Florida legislators also established a state-run insurance pool that acts as the insurer of last resort for homeowners. Nearly one million property owners became customers of the pool after Andrew.

The state also sponsored a fund to bail out insurers with heavy hurricane losses.

While the reforms stabilized the insurance market, Florida homeowners continue to be battered by premium increases in the years since Andrew. And the four hurricanes that struck the state in 2004 exposed more flaws in the state's insurance system. In 2004, many insurance companies have filed for double-digit rate increases and some have dropped policyholders.

## Northridge Earthquake

On January 17, 1994 a quake struck Northridge, California with a magnitude of 6.7 on the Richter Scale. In a matter of 40 seconds 60 people died, 12,000 were injured, 200,000 homes and apartments were destroyed or damaged, another 114,000 buildings were damaged, destroyed or left uninhabitable, thousands of vehicles were destroyed or damaged, and several major roads and bridges were left defective. Claims filed reached

600,000 according to the Institute for Business and Home Safety and the National Geographic.

The initial insurance estimate of damage ranged from $ 1 to 1.5 billion. By October 1994, the Property Claims Services (PCS), a division of the American Insurance Service Group, estimated the insurance losses at more than $ billion. One year later the estimate was at $ 12.5 billion and today, the total insured losses from Northridge earthquake have reached $ 16.3 billion.

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From 1968 to 1994 California's insurance industry collected a total of 3.9 billion in earthquake premiums. The payout for the Northridge earthquake alone is almost four times more than what was collected for the previous 25 years.

The Senate Insurance Committee's Northridge earthquake website has received fewer than 200 complaints. This is a .032 percent complaint ratio. Out of the 600,000 claims filed, it is estimated that there are less than 1 percent outstanding claims industry-wide for the Northridge earthquake.

Insurance is the sale of a promise to pay claims when losses occur. The industry is backed by an impressive array of human and technical resources, including the NAIC and fifty-one state insurance departments that collectively employ more than 10,500 people and spend $950 million annually on insurance supervision. In addition, the state insurance guaranty funds have the capacity to provide up to $10 billion to compensate American consumers in the event of insurer insolvencies.

## Power of Private Market Competition

The international commercial property/casualty insurance market is very powerful, dynamic, and competitive. As a free market, it responds to new information quickly, and sometimes with great volatility. Like the stock exchanges, insurance market participants often react in unison to reach the same conclusion at the same time with regard to what products are viable and profitable, meaning that the price and availability of specific products will rise and fall in conjuncti0on with the industry's collective willingness to sell them. Substantially negative information, such as the September 11th terrorist attacks, can disrupt the entire market until new information becomes available that makes insuring terrorist risks acceptable.

Given sufficient time to adjust, the commercial insurance market has found ways in the past to assess and insure extremely large and difficult risks that were initially considered uninsurable. During the 1980's and 1990's, the insurance industry weathered enormous financial losses from asbestos, medical malpractice, and environmental pollution claims against corporate policyholders that were not foreseen by insurers.

In those instances, insurers said they had not reasonably expected to be held responsible for such colossal claims, and therefore had not collected sufficient premiums or established sufficient loss reserves to cover those claims.

The insurance market responded to huge environmental exposures with policy cancellations, coverage limitations, exclusions, and increased prices, as is being threatened now with regard to terrorism risk coverage. In the longer term, coverage for these risks became available through a combination of aggressive risk management self-insurance, captive insurance pools, other alternatives risk-sharing mechanisms, and renewed interest by commercial insurers as they gained confidence in their abilities to adapt their policies and pricing to a level where they could underwrite the business profitably.

Ultimately, the creativity and competitive discipline of the market overcame its initial period of contraction and volatility to provide viable insurance solutions for enormous risks that were previously uninsurable.

The business of insurance is about measuring risks and selling promises to cover them at a reasonable profit. Insurance experts who perform these tasks are exceptionally talented. Over time, they have demonstrated a remarkable ability to adapt to unforeseen circumstances, while making available the insurance products that are essential to the growth and productivity of American business.

As expected in a free competitive market, individual companies may stumble, falter, and even fail when substantial adversity strikes, but the United States industry as a whole has a long and proud record of finding ways to overcome new obstacles while advancing its business goals and serving the interest of the insurance- buying public.

Federal Government Action can help Private Market to Recover.

State regulators know from their own experience that government action can help the insurance market recover when it becomes overwhelmed by changing risk factors or catastrophic losses. When the psychology of the market results in industry reactions that harm the public, government has unique powers to alter the insurance market place for the benefit of customers. Successful government assistance involves tailoring actions to fix specific problems and keeping the program as narrow as possible.

Hurricane Andrew provides a useful example of limited government intervention that works. Following the tremendous losses from this hurricane in 1992, commercial reinsurers restricted their coverages for windstorms and raised prices. This caused a corresponding reaction from primary insurers, who moved to raise prices, cancel coverage for coastal properties, and increase deductible amounts for consumers having significant hurricane exposure. Within a couple of years, normalcy returned to the reinsurance market, and then to the primary market. The Florida Insurance Department assisted with the recovery of the industry by introducing a moratorium on policy cancellation. The Florida legislature later adopted a Hurricane Catastrophe Insurance Pool that provides a state-based backstop for catastrophic windstorms in Florida. These collective actions have resulted in a robust and competitive market for homeowners insurance in the state of Florida.

## State Actions on Terrorism Insurance

What is the impact of state laws on terrorism insurance? Primarily, it falls into three areas - workers' compensation requirements, policy form regulations, and rate regulations. These areas have a limited and indirect effect upon the price and availability of terrorism coverage in commercial property/casualty policies for large business projects that significantly affect the American economy.

States do not initiate market requirements in these areas, but they do react to market forces that threaten to deny consumers fair insurance coverage. In normal practice, for example, an insurer would ask a state regulator for permission to exclude a specific type of coverage, such as terrorism, when the insurer issues a policy to customers. The regulator has general authority under state law to deny the insurer's request for the coverage exclusion. However, the insurer makes the ultimate decision as to whether it will offer an insurance policy at all, and can refuse to offer insurance policies in the state if terrorism coverage is not excluded. If enough insurers threaten to withdraw from a state's insurance market, state regulators will be under tremendous pressure to grant an exclusion for terrorism in order to keep insurers in the market providing other types of insurance.

**Workers' Compensation Requirements**

State workers' compensation laws were developed early in the 20th century. In the late 1800's and early 1900's the number of occupational injuries and illnesses occurring in the American workplace was hindering the Industrial Revolution. Businesses were asking how they could assure that working men and women who are injured on the job get the care they needed, while protecting industry and commerce from the financially crippling and demoralizing prospect of employees suing their bosses for every work related injury. The question was answered with the state workers' compensation system. This system was designed to cover employees' medical expenses and lost wages for work-related injuries and disease, regardless of who was at fault.

In return, employees are limited to the benefits provided by the workers' compensation system as their exclusive remedy. State workers' compensation laws require a set of benefits that are guaranteed by employers to their employees who are injured on the job. Insurers play a major role in the delivery of the benefits promised by employers. Typically, insurers assume by contract the obligation to provide the employer's share of medical benefits, rehabilitation benefits, and survivor's benefits in exchange for premiums the employer pays to the insurer. Since the state law obligates the employer and therefore the insurer that has assumed the employer's obligations to provide the benefits specified in a state's Workers Compensation Act, the insurer can not introduce either an exclusion for war or exclusion for terrorist acts.

As a no-fault safety net for workers' injuries on the job, state workers' compensation laws do not permit terrorist coverage exclusion as a matter of public policy.

## State Policy Form Regulations

Many states have statutory authority over insurance contract language through policy form regulations. These laws typically prohibit contract language that is misleading, illusory, inconsistent, ambiguous, deceptive, or contrary to public policy. Since no currently enacted state laws specifically prohibits an insurer's request to exclude coverage for terrorist acts, states would have to rely upon the general provisions above if they seek to deny an insurer's request to exclude terrorism coverage. Under state law, an adverse regulatory decision can be challenged by an insurer through the state insurance department's administrative process, with the right of appeal to state courts.

State insurance regulators are also responsible for monitoring the solvency of insurers. An action to deny an exclusion of terrorist activities under general policy form provision could cause financial difficulties for insurance companies. However, it is the insurer's choice whether to provide coverage for a specific business event or peril. Primary insurers may be hesitant to exclude coverage for terrorist acts because they know their business and individual customers will want assurances that the coverage is provided. Reinsurers do not directly deal with businesses and families, and therefore do not face the same pressures to provide terrorism coverage.

## State Rate Regulations

State rate regulations are primarily focused on protecting small businesses and individual policyholders. For commercial lines insurance products, only 13 states (in 2001) still require that the insurance department exercise prior approval requirement for most rate changes. The remaining 38 jurisdictions have some form of competitive rating mechanism that allows insurers to file and use rates, or use them even before they are filed with insurance regulators. In recent years insurers have been successful in convincing state legislatures to create rate regulations exemptions for large commercial policyholders.

The insurance industry remains strong and that it retains tremendous strength to recover from the September 11th attacks and adjust its business practices to new conditions in the marketplace.

## The Terrorism Risk Insurance Act of 2002

**Congress approved a terrorism insurance bill designed to provide the insurance industry with federal backup protection in the event of another catastrophic terrorist attack. The Terrorism Risk Insurance Act of 2002 establishes a new program which temporarily shares the risk of loss from future terrorist attacks between the federal government and private insurers. The Act was introduced to curtail the widespread financial market uncertainties stemming from the aftermath of the September 11 terrorist attacks.**

### Scope of program

The Act establishes the Terrorism Insurance Program within Treasury department. This new program applies only to commercial property and casualty insurers and will only cover terrorism-related losses arising under primary and excess commercial property and casualty policies (including workers' compensation policies). The Treasury Secretary has the authority, however, to expand the program to cover captive insurers and self-insurance arrangements. The Act specifically excludes coverage for health and life insurance, reinsurance, and certain other forms of insurance. The Act calls for the Treasury Department to conduct an expedited study of expanding the program's coverage to include group life insurance and other forms of personal lines insurance.

**Program Structure**

Under the new program, the federal government will pay 90% of all terrorism losses in excess of prescribed insurer-paid deductibles. In additional to paying their respective deductibles, insurers will be responsible for paying the remaining 10% of all losses. Insurer's deductibles will be calculated as a percentage of an insurer's direct earned premiums, ranging from 7 % for the first year of the program and increasing to 15 % by 2005. Losses covered by the Act will be capped at $ 100 billion per year. Insurers may reinsure their deductibles and 10% quota share. The provision will be invoked only if the Treasury Secretary, Attorney General and Secretary of State have determined that an act of terrorism has been committed by a foreign terrorist. Domestic terrorist acts are not covered under the Act. Personal insurance ( home, auto, and the like) crop and medical malpractice insurance are also not included in the Act.

With respect to coverage offered in compliance with the Act, insurers will receive reimbursement from the Federal government for a portion of paid losses. This apportionment is structured as follows:

Insurer deductibles and retentions apply on a calendar-year basis, with the period from November 26, 2002 (the effective date of the Act), to December 31, 2002, referred to as a "transition period." During that transition period, insurers will be liable for paying the initial amount of covered losses up to 1 percent of the insurer's direct earned premiums for the preceding calendar year. For "Year 1" of the program (2003), this percentage "deductible" increases to 7 percent of the previous calendar year's direct earned premium.

For "Year 2" (2004), the "deductible" will be 10 percent. If the program continues (upon the determination of the Treasury Secretary) into "Year 3" (2005), insurers will be liable for an amount equal to 15 percent of their previous year's direct earned premium. This graduated deductible feature assumes-and is designed to encourage-ongoing insurer success in underwriting, pricing, and reserving for terrorism losses.

The Act provides for the Federal government to recover a portion of any payments it makes under the program. Two phases of recoupment are set up by the Act. A mandatory recoupment of Federal payments will be made, based on the difference between the total paid out in certified terrorism losses by insurers-that is, the percentage-of-earned-premium deductibles plus the 10 percent insurer participation and a specified dollar amount, referred to as the "insurance marketplace aggregate retention amount." When the total of insurer deductibles and percentage participation does not equal this aggregate retention, insurers will have to pay the difference back to the Federal government. The Act specifies the following insurance marketplace aggregate retentions:

| | |
|---|---|
| Transition Period + Year 1 (2003) | $ 10 billion |

| | |
|---|---|
| Year 2 (2004) | $ 12.5 billion |
| Year 3 (2005) | $ 15 billion |

**What the Act does**

The Act addresses only a defined category of terrorism losses. To come within the new Federal program, an “act of terrorism” must be certified as such by the Secretary of the Treasury and must have the following characteristics:

1. It must be a violent act or an act that is dangerous to human life, property, or infrastructure.

2. It must have resulted in damage within the United States, or to a an air carrier as defined in the United States code, or to a U.S. flag vessel or other vessel based principally in the United States and insured under U.S. regulation, or on the premises of any U.S. mission (e.g., an embassy or consulate).

3. It must have been committed by someone acting on behalf of A “foreign person or foreign interest, as part of an effort to Coerce the civilian population of the United States or a to influence the policy or affect the conduct of the U.S.

4. It must produce property and casualty insurance losses in excess of $ 5 million.

Acts that might otherwise meet these criteria but that occur in the course of a declared war cannot be certified as acts of terrorism under the Act, except with respect to workers compensation claims.

**How coverage is to be Provide**

The Act renders void all terrorism exclusions currently in force on commercial property and casualty policies, to the extent that such exclusions eliminate coverage for certified acts of terrorism as covered by the Federal program.

Likewise, state regulatory approval of such terrorism exclusions is voided by the Act to the extent to which the approved exclusions eliminate coverage as mandated under the Act.

To be eligible for Federal reimbursement of certified terrorism losses, insurers must provide notice to their insureds of the premium for coverage being provided under the program, and the extent to which losses paid under the program are reimbursed by the Federal government. This notice must be given to insureds within 90 days of the enactment of the program (November 26, 2002) for policies already in effect in that date.

Although terrorism exclusions applicable to certified terrorism losses under the program were voided as of November 26, they can be reinstated if the insured decides not to purchase the Federal backed coverage. Either of two conditions must be met before an existing terrorism exclusion can be reinstated on an insured policy:

1. A written statement from the insured affirmatively Authorizing the reinstatement; or

2. Failure of the insured to pay the terrorism premium within 3 days after the insurer provide notice as required by the Act.

**Terrorism Endorsements**

For use with policies currently subject to a terrorism exclusion, the two major policy-drafting and statistical bureaus-ISO and the AAIS-have filed endorsements that define the newly mandated coverage for certified terrorism losses, or alternatively (for insureds that have declined the coverage) **REINSTATE AN EXCLUSION OF CERTIFIED TERRORISM LOSSES, OR ALL LOSSES RESULTING FROM TERRORISM. THESE FILINGS HAVE BEEN MADE UNDER A PROVISION OF THE ACT THAT EXEMPTS THEM FROM INDIVIDUAL STATES' PRIOR APPROVAL LAWS. THIS MEANS THAT THE ENDORSEMENTS BECOME AVAILABLE FOR USE IMMEDIATELY UPON FILING.**

For property coverages subject to the Federal program, including commercial property, boiler and machinery, commercial crime, commercial inland marine, and farm coverages, the ISO endorsements are classified as interline, since they are designed for use in many cases with more than one of those coverage lines.

1. endorsements that modify existing terrorism exclusions to bring them into compliance with the Act.

2. Endorsements that remove existing terrorism exclusions altogether.

3. Endorsements that merely impose the statutory cap on "certified act of terrorism" losses. Issuer's obligation is limited to a **$ 100 billion cap on total payments.**

5. Endorsements that exclude "certified act of terrorism" altogether.

6. Endorsements that exclude "certified act of terrorism" Losses with an exception for certain fire losses.

The Treasury Department's new rules require insurers to make clear and conspicuous disclosures to policyholders within specified time as a condition for federal payments of terrorism insurance

## September 11, 2001 losses due to the terrorist attacks

The Insurance information Institute estimates that insurers will have to pay about $ 40.2 billion in claims arising from the September 11, 2001 attacks in New York, Virginia, and Pennsylvania. Experts believe that the Sept. 11 assault was the biggest insured catastrophe in American history. Fortunately, the vast majority of homes and automobiles claims have been paid. On the other hand it is believed the commercial claims will take years before they are finally settled.

The Insurance Information Institute estimate of $ 40.2 billion in insured losses is listed below.

| | |
|---|---|
| 1. Claims for business interruption | $ 11 billion |
| 2. Liability claims | $ 10 billion |
| 3. Property claims for property and autos (Not including the World Trade Centers) | $ 6 billion |
| 4. Property claims due for destruction of WTC building | $ 3.5 billion |
| 5. Aviation liability claims | $ 3.5 billion |
| 6. Life insurance claims | $ 2.7 billion |
| 7. Workers Compensation claims | $ 2.0 billion |
| 8. Event cancellation claims | $ 1.0 billion |
| 9. Hull claims for the loss of the four planes | $ 500 million |

## WORLD TRADE CENTER FRAUD

Since the tragic events of September 11, the Frauds Bureau has been fast-tracking World Trade Center claims to ensure that they receive prompt attention. The Insurance Department of New York has actively coordinated with other law enforcement agencies to make certain that a strong line of communication exists among all agencies involved in this issue. That link has proven to be invaluable because in some instances, there is a crossover between charity fraud and insurance fraud.

Considering the scope of the disaster, the Frauds Bureau opened relatively few fraud investigations during 2002: 21 involved life insurance, 16 workers' compensation, 6 auto fraud and 23 were miscellaneous in nature for a total of 66. The following are summaries of several of these cases:

- Three individuals were arrested in March and charged with falsely filing for death certificates claiming that members of their families died in the attacks. It was further alleged that, based on these certificates, they filed fraudulent death benefit claims and sought and received other disaster relief funds. These arrests were the result of an investigation by the Frauds Bureaus.

* In March, a woman was arrested in Florida and returned to New York to face charges that she submitted a fraudulent claim to Metlife for $ 500,000 in death benefits on behalf of the

beneficiary, her 14-year old daughter. The defendant claimed that her ex-husband, whose life was insured by the policy, resided in New York City and died while at his job as an engineering maintenance worker at the World Trade Center on Sept. 11. Medlife found the claim suspect and reported their suspicions to the Fraud Bureau. The investigation uncovered evidence that the insured was alive and living in Florida. He was unaware of his ex-wife’s activities.

Prison

* A Brooklyn man was charged in April with falsely claiming his BMW was destroyed in the garage of the World Trade Center on September 11. GEICO reimbursed him a total of $38,361 for the loss. However, evidence gathered during the investigation by the Frauds Bureaus, together with NYPD, the Brooklyn District Attorney's Office, the National Crime Bureau and GEICO"s Special Investigation Unit, revealed that the suspect subsequently attempted to insure the some BMW with the same insurer. The car was recovered at the time of the arrest.
* A Staten Island resident was arrested in June as part of a sweep by the Manhattan District Attorney's Office that charged 15 people with stealing more than $ 52,000 from charities established to assist victims of the World Trade Center attacks. In some cases, defendants allegedly filed insurance claims in an attempt to fraudulently obtain benefits. The arrested Staten Island man applied for disaster relief through the Federal Emergency Management Agency, alleging he had lost his job at HIP as a result of the destruction of HIP's offices in the World Trade Center on Sept. 11. However, an examination of HIP's records showed that he had been terminated on April 12, 2001 after he failed to appear for work.

  His arrest came as a result of an investigation by the Frauds Bureaus and the FEMA.

- Ajay Chawla was convicted in August in Common Pleas Court in Butler county, Ohio of insurance fraud, attempted aggravated theft by deception, telecommunications fraud and falsification. The case is believed to be Ohio's only case of insurance fraud related to September 11. Chawla filed a claim against a $ 100,000 life insurance policy, maintaining that his father had been inside the World Trade Center when it collapsed.  However, evidence revealed that Chawla knew his father was alive and well in his native India.  He faces up to eight years in prison at sentencing.  The coordinated efforts of the frauds Bureaus and local police departments in New York, Ohio, and Illinois led to his arrest.

## Facts about terrorist insurance in America

Property-and-casualty insurance coverage for projects and the availability of terrorism coverage has become very expensive.

Contractors are having a difficult time getting the proper insurance. In some cases, insurance companies are cutting off smaller policyholders.

While many point to 9/11 as the sole source of the problem, experts believe that the property-and-casualty market was hardening prior to the terrorists' attacks; many contractors already had experienced premium increases.

Contractors, especially those from the West Coast, are having difficulties buying general liability coverage and complete operations coverage. Renewal rates increases of 50% to 60% are common."

The market began to change in early 2001 due to three factors: excess losses in the insurance industry; "incredibly competitive rates at the time that were so low that most companies could not make money"; and the stock market slump, which reduced insurance company investment income.

Even before 9/11, the insurance industry was under reserve, and there has also been a significant increase in the cost of claims. In addition, there has been more demand for insurance and less capacity available from reinsurers."

The Insurance Services Office reports that the property-and-casualty industry's net income dropped 76% for the first six months of 2001 from the same period in 2000, leading to the insufficient capacity. Post-9/11 claims on property-and-casualty insurers and reinsurance companies could reach as high as $60 billion, the highest for any incident in history. (Hurricane Andrew, the largest prior single event insurance loss in U.S. history, was $16 billion.)

Insurance companies are passing along the price increases from their reinsurance companies. In fact, reinsurance may not even be available for some small or unstable insurance companies, possibly forcing them into bankruptcy. Even many of the strong insurance companies may not be able to negotiate next year's policies with clients until they negotiate with their reinsurers. And when they do negotiate, clients can expect costs to rise 30% to 70%.

Since 9/11, the market has contracted even more, and the reinsurance market, which provides support to insurance market, is also contracting,  In sum, there is a shortage of capacity, and the capacity that does exist will cost more.

Expect P-and-C rates to continue to increase for at least 18 months, possibly for three years.

**Terrorism coverage**

Since 9/11, many major insurance and reinsurance firms have been refusing to provide coverage for future losses due to terrorism. In fact, many insurers have filed terrorism exclusions with the insurance departments in the states where they do business.

The National Association of Independent Insurers reports that at least 35 state insurance departments have issued statements agreeing to adopt exclusion language.

Even in states that have allowed this exclusion, however, insurance companies must still cover terrorism-related workers' compensation claims, for which there are no exclusions.

CAN will be attaching a terrorism exclusion to all its  policies where it is approved by the state's department of insurance.

This lack of available coverage has caused many lenders to walk away from some large projects because of inadequate insurance coverage. GMAC Commercial Holding Corp., for example, will not do any significant construction loans without a terrorism policy that would cover the term of the loan, said David E. Creamer, chairman and CEO.

Banks are becoming concerned about carriers excluding terrorism coverage in their construction contracts."

CNA is seeing bank loan availability drying up for contractors that don't have terrorism insurance on certain jobs. So, while most financing today requires terrorism coverage on major projects, it is being excluded from most insurance contracts.

As a result, contractors will have to search for independent terrorism coverage, AIG's Terrorism insurance, though expensive and somewhat limited, is more easily available. Three companies today are providing independent terrorism coverage: AIG and Berkshire Hathaway in the United States and Lloyd's in London.

AIG rates range from 2.5 cents to 25 cents per $100 of coverage. If a normal construction premium is $100,  it probably would be $125 with terrorism coverage.

In the meantime, what should you do?

Construction insurance has always been a specialty area, but during a soft market, almost anyone could broker it. Now, with the changing market and the critical need for specialists, insureds need to locate brokers who have qualified construction specialists on staff.

Many experts expect to see more companies moving toward self-insurance or make a push for creating some self-insurance pools.

# Fraud at the Workplace

In the 1940's renowned criminologist Donald R. Cressey developed what has become one of the most widely respected theories on the conditions that lead to workplace fraud.  His so called fraud triangle consists of several key elements.

The first is opportunity.  For an employee to even consider fraud, the opportunity must be there to commit a fraud- and perhaps more important, believe he or she can get away with it.

Cressey's second factor is a financial problem that is non-shareable. Employees can run into financial difficulties through no fault of their own or for reasons such as a gambling addiction.  The employee has a need he can't meet within his own financial means.
Or the employee could simple be a person who is greedy!

The third factor is the ability to rationalize the fraud.  They have to be able to convince themselves that what they're doing is ethical and not illegal.  The amazing thing about people caught committing fraud is that few of them believe they were doing anything wrong.

Surprisingly, employees caught committing fraud are often the ones least suspected.  While not always the case, they often work long hours, come in on weekends and will skip vacation.  They may work on weekends to maintain a second book and will skip vacations because they're afraid that their replacement will discover what has been going on.

**Take Control**

The first and easiest step a business owner can take is to keep control of the checkbook. Write and reconcile all checks themselves. If the business is too big, have one employee write the checks and another reconcile the accounts.

The second thing to do is establish a clear separation of duties in the business. This ensures that several employees would have to collude before fraud can be committed, and odds against this happening are much greater.

Another possible option is to bring in an auditor. Tell employees that from time to time an auditor will be brought in to audit the books, with no warning.

**Important Facts**

1. It's estimated that 6 percent of revenue lost in 2000 was the result of occupational fraud. This translates to about $600 billion or nearly $4,500 per employee.

2. Small businesses will be the hardest hit. The average scheme will cost a small business $127,000 in loses, compared with $97,000 for larger companies.

3. Organization with fraud hotlines cut fraud losses in half. The most common method of detecting workplace fraud is tips from employees, customers, vendors and anonymous sources.

4. The typical business fraud perpetrator is a first time offender. Previous offenders commit only 7 percent of fraud.

5. More than 80 percent of occupational frauds involve asset-misappropriation with cash being the target asset 90 percent of the time.

6. The average fraud scheme lasts 18 months before being detected.

# The Insurance Services Office

Insurers are now using the Insurance Services Office (ISO) guidelines to determine terrorism risk and loss costs. These higher costs are reflected in the insurer's rate filings with each State of the Union including the District of Columbia. ISO's models base its terrorism insurance rates on the frequency and severity of terrorist claims, developed by its subsidiary AIR Worldwide.

Metropolitan areas are now placed into one of three Tiers, based on the likelihood of a terrorist attack. The following information indicates which Tier each U.S. city has been designated.

Tier I

1. New York
2. Chicago
3. San Francisco
4. Washington, D.C.

Tier II

1. Boston
2. Houston
3. Los Angeles

4. Seattle
5. Philadelphia

Tier III
The remainder of the United States and Puerto Rico are in this final Tier. For example Maryland and Virginia are in Tier III

The ISO system rates Tier one cities as being 10 times riskier than Tier two cities and 100 times riskier than Tier three cities of a terrorist attack.

Some metropolitan areas are currently opposed to its placement in Tier I and claim that the higher rates threaten to drive business out of it's cities to locations in Tier III.

## Businesses shun terrorism insurance

**Businesses and other commercial interests across the United States are not buying terrorism coverage. They believe that they are not targets of terrorism and the cost is too high. According to a survey conduct by the Council of Insurance Agents and Brokers, nearly 60% of brokers responding to the survey said fewer than 10% of their small commercial property& casualty customers and fewer than 20% of medium-sized customers have purchased terrorism coverage offered to them by insurance carriers.**

# Mold Damage

How serious is mold damage?

In states such as Arizona, California, Nevada, and Texas mold damage has become an increasingly costly problem for insurers. Claims have risen sharply during the last few years. The District of Columbia and 36 states have approved homeowner's exclusion for mold. Maryland has received over 200 form filings from property and casualty insurers who are licensed in the state. They are asking the state to exclude or limit coverage for damages arising out of mold or related exposures.

Insurers believe that they are caught in the middle on the issue of mold. There is no scientific consensus on what the mold problem is or how to deal with it. There are no generally accepted standards for the remedy for mold damage and no state or federal agencies currently offering testing services for mold samples. If insurers pay for mold damage, they have no certainty that what is being done is effective or even necessary. Insurers are not supposed to pay claims that are not covered by a policy.

In Maryland insurers can not exclude mold from personal or commercial liability, but are allowed to limit coverage. Insurers are allowed to limit coverage for mold removal to $15,000 and $50,000 for liability. Mold, the fungus that gave us the wonder drug penicillin, is being blamed for everything from asthma to cancer to immune deficiencies. Insurers doing business in Maryland and providing property or liability coverage must annually submit data on mold claims to the insurance administration for the next three years.

Insurers can not unreasonably restrict the time period for reporting a mold claim. The policy can not require that mold damage be reported during the policy period in which the original loss occurred.

COURSE NAME: **Insurance Industry/Terrorism**
NAME.............................................................................................
ADDRESS........................................................................................
CITY...............................................................STATE..................
TELEPHONE..............................................FAX..............................
SOCIAL SECURITY #................................................
E-MAIL ADDRESS.........................................................

**HOW DID YOU PAY FOR THIS COURSE? PLEASE CHECK ONE:**

**___CREDIT CARD ___CHECK/CASH**

# ANSWER SHEET

| | | | |
|---|---|---|---|
| 1..... | 17..... | 33........ | 49.... |
| 2..... | 18.... | 34........ | 50.... |
| 3..... | 19.... | 35........ | 51.... |
| 4..... | 20.... | 36........ | 52.... |
| 5..... | 21.... | 37........ | 53.... |
| 6..... | 22.... | 38........ | 54.... |
| 7..... | 23.... | 39........ | 55.... |
| 8..... | 24.... | 40........ | 56.... |
| 9..... | 25.... | 41........ | 57.... |
| 10..... | 26.... | 42....... | |
| 11..... | 27.... | 43....... | |
| 12..... | 28.... | 44....... | |
| 13........... | 29.... | 45....... | |
| 14........... | 30... | 46....... | |
| 15............ | 31.... | 47....... | |
| 16........... | 32.... | 48... | |

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# Questions

**INSURANCE INDUSTRY/RISK/RATES/FRAUD/TERRORISM**

1. **The Northridge Earthquake was in what state?**
   a. **Maryland**
   b. **Maine**
   c. **California**
   d. **New York**

2. **How many claims were filed with insurers for September 11, 2001 terrorist attacks.**
   a. **100**
   b. **1,000**
   c. **30,000**
   d. **100,000**

3. **How many people died as a result of the September 11th terrorist attacks?**
   a. **125**
   b. **501**
   c. **3,000**
   d. **40,000**

4. **Which event was the worst disaster on record?**
   a. **Hurricane Andrew**
   b. **Northridge Earthquake**
   c. **September 11th terrorist attack**
   d. **The Kansas City bombing**

**5. In 2001, the United States insurance industry had how much in total assets?**

**a. 1 million**
**b. 250 million**
**c. 10 billion**
**d. 3 trillion**

**6. In Maryland, credit scoring can be used as an underwriting tool for?**

**a. Homeowner's insurance**
**b. Auto insurance**
**c. Both a and b**
**d. None of the above**

**7. The basic homeowner's insurance policy**

**a. covers replacement cost of the house**
**b. protects the lender from financial loss**
**c. Is required by lenders**
**d. All the above**

**8. In the past replacement insurance has been**

**a. expensive**
**b. affordable**
**c. free**
**d. all the above**

**9. The basic homeowner's policy covers**

**a. satellite dishes**
**b. computers**
**c. expensive collections**
**d. replacement cost of the house**

**10. How many people died as a result of Hurricane Andrew?**

**a. none**
**b. 23**
**c. 1,000**
**d. 400**

**11. State Workers' Compensation laws were developed early in**

**a. 17$^{th}$ century**
**b. 15$^{th}$ century**
**c. 20$^{th}$ century**
**d. none of the above**

**12. As a matter of public policy, state worker's compensation laws do not permit _____________ coverage exclusions.**

**a. auto**
**b. flood**
**c. terrorism**
**d. earthquakes**

**13. In 2001 how many states required prior approval for commercial lines insurance products.**

**a. 1**
**b. 10**
**c. 13**
**d. 20**

**14. The Terrorism Risk Insurance Act of 2002 includes all of the following except**

- **a. Workers' Compensation**
- **b. Property & Casualty**
- **c. Reinsurance**
- **d. Life & Health insurance**

**15. Under the above Act, the federal government will pay ________% of all Terrorist losses, after the insurers deductible.**

- **a. 50%**
- **b. 60%**
- **c. 80%**
- **d. 90%**

**16. Under the Terrorism Act of 2002, the insurers will pay......... % of certified terrorist losses after paying the deductible.**

- **a. 50%**
- **b. 10%**
- **c. 90%**
- **d. 75%**

**17. All of the following are covered under the Terrorism Act of 2002 except**

- **a. Personal insurance**
- **b. Malpractice insurance**
- **c. Crop insurance**
- **d. none of the above**

**18. How much in total premiums did the insurance industry Bring in during 2001.**

**a. 1 billion**
**b. 100 billion**
**c. 10 billion**
**d. 1 trillion**

**19. The average fraud scheme lasts __________months before being detected.**

**a. one**
**b. six**
**c. twelve**
**d. eighteen months**

**20. Mold damage is a serious problem in which of the following states**

**a. Arizona**
**b. Texas**
**c. California**
**d. all of the above**

**21. The typical business fraud perpetrator is a................ time offender.**

**a. first**
**b. second**
**c. third**
**d. fourth**

**22. Approximately how much a homeowner would have to pay to add sewer backup to his homeowner's policy?**

- **a. $ 100 per year**
- **b. $ 300 per year**
- **c. $ 25 per year**
- **d. no charge, it is included**

**23. Most standard policies include $ ............of liability coverage.**

- **a. 100,000**
- **b. 200,000**
- **c. 300,000**
- **d. 400,000**

**24. Many policy owners bump their homeowners policy from a $ 250 deductible to a $ 500 deductible to save ............. percent on their premiums.**

- **a. 50 %**
- **b. 75%**
- **c. 25%**
- **d. 15%**

**25. Many legislators and consumer group believe credit scoring ..........used in underwriting insurance.**

- **a. should be**
- **b. should not be**
- **c. should some times**
- **d. none of the above**

26. The California's Northridge earthquake occurred in what year?

    a. 1898
    b. 1945
    c. 1990
    d. 1994

27. How many people died in the Northridge earthquake?
    a. 20
    b. 30
    c. 50
    d. 60

28. How many claims were filed because of the Northridge earthquake?
    a. 50
    b. 2,000
    c. 600,000
    d. 50,000

29. Worker' compensation was designed to cover employees'
    a. vacation
    b. sick time
    c. medical expenses and lost wages
    d. over-time pay

**30. How many states currently have some type of competitive rating mechanism in place?**

**a. 2**
**b. 15**
**c. 38**
**d. 10**

**31. The Terrorism Insurance Program is under which government agency?**

**a. Dept. of Labor**
**b. Dept. of Defense**
**c. Dept. of the Treasury**
**d. None**

**32. In year 2, the insurers deductible will be what?**
**a. 5%**
**b. 10%**
**c. 15%**
**d. 20%**

33. A terrorist attack must have produced at least how many millions in losses under the Terrorism Act?
a. 5
b. 10
c. 15
d. 20

34. When did the Terrorism Risk Insurance Act go into effect?
    a. 1999
    b. 2002
    c. 2001
    d. 2000

35. When insurers compare claims of people with the same background, those with the worst credit filed the........claims.

    a. least
    b. most
    c. same
    d. none of the above

36. The CLUE report is used by insurers
    a. to view the history of claims against the property
    b. to determine whether the problem that caused a claim has been repaired
    c. to view the history of break-ins
    d. all the above

37. In Texas, Louisiana, and California, mold-claims cost insurers how in 2001?
    a. $ 50 billion
    b. $ 10 billion
    c. $ 5 billion
    d. $ 1.3 billion

38. Major insurers have ...........coverage for mold damage in many states.

a. cut out
b. added
c. left alone
d. none of the above

39. What person conceived the “fraud triangle theory?”
a. Cressey
b. Bell
c. Campbell
d. Williams

40. The first and easiest step a business owner can do to prevent fraud is to
a. keep control of the checkbook
b. give the employees a rise
c. hire all new workers
d. have a police guard on the premises

41. Which FICO score is considered to be a category I?

a. 720
b. 585
c. 520
d. 675

42. Fair, Isaac and Company was founded in what year?

a. 1911
b. 1929
c. 1948
d. 1956

43. A person with a FICO score of 750

   a. will have a real problem getting a loan
   b. may have a little trouble getting a loan
   c. will have no trouble getting a loan
   d. will have to get a co-signer for a loan

44. Fair Isaac has offices in how many countries?

   a. one
   b. five
   c. seven
   d. nine

45. Which of the following organizations use the FICO systems?

   a. insurers
   b. healthcare providers
   c. credit card issuers
   d. all of the above

46. Which of the following is not a major credit reporting agency?

   a. Equifax
   b. Experian
   c. TransUnion
   d. Nationwide Insurance

47. Consumers should review their credit report how often?

   a. once a month
   b. every three months
   c. once a year
   d. once every two years

48. Based on ISO's model, Washington, D.C. is in which Tier?

a. Tier I
b. Tier II
c. Tier III
d. Tier IV

49. Maryland is in which Tier?

a. Tier I
b. Tier II
c. Tier III
d. Tier IV

50. New York is in which Tier?

a. Tier I
b. Tier II
c. Tier III
d. Tier IV

51. In Sept. 11, 2001 the terrorist attacked all of the following states except

a. New York
b. Pennsylvania
c. Virginia
d. Maine

52. Sept. 11$^{th}$ losses are estimated to be......................

a. 16 billion
b. 20 billion
c. 30 billion
d. 40.2 billion

53. Sept. 11th Claims for the World Trade Center buildings One and Two are estimated to be............................

a. $ 1.0 billion
b. $ 2.0 billion
c. $ 3.5 billion
d. $ 4.0 billion

54. In New York, the Frauds Bureau conducted how many insurance fraud investigations that were linked to the Sept. 11 attacks?

a. 10
b. 30
c. 66
d. 99

55. How many of these investigations involved life insurance fraud?

a. 10
b. 21
c. 30
d. 40

56. How many of these investigations involved workers' compensation fraud?

a. 10
b. 16
c. 25
d. 40

57. How many of these investigations involved auto insurance fraud?

a. 5
b. 6
c. 10
d. 20