

14. Insurance 4: Protecting Assets through Auto, Home/Renters, and Liability Insurance

Introduction

In addition to life insurance and health insurance, you should own and understand three other important types of insurance: auto insurance, homeowner's/renter's insurance, and liability insurance.

These types of insurance are valuable assets for any family working toward financial security. They ensure that when the unexpected happens, you will not lose the things you have worked for all your life because you do not have the necessary funds to pay for damages.

As with all types of insurance, the amount of insurance and the type of coverage you carry should be updated annually. Your insurance policies should also be updated when you acquire additional personal property or when inflation increases the value of your home or other assets.

Objectives

When you have completed this chapter, you should be able to do the following:

1. Understand the key areas of auto insurance and know how to reduce your costs
2. Understand the key areas of homeowner's and renter's insurance and know how to reduce your costs
3. Understand the key areas of personal liability insurance
4. Understand some strategies of asset protection for different stages of your lives

Understand Auto Insurance and Know How to Reduce Costs

“There are 30 million accidents in the United States annually, which equals about 1 accident for every five licensed drivers. These accidents result in over \$100 billion in economic losses, 2 million injuries, and 40,000 deaths.”¹

There are many steps you can take to reduce the probability of an accident. You can drive defensively, obey all traffic rules, avoid high-traffic areas, and use good judgment when driving. However, although you can control how you drive, you cannot control how others drive; therefore, your risk of being in an automobile accident remains high. Auto insurance is a necessity for all drivers.

Basic Parts of Auto Insurance

Auto insurance is a contract between you and the insurance company in which you agree to pay a monthly premium, and the insurance company agrees to pay a specified amount for any losses defined in your policy. Losses that exceed your policy's limit are your liabilities, so it is important that you have adequate coverage.

To legally drive your car, you are required by law to carry a minimum level of auto insurance. However, most experts agree that the minimum coverage required by law is insufficient. There are four basic parts of automobile coverage:

- Part A: Liability coverage
- Part B: Medical payment
- Part C: Uninsured/underinsured motorist coverage
- Part D: Comprehensive physical damage coverage

Part A: Liability coverage pays for losses related to bodily injury, property damage, lawsuits, and defense costs. Bodily injury refers to expenses related to deaths or injuries resulting from an accident. Property damage refers to costs for damage to the car or cars involved in an accident, as well as damages to other property (such as lampposts or fire hydrants). Lawsuit coverage refers to losses related to any lawsuit resulting from an accident; in addition to the maximum amount of expenses your policy covers for a lawsuit, your policy may also cover your defense costs if the case goes to trial.

Liability coverage may be listed on your policy as a combined limit or as a split limit, depending on the type of insurance you have. Combined-limit insurance lists one maximum amount the insurance company will pay to cover all types of liabilities. Split-limit insurance lists the maximum amount the insurance company will pay for each of the specific types of liability. For example, if you have a 100/300/50 split-limit insurance policy, it means your limits are \$100,000 per person for bodily injury liability coverage, \$300,000 per accident for bodily injury liability coverage, and \$50,000 per accident for property damage coverage. These dollar amounts are the maximum amounts your insurance company will pay per person or per accident. Should the costs of the accident exceed these limits, you will be responsible for paying the difference. My recommended split-limit minimum liability coverage limits are \$100,000 per person and \$300,000 per accident with \$50,000 for property damage. My combined-limit recommended liability coverage limits are a minimum of \$300,000 per accident with \$50,000 property damage.

Part B: Medical payment coverage pays for accident-related medical costs and funeral expenses incurred by you or your family members within three years of an accident. It also covers the insured while walking, even though he is not in a vehicle. My recommended minimum medical payment coverage is \$50,000.

Medical payment coverage does not cover all medical expenses, however. For example, it does not cover your medical expenses if you are injured by a vehicle that is not designed for public

streets, such as an unlicensed three- or four-wheel all-terrain vehicle. Be sure you know what types of injuries are excluded from your policy.

Part C: Uninsured or underinsured motorist coverage covers your costs if you are injured by an uninsured motorist or if you are injured in a hit-and-run accident. It also covers your costs if the other driver's insurance is insufficient to pay for your expenses (in other words, if the other driver is underinsured). The other driver must be at fault for you to collect on this coverage. I recommend that you keep your uninsured/underinsured insurance coverage the same as your liability coverage.

Part D: Comprehensive physical damage coverage (also called collision coverage) pays for damage resulting from any collision, regardless of who is at fault. If the other driver is at fault and has liability insurance, your insurance company should be able to recover losses from the other driver's insurance company. If the accident does not involve a collision with another car, comprehensive physical damage coverage pays for damage to your vehicle.

Standard Exclusions

Exclusions are clauses in your contract that limit the insurance company's liability to pay for specific claims. For example, your insurance company may not pay on a claim if the following situations apply:

- You intentionally cause damage or injury
- You drive the vehicle without permission
- Your vehicle has fewer than four wheels
- You drive someone else's vehicle on a regular basis
- Your automobile is not listed on your policy
- You are carrying passengers for a fee
- You are driving in a race or speed contest

You should be aware of and avoid any circumstances where exclusions to your insurance would apply.

No-Fault Insurance

No-fault insurance is coverage that pays for the driver's injuries, regardless of who causes the accident. Such policies are designed to promote faster reimbursement and reduce the amount of litigation necessary. No-fault policies vary from state to state and are available only in "no-fault" states. There are many advantages to having no-fault insurance. It is easier to deal with because your insurance pays for your injuries, and the other driver's insurance pays for his or her injuries—there are no legal battles. Claims are processed faster because you are guaranteed immediate compensation for your losses.

However, there are disadvantages to having no-fault insurance as well. Damages from pain,

suffering, and emotional distress are not usually covered by no-fault insurance; other disadvantages include lower dollar limits on medical expenses and lost income, and losses above your established limits are not covered. Vehicle damage is not covered: to repair your vehicle, you must rely on your collision coverage or the other driver's. No-fault insurance also has liability thresholds that may restrict your ability to pursue a liability lawsuit.

Keeping Costs for Automobile Insurance Down

The cost of your auto insurance is determined by the type of car you drive, how much and how far you drive the car each day, and your driving characteristics. These driving characteristics include your driving record, where you live, and any discounts for which you qualify. Insurance companies also use your credit score to determine the cost of your insurance. The following are some tips for keeping your automobile insurance costs down:

1. **Shop comparatively.** Know what different insurance companies in your area are charging for similar coverage. Determine the amount and type of insurance you need and then shop comparatively.
2. **Consider only high-quality insurance companies.** Review insurance ratings from different companies such as A.M. Best (look for a rating of A and higher) at www.ambest.com, Standard & Poor's (AA and higher) at www.standardandpoors.com, Fitch (AA and higher), and Moody's (Aa2 and higher). Make sure the company you have chosen is sound. Find examples of others who have made claims with the company and determine how well the company handled those claims. Having cheap insurance is worthless if the company fails to pay on claims.
3. **Make use of all available discounts.** Apply for all discounts you think you or your family members would qualify for, such as non-smoking, non-drinking, good grades, and multiple vehicles. In addition, consider buying auto insurance from the same company with which you have your homeowners' insurance or life insurance because you should get a multiple-policy discount. Always ask your insurance agent, "Are you sure you can't do better than that?" and "Are you sure there are no other discounts?"
4. **Buy vehicles that are inexpensive to insure.** Ask your insurance company about the costs of insuring specific vehicles before you purchase a new car. Buying a car that is a favorite of thieves is likely to raise your insurance costs. However, buying a car with extra safety features and antitheft devices may reduce your insurance costs.
5. **Drive defensively.** Driving defensively is critical to reducing your insurance costs. Keep your driving record clear of tickets and accidents. If you or someone in your family gets a ticket, go to traffic school to keep the ticket off your record whenever possible.
6. **Raise your deductibles.** If you want to cut monthly insurance costs, raise your deductibles. Moreover, consider dropping collision coverage completely once the value of your car drops

below \$2,000; it may be more cost effective for you to pay repair costs out of your own pocket if the car is in a collision.

7. **Keep adequate liability insurance.** Never reduce your liability limits to reduce your insurance costs! Liability insurance is fairly inexpensive, but it is very important: keep your limits high.
8. **Be cautious of allowing others to drive your car.** Remember that if a friend causes an accident in your car, and you gave your friend permission to drive the car, you (and your insurance company) will likely have to pay the bill, and your insurance costs may go up.
9. **Improve your credit score.** Take the steps necessary to improve your credit score; insurance companies believe that those with high credit scores are less of an insurance risk than those with lower credit scores. Review your credit score and credit reports every few years and make sure they are correct.
10. **Review your insurance coverage on a regular basis.** Review your insurance costs, coverage, liability limits, and discounts on a regular basis—at least annually. Make sure all your vehicles are included in your policy. Review your CLUE (Comprehensive Liability Underwrites Exchange) report at www.choicetrust.com and make sure it is correct.

Filing a Claim on Your Auto Insurance

If you are in an accident, the following tips may be helpful.

First, use wisdom in your actions: If there is an accident, call the police immediately and cooperate with them when they arrive. Move the vehicles out of traffic or put up flares. (I recommend that you keep flares in your vehicle's emergency kit.) Get help for anyone who has been injured. Write down the names and contact information of any witnesses to the accident. Insist that all drivers be tested for alcohol consumption if you are concerned that alcohol may have been a factor in the accident. Before leaving the scene of the accident, get the police case number for your records.

Second, keep calm and stay in control. Write down your memories of the events leading up to and following the accident. Don't sign anything or admit guilt. Remember to be firm on your views about what happened when you speak with the police officers. Don't be afraid to speak up and give pertinent information about the accident—even if that information contradicts the other driver's story.

Third, follow up on the accident properly and promptly. Get the name of the other driver's insurance company and call your insurance company as soon as possible. Cooperate with your agent and your claims adjuster, the person assigned by your insurance agent to determine the amount of the loss. Obtain a copy of the police report and keep records of all accident-related expenses. Review the settlement steps in your policy and follow these steps exactly.

Finally, if you are dissatisfied with the settlement the insurance company offers, request a meeting with your agent and your claims adjuster. If you are still not satisfied after this meeting, contact your insurance company's consumer affairs office or the state insurance commissioner and explain your concerns.

Understand Homeowner's and Renter's Insurance and Know How to Reduce Costs

Your home is likely one of the largest purchases you will ever make. Because your home is such an important purchase, it needs to be protected. The purpose of homeowner's insurance is to cover the costs of repairing or replacing your home in the event it is damaged by specific disasters, such as fire, theft, or storms. Know which risks you want homeowner's insurance to cover, and make sure you get the type of that covers those risks.

Basic Types of Homeowner's Insurance

There are six basic types of homeowner's insurance:

1. **HO-2** is a general form of homeowner's insurance and the least expensive type; it covers only named perils. These perils may be fire, lightning, hail, explosions, and so on. If a peril is not listed, it is not covered by the insurance.
2. **HO-3** includes open perils protection. Open perils protection covers all direct physical losses to your home and lists specific exclusions. All forms of homeowner's insurance exclude certain types of damage, including damage caused by law (problems caused by a lack of proper permits), earth movement (earthquakes), water damage (floods), power failure, neglect, war, nuclear accidents, and intentional loss. Although HO-3 excludes these perils as a general rule, coverage for some of these specific perils may be added separately to the policy. HO-3 coverage is generally recommended as a minimum level of homeowner's insurance.
3. **HO-4** is renters' and tenants' insurance. Because this coverage is available only to renters and tenants, it covers damage or loss of personal property rather than loss or damage to the structure itself. HO-4 provides liability coverage in case of an accident, but it does not cover structural damage. The personal property coverage provided by HO-4 is similar to the coverage provided by HO-2. All-risk coverage is available for HO-4 insurance and is recommended. All-risk coverage includes coverage for all risks except those excluded from homeowners coverage.
4. **HO-5** is a new, unique form of homeowner's insurance that covers open perils and includes a rider (HO-15) that allows open perils coverage on personal property in addition to other coverage. HO-5 covers all direct physical losses to your home, or open perils protection. HO-5 has the same exceptions as HO-3.
5. **HO-6** is condominium owners' insurance. HO-6 is similar to HO-4 coverage, but it is

available only to co-op or condominium owners. Besides covering personal property, this insurance also covers improvements you have made to the dwelling. All-risk coverage is available as an option and is recommended.

6. **HO-8** is modified coverage for older homes. HO-8 is similar to HO-1 coverage, or insurance against named perils. It insures the dwelling for the repair cost or market value instead of the replacement value. All-risk coverage is available as an option and is recommended.

Basic Parts of Homeowner's Insurance

Homeowner's insurance covers four key components: the main dwelling, other structures, personal property, and loss of use.

Coverage A: Main dwelling coverage protects the home and any attachments to the home. It does not cover any damage to the land.

Coverage B: Other structures coverage protects buildings on the property that are not attached to the main dwelling, as well as landscaping; however, it does not protect land or structures used for business purposes. Coverage of other structures is limited to 10 percent of the value of the home's coverage.

Coverage C: Personal property coverage pays for all personal property that is owned or used by the policyholder. It covers personal property regardless of the property's location. For example, loss to contents in your personal vehicle at work would be covered by the personal property component of your homeowner's insurance. Personal property coverage also covers property of guests in your home. It is limited to 50 percent of the home's coverage. For example, if your home is covered for \$250,000, you can have up to \$125,000 coverage for personal property. In addition, there is a \$200 limit on cash, gold, and silver; a \$1,000 limit on securities, tickets, and stamps; and a \$2,500 limit on silverware. Note that birds, fish, and other animals are not considered personal property.

Coverage D: Loss of use coverage pays for losses that are incurred if your home becomes uninhabitable. It is limited to 20 percent of the home's coverage. Benefits of this type of coverage cover living expenses that are incurred if you need to relocate temporarily until your home is repaired. This type of coverage also covers fair rental value of any structure in which a renter was leasing part of the home. Finally, this type of coverage covers losses in the case that a civil authority prohibits you from using the structure.

If you need additional coverage, a homeowner's policy can be supplemented in a number of ways through endorsements or additions to your policy. Examples of endorsements include inflation, floaters, and specific risk coverage. An inflation endorsement allows insurance protection to increase parallel to the increase of repair and rebuilding costs. A floater policy

endorsement insures valuable personal property for an amount that is higher than your existing homeowner’s policy limits. Flood insurance, earthquake insurance, and terrorism insurance provide protection in case of specific types of loss as well.

Keeping Costs for Homeowner’s Insurance Down

Three basic factors determine how much a policy costs: location of structure, type of structure, and level of coverage. There are eight major areas you should consider when looking to reduce your homeowner's insurance costs:

Table 1. Homeowner’s Insurance Coverage

Policy	Coverage A: Dwelling	Coverage B: Other Structures	Coverage C: Personal Property	Coverage D: Loss of Use
Section 1: Property				
HO 02: Basic Insurance Coverage				
	Broad form \$15,000 min	Broad form 10% of A	Broad form 50% of A	Broad form 20% of A
HO 03: Broader form, includes open perils				
	Open Peril \$20,000 min	Open Peril 10% of A	Broad form 50% of A	Open Peril 20% of A
HO 04: Renters, or Tenant’s Insurance				
	Not covered	Not covered	Broad form \$6,000 min	Broad form 20% of C
HO 05: Broader form, incl. open perils coverage on Per. Property				
	Open Peril \$20,000 min	Open Peril 10% of A	Open Peril 70% of A	Open Peril 30% of A
HO 06: Condominium Insurance				
	\$1,000	Included in A	Broad form \$6,000 min	Broad form 40% of C
HO 08: Modified coverage for Older Homes				
	Basic \$15,000	Basic 10% of A	Basic 50% of A	Basic 10% of A
Broad form: Covers only named specific perils. If not noted, it is not included. Open Peril: Covers all direct physical losses to your home, i.e. open perils protection. It lists specific exclusions. In general, all forms exclude law, earth movement, water damage, power failure, neglect, war, nuclear accidents, and intentional loss.				
Section 2: Liability				
Coverage E:		Coverage F		
Comprehensive liability		Medical Payments to others, claims, expenses, damage to other’s property		

1. **Know your needs.** Know what you want out of your homeowner's insurance. Remember to insure against the high-risk, high-severity items and self-insure against the low-severity, low-risk events.

It may be wise to buy guaranteed full-replacement cost coverage for your home in case

the home is damaged beyond repair. If you have this type of coverage, your home will be replaced without cost to you, regardless of what you paid for the home. Also, determine whether other structures or landscaping on your property have adequate coverage. Purchase additional insurance if part of your home is used as an office. You can also purchase extra coverage for unique situations if you have specific concerns that are not included in a policy; for example, if you live on a flood plain, you may want to add flood insurance to your policy. Finally, consider extra coverage, or floater policies, for valuables such as paintings, jewelry, or collections.

1. **Don't underinsure.** The 80-percent rule states that a dwelling should be insured within 80 percent of its replacement cost. If you do not carry adequate insurance on your home, co-insurance requires you to pay for a portion of your home's loss. If your home is not insured for at least 80 percent of its replacement cost, your settlement will be the greater of two amounts: either the settlement will be the cash value of the damaged or lost portion of the home or the settlement will be the amount of your insurance coverage divided by 80 percent of the replacement cost multiplied by the value of the loss. For example, if your home was insured for \$300,000 but its replacement cost was \$400,000, you are underinsured. You should have had a minimum insurance amount of \$320,000, or 80 percent of \$400,000. If you had a loss of \$250,000, the company would pay \$300,000 (your insured amount) divided by \$320,000 (80 percent of the replacement value), times \$250,000—or \$234,375 (not including deductibles). You would be personally responsible for \$15,625.
2. **Select a financially sound insurance company with comparatively low costs, and stick with them.** Shop around for homeowner's insurance—knowledge is your most important asset. Remember, the more types of insurance you have with a single insurance company, the lower your costs on specific types of insurance will be (multiple-policy discounts can be substantial). Once you have decided on an insurer, check with www.ambest.com to review your insurer's ratings and financial health. Pick a good insurer that is not likely to go out of business. Different companies have different discounts for different areas; talk with your agent and get as many discounts as you possibly can.
3. **Get a CLUE (Comprehensive Loss Underwriting Exchange) report for both your home and your automobiles.** A CLUE report is similar to a credit report. It gives a list of all payments made by the insurance company on your behalf. Review this report—this is what potential insurance companies will see when they are considering you as a client. You can get one copy a year from www.choicetrust.com. Be careful that inquiries are not listed as actual payments.
4. **Reduce the insurance company's risk.** There are a number of ways to do this. First, you may want to consider paying your premiums annually instead of monthly; paying your premiums annually lowers administrative costs for your insurer and usually lowers your costs as well. In addition, some companies will give you a 5 to 10 percent reduction in

costs if you allow them to deduct your insurance costs monthly through electronic funds transfers (EFTs). Second, increase your deductible. The higher your deductible, the lower your premium costs; by raising your deductible you are self-insuring a greater part of your risk.

Third, make your home more disaster-resistant and safer. Companies may give discounts if you make your home more disaster-resistant, for example, by adding storm shutters or buying strong roofing materials. Contact your insurance company to find out about possible discounts. Insurance companies may also give a 5 to 10 percent discount if you add fire extinguishers and burglar alarms that are connected to police monitoring. Because of the high cost of home security systems, contact your insurance agent to see what the agent recommends and how much savings would be before you purchase these systems.

5. **Know your coverage restrictions.** You should read and understand your policy completely. Remember, the amount paid by the insurance company will never exceed the limit listed on your policy. An important restriction you should be aware of stipulates that in order to receive full insurance benefits, you must rebuild in the same location. If you don't rebuild in the same location, your insurance company will give you only the cash value of the home and not the replacement value.
6. **Make your coverage work.** Create an inventory of everything you insure, preferably on videotape, to establish proof of ownership. Keep the inventory in a safe place away from the house and update it yearly. Videotape the exterior of your home to document the value of landscaping and the condition of the house and update this record yearly as well. Make a list of the value of your assets. These records will be invaluable if your home or assets are damaged.
7. **Keep your credit score high.** Having a solid credit history can reduce your insurance costs. Monitor your credit report annually, check your credit score every two years, and keep your credit score high.

Filing a Claim on Your Homeowner's Insurance

If you have to make a claim on your homeowner's insurance, there are a number of steps you should take to protect yourself and speed the insurance process.

First, notify the police immediately of any theft or loss. Get copies of all police reports. Call your insurance company and notify the company of the loss as well. In some circumstances, you will need to follow up your call with a written claim.

Second, make a list of damaged, stolen, and destroyed items. If the loss required you to live outside the home, submit receipts for any additional living expenses to your insurance company as needed. Provide information requested by your claims adjuster, and accommodate the

insurance company as much as possible.

Finally, review the steps of settlement explained in your policy and follow these steps exactly. If you are dissatisfied with the settlement offer, request a meeting with your insurance agent and claims adjuster. If you are not satisfied after this meeting, contact your insurance company's consumer affairs office or the state insurance commissioner and explain your concerns.

Explain the Basics of Personal Liability Insurance

A liability is the financial responsibility one person has to another person in certain situations. Liability results from negligence or the failure of one person to exercise the necessary care to protect other people from harm.

The cost of liabilities can be substantial. Every year, thousands of people are sued for more than one million accidents caused by or related to cars or homes. The purpose of personal liability insurance is to protect you from the financial costs of legal liability and negligence.

There are the two major forms of liability insurance: (1) the liability portions of homeowner's and automobile insurance and (2) an umbrella liability policy.

An umbrella liability policy is an insurance policy that adds additional protection to the protection provided by your homeowner's and automotive policies. An umbrella policy becomes effective only after the limits of your homeowner's or automotive policy have been reached. Therefore, many companies require specific coverage limits on homeowner's and automotive policies. For example, an insurance company may require you to have 250/500/100 insurance on all vehicles and \$300,000 on all homes before they will write an umbrella policy.

Understand Plans and Strategies for Asset Protection

As part of your Insurance Plan, you will need to think through what asset protection strategies you will use during your life. Following are a few ideas for asset protection strategies over different time periods.

Students and young marrieds

- Keep your credit score high to keep your insurance costs low.
- Have adequate auto insurance, with a minimum 100/300/100 split coverage initially.
- Have adequate renters insurance. If you get renters insurance from your auto insurer, there is likely a reduction in auto insurance costs. Some actually save money by purchasing renter's insurance.
- Keep an adequate emergency fund. With a higher emergency fund, you can raise your auto and home deductibles to reduce costs and co-insure a greater proportion of your assets.

Married with families

- Raise your split coverage to 250/500/100 to offer more protection when you have teenage drivers.
- Make sure teenage drivers take “safe-drivers courses” to reduce their insurance costs.
- Use all “good student discounts” for auto insurance. Have children keep their grades up to keep the costs lower.
- Stay ticket free. If you get a ticket, go to traffic school. Get the ticket removed from your record.
- Consider an umbrella policy to reduce the risk of future litigation expense as your assets rise.

Empty nesters

- Make sure you have sufficient auto and home insurance to meet your family needs.
- Review your insurance needs annually to ensure you have adequate coverage.
- As children leave home, make adjustments to your asset insurance to be cost effective with your coverage.
- Consider an umbrella policy to reduce the risk of future litigation expense as your assets increase.
- Take into account toys that are used for kids and grandkids and keep coverage up.

Summary

Auto insurance is a contract between you and the insurance company in which you agree to pay a monthly premium, and the insurance company agrees to pay a specified amount for any losses defined in your policy. Losses that exceed your policy’s limit are your liabilities, so it is important that you have adequate coverage.

Your home is likely one of the largest single purchases you will ever make; it is important for you to protect this important purchase. The purpose of homeowner’s insurance is to repair or replace your home in the event it is damaged by specific disasters. Know which risks you want homeowner’s insurance to cover, and make sure the policy you choose covers those risks.

An umbrella liability policy is an insurance policy that adds additional protection to the protection provided by your homeowner’s and automotive policies. This policy becomes effective only after the limits of your homeowner’s policy or automotive policy have been reached.

As part of your Insurance Plan, you should come up with strategies how you will utilize insurance in asset protection.

Assignments

Financial Plan Assignments

There are several different assignments for this chapter. Having auto insurance is a critical part of owning and driving a car; in fact, it is illegal to drive a car unless you have insurance. Your assignment is to get a copy of your auto insurance and include it in your financial plan and include these in your [PFP Insurance Template](#) (LT01-09).

Auto insurance. Look at your credit score if it is reported on your policy. The credit score shown on your policy should be consistent with the credit score you received from the credit-scoring agencies for an earlier assignment. Improving your credit score can lower the cost of your auto and other insurance.

Look at the discounts on your policy, such as discounts for good students, good drivers, multiple cars, and so on. Call your insurance provider and find out if there are any other discounts you qualify for. Discounts can reduce the cost of your insurance policy.

Review each of the four basic parts of your insurance: liability coverage, medical coverage, uninsured/underinsured coverage, and comprehensive physical damage coverage. What are your liability limits? If you have split coverage, how is the coverage split? Remember that most state requirements for liability insurance were set more than 30 years ago; these requirements are generally insufficient, given the rising costs of medical and automobile repair. If you must reduce your insurance costs, increase your deductible rather than reducing your liability limits.

Homeowners/renters insurance. If you own a home or a condo, get a copy of your homeowner's policy and review it carefully. Which type of homeowner's insurance do you have? Is your homeowner's insurance sufficient for your needs? Does it cover the current value of your home? What could you do to improve your coverage?

Liability insurance. Do you have a need for umbrella coverage? As the size of your assets increases, umbrella insurance may be something to look into.

Find out what insurance companies see when they look at your insurance reports. Under the FACT Act of 2003 (Fair and Accurate Credit Transactions Act) you can obtain a free copy of the following reports each year from the Comprehensive Liability Underwriting Exchange, or CLUE:

- **CLUE Auto:** A five-year loss-history report is generated if a loss is filed against your automobile insurance policy and the insurance company reports the information to CLUE.
- **CLUE Personal Property:** A five-year loss-history report is generated if a loss is filed against your homeowner's insurance policy and the insurance company provides this

information to CLUE.

To get both CLUE reports, go to www.choicetrust.com, click on *CLUE Reports*, click on *CLUE reports* again, then *order options*, then *both reports*, then *new member*. Fill out the information for new members, including Social Security number, driver's license number, and address. Then verify the information and obtain the reports. If claims that the insurance company has paid are shown on these reports, copy the reports and include them in your Personal Financial Plan. You can also dispute the information if it is not correct or if you are planning on switching insurance companies.

Review Materials

Terminology Review

Auto insurance. Insurance against financial loss due to an auto accident. It is a contract where you agree to pay the premium and the insurance company agrees to pay up to a specified amount for any policy defined losses. Losses in excess of policy limits are your responsibility.

Auto split-coverage insurance limits. These limits have reference to your coverage amounts which includes bodily injury liability per person, bodily injury liability per accident, and property damage liability per accident. These are the maximum amounts your insurance company will pay per person or per accident. Should the cost of the accident exceed the stated limits, you are personally responsible for any amounts exceeding these limits.

Exclusions. Exclusions are contract clauses which limit the insurance company's liability in specific situations or events. Your insurance may not pay up if: there is intentional injury or damage, there was use of the vehicle without permission, the vehicle has less than four wheels, someone else's vehicle was provided on a regular basis, its your automobile, but not listed on your policy, you were carrying passengers for a fee, or you were driving in a race or speed contest.

Homeowners Insurance. Homeowners insurance repairs or replaces your home from specific perils or accidents including: Fire, theft, storms; faulty household systems or appliances; and riot, volcanoes, vehicles, aircraft. Three key areas of homeowners insurance are: Dwelling: direct and consequential loss resulting from damage to the dwelling itself; Personal Property: loss or damage to personal property, and Liability: liability for unintentional actions arising out of the non-business, non-automobile activities of the insured and the insured's family. It is sold in six basic versions.

Homeowners Insurance Coverage. Homeowners insurance is divided into six areas:

- **Coverage A: Dwelling.** This protects the dwelling and any attachments. It does not cover any damage to the land.
- **Coverage B: Other Structures.** This protects other, unattached, dwellings on property.

It also covers landscaping as well as buildings, but not the land. It also does not cover other structures used for business purposes. It is limited to 10% of the home's coverage.

- **Coverage C: Personal Property.** This covers all personal property owned or used by the policyholder up to policy limits, and covers it regardless of location. It also covers property of guests in your home as well. It is limited to 50% of the home's coverage, with a \$200 limit on cash, gold, and silver; \$1,000 limit on securities, tickets, and stamps; and \$2,500 limit on silverware. Animals, birds, and fish are excluded.
- **Coverage D: Loss of Use.** This covers losses incurred as a result of your home being uninhabitable or un-useable. It is limited to 20% of the amount of coverage on the home. There are three benefits of coverage: additional living expenses should to need to relocate temporarily; fair rental value, and prohibited use.
- **Coverage E: Personal Liability.** The insurer will pay, to the limit of liability in the contract, all amounts due to bodily injury or property damage.
- **Coverage F: Medical Payments.** The insurer will pay all reasonable medical payments to others, claims, expenses, and damage to the property of others to the limits of the policy. Other coverage includes claims expenses, first aid expenses, damage to the property of others, and loss assessment coverage

Homeowners Insurance Types. Homeowners insurance comes in various forms.

- **HO-2.** It is a broad form homeowner's insurance, and covers only named specific named perils. These perils may be fire, lightning, hail, explosions, etc. If the peril is not named, it is not covered by the policy. In general, all forms of coverage exclude law, earth movement, water damage, power failure, neglect, war, nuclear accidents, and intentional loss.
- **HO-3.** It is a special form of homeowner's insurance that includes open perils. This is generally recommended at a minimum. It covers all direct physical losses to your home, i.e. open perils protection. It lists specific exclusions to the policy for perils not covered.
- **HO-4.** It is Renter's or tenant's insurance. It is equivalent to HO-2 perils for personal property, but only for renters and tenants. It covers personal property rather than the dwelling, and provides liability coverage in case an accident, but does not cover causing damage to the structure. All-risk coverage available as an option (this is recommended).
- **HO-5.** It is a newer special form homeowner's insurance that includes open perils and includes a rider (HO-15) that allows open perils coverage on personal property in addition to other coverage. It covers all direct physical losses to your home, i.e. open perils protection. The listed exceptions are the same as HO-3.
- **HO-6.** It is condominium owner's insurance. It is similar to HO-4 coverage, has the same named perils for personal property as HO-2, but is available to co-op or condominium owners. It also covers improvements you've made. All-risk coverage is available as an option (recommended).
- **HO-8.** It is modified coverage for older homes. It insures the dwelling for the repair cost or market value, instead of the replacement value and is designed specifically for older homes. All-risk coverage available as an option (recommended).

Homeowners Policy Riders. Should you need to add additional coverage, a homeowners policy can be supplemented in a number of ways through specific endorsements or riders including: Inflation: This allows protection to increase with the increase in repair and rebuilding costs; Floater Policies: These are policies that provide protection for valuable personal property over and above existing policy limits; and Flood, Earthquake and Terrorism Insurance: This provides protection in the event of a flood, earthquake, or terrorist activity.

No Fault Insurance. No-Fault Insurance is insurance coverage that pays for each driver's own injuries, regardless of who caused the accident. No-fault varies from state to state. Such policies are designed to promote faster reimbursement and to reduce litigation, and is only available in "no-fault" states (including Utah). The advantages of no-fault insurance are its easier and faster as your insurance pays for your losses and their insurance pays for their losses. However, generally damages from pain, suffering, emotional distress are not covered and there are dollar limits on medical expenses and lost income and vehicle damage is not covered.

Other than collision, it covers comprehensive physical damages.

Personal Automobile Policy. This includes the four key areas of automobile coverage: A. Liability, Part B: Medical Payment, Part C: Uninsured/Underinsured Motorist's Protection, and Part D: Damage to Your Car.

- **Liability Coverage (Part A).** Liability coverage is payment for losses due to: Bodily injury: Death or injury for all those involved in the accident; Property damage: All damage to the car or cars and any property damage; and Losses due to lawsuits: Losses from lawsuits resulting from the accident. Liability coverage may be a combined single limit or a split-limit coverage.
- **Medical Payment Coverage (Part B).** Medical payments covers all reasonable medical costs and funeral expenses incurred, by the insured or the insured's family members within 3 years of an accident. It also includes coverage for the insured when walking. It does not cover medical expenses if the insured is injured by a vehicle not designed for public streets, such as an unlicensed 3 or 4 wheeler (quad, four wheeler or go cart).
- **Uninsured/Underinsured Motorist's Coverage (Part C).** Uninsured/underinsured insurance covers costs if injured by an uninsured motorist or a hit-and-run driver. The other driver must be at fault to collect on this coverage. It also covers costs in excess of the other driver's liability coverage (i.e., under-insurance), if it is inadequate to pay for your losses.
- **Comprehensive Physical (Part D).** Comprehensive covers collision loss regardless of who is at fault. If the other driver was at fault and has liability insurance, your insurance company should be able to recover losses without collision coverage from the other driver's insurance company

Renters Insurance. Renters insurance repairs or replaces your rental property's contents from specific perils or accidents including fire, theft, storms, water damage, etc. It also provides liability insurance against accidents caused by you or a member of your family. Your landlord has insurance only for the rented property and building. You are responsible for your contents and the liability risks you and your family bring. Renters insurance is relatively cheap and protects your property regardless of location.

Umbrella liability coverage (or umbrella policy). It is an insurance policy that adds protection over and above the insured's homeowners and auto policies, i.e., the policy becomes effective only after the limits of the homeowner's and automotive policies have been reached. As such, many companies require specific coverage limits, i.e., 250/500/100 insurance on all vehicles and \$300,000 on the home before they will write an umbrella coverage.

Review Questions

1. What is auto insurance? Homeowner's insurance? Liability insurance? Why have them?
2. What are the four basic parts of an auto insurance policy?
3. What are "exclusions"? What is an example?
4. What are the four basic components of a homeowner's insurance policy?
5. What is an umbrella policy? When does it become effective?

Case Studies

Case Study 1

Data

Larry has a split-limit 100/300/50 automobile liability insurance policy. Several months ago Larry was in an accident in which he was found to be at fault. Four passengers were injured in the accident and were awarded \$100,000 each because of Larry's negligence.

Application

How much of this will Larry's insurance policy cover? What amount will Larry have to pay out of pocket? Note: Larry's coverage is (A/B/D) 100/300/50: A = Liability: bodily injury liability per person, B = Medical: coverage per accident, D = Damage: collision or comprehensive coverage.

Case Study 1 Answers

Larry's maximum liability limit is \$300,000 per accident. This amount must cover payments to all persons involved in the accident.

Unfortunately, it is not enough, because the four liability claims total \$400,000. The remaining \$100,000 awarded in the settlement will not be covered by Larry's insurance, and Larry must pay this expense out of his own pocket.

Case Study 2

Data

Janet currently insures her home for 100 percent of its replacement value with an HO-2 policy. For Janet, dwelling coverage (A) comes to \$280,000.

Calculations

What are the maximum-dollar coverage amounts for parts B, C, and D of her homeowners policy?

Case Study 2 Answers

To determine the base amount of coverage on B, C, and D, use the \$280,000 of the dwelling coverage (A) as a starting point. Coverage B (other structures) is limited to 10 percent of the dwelling coverage and is calculated as $(\$280,000 * 10\%) = \$28,000$. Coverage C (personal property) is limited to 50 percent of the home's coverage and is calculated as $(\$280,000 * 50\%) = \$140,000$. And coverage D (loss of use) is limited to 20 percent of the home's coverage and is calculated as $(\$280,000 * 20\%) = \$56,000$.

Case Study 3

Data

Kelly has personal property coverage with a \$250 limit on currency; a \$1,000 limit on jewelry; and a \$2,500 limit on gold, silver, and pewter. She does not have a personal property floater. Her deductible is \$250.

Calculations

- A. If \$500 in cash, \$2,500 of jewelry, and \$1,500 of pewter ware were stolen from Kelly's home, how much of the loss would be covered by her homeowner's policy?
- B. How much will she pay (or lose) on the claim?

Case Study 3 Answers

Kelly's policy would pay as follows:

Item	Amount Insurance Pays	Amount Kelly Pays	Total
Cash	\$250	\$250	\$500
Jewelry	1,000	1,500	2,500
Pewter	1,500	0	1,500
Totals	2,750	1,750	4,500
Deductible	-250	250	
Total Amount Paid	\$2,500	\$2,000	\$4,500

The insurance company would pay \$2,500, and Kelly would pay \$2,000.

Case Study 4

Data

Catherine called her insurance agent to learn how she could reduce her \$1,000 annual homeowners insurance premium. The agent suggested increasing the \$250 deductible on her policy to \$500: this would result in a 10 percent premium savings. Her agent also indicated that if Catherine were to increase her deductible to \$1,000, she would save 18

percent, and if she were to increase her deductible to \$2,500, she would save 25 percent.

Calculations

A. How much will Catherine save per year in premiums if she increases her deductible to \$500, \$1,000, or \$2,500?

B. What are the advantages and disadvantages of increasing Catherine's policy deductible? What should be the key factor in her decision?

Case Study 4 Answers

A. Her current policy is \$1,000 per year. Annual savings would be as follows:

\$500 deductible = 10 percent savings, or \$100

\$1,000 deductible = 18 percent savings, or \$180

\$2,500 deductible = 25 percent savings, or \$250

B. The advisability of increasing homeowner's insurance deductibles depends on the adequacy of her emergency fund or her capacity to cover a loss from current earnings. Catherine would save \$250 on her annual premium by increasing her deductible from \$250 to \$2,500. On the other hand, she would be responsible for the first \$2,500 of losses. Catherine would need about 10 claim-free years ($\$2,500/\250) to break even. Her decision should be based primarily on her emergency fund.

Case Study 5

Data

Paul is confused about his umbrella policy. His insurance agent requires him to have 250/500/100 split insurance on each of his automobiles before they can be put under his umbrella policy. He also has to have similar liability coverage for his home.

Application

What is the purpose of an umbrella policy? Does it pay before or after Paul's home or auto coverage?

Case Study 5 Answers

Paul's umbrella policy provides protection against lawsuits and judgments. It doesn't go into effect until after he has exhausted his homeowner's and automobile liability coverage. For that reason, the insurance company requires high liability coverage on his home and automobiles.

¹ Louis Boone, David Kurtz, and Douglas Hearth, *Planning Your Financial Future*, 3rd ed., 2003, 275