

Viewpoint

AMERICAN ASSOCIATION OF INSURANCE SERVICES

AIS

Winter 2010

ses" caused by
or overflow
the "insured

r appliance
steam

20. "Terms" means all provisions, limitations, exclusions, conditions, "declarations", and definitions used in this policy.

21. "Volcanic action" means:

- a. airborne volcanic blast or airborne shock waves;
- b. ash, dust, or particulate matter; and
- c. lava flow.

"Volcanic action" does not include the cost to remove ash, dust, or particulate matter that does not cause direct physical loss to covered property.

PROPERTY COVERAGES

PRINCIPAL PROPERTY COVERAGES

Coverage A -- Residence

"We" cover the "residence" on the "insured premises". This includes additions and built-in components and fixtures, materials and

What makes a policy
READABLE?

**ALSO
INSIDE**

*'Your work'
and 'faulty
workmanship'*

*Equipment
breakdown in
construction*

*Defective
drywall
claims*

*The long and
short of modeling
for hurricanes*

AAIS means agribusiness



You need more than a patchwork of yesterday's products to insure today's agribusinesses. You need--

The AAIS Agricultural Output Program (AgOP)

The AAIS Agricultural General Liability Program (AgGL)

These are the first standardized programs specifically designed to insure property and liability exposures of large farms and agricultural processing enterprises.

They are available only from AAIS, an advisory organization used by more than 150 insurers for their farm and ag forms and rating information.

The AgOP features--

- Broad commercial property and inland marine coverage built into its base form, and a wide range of coverage options, including equipment breakdown and crime
- Supplemental coverage limits determined individually through dec page entries
- A flexible rating procedure that addresses the unique exposures of each risk

The AgGL features--

- A choice of two base forms:
 - A farm commercial form that can be endorsed to cover other exposures
 - An agribusiness CGL form that can be endorsed to exclude specified exposures
- Up-to-date coverages and exclusions unique to agriculture
- Rating information for more than 300 agricultural classifications

Policies based on these programs can be packaged together to implement comprehensive coverage of today's vertically integrated agricultural operations.

Both programs include provisions addressing personal exposures of individuals residing at the insured location, an enduring feature of agricultural insurance.



To learn more, contact
Rick Maka, director of marketing,
at rickm@AAISonline.com
or by calling 800-564-AAIS.

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www.AAISonline.com

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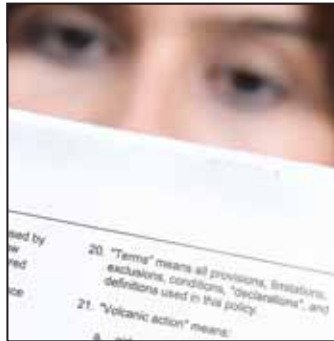
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What makes a policy ‘readable’?

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Works in Progress

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It’s rare that insurers find themselves fighting to maintain coverage that some of them, at least, intended to provide.

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Chinese Drywall

You may have read that 14 U.S. commercial insurers have been served with a complaint related to coverage for defective drywall. You might say that free trade itself is on trial.

No matter what is litigated or settled in U.S. courts, the case is overshadowed by the specter of Taishan Gypsum Co. failing to answer a summons from a 14

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[From the editor]

*If you don't want to read this magazine, I have a problem.
If you don't want to read an insurance policy, that's understandable.
However, as a property/casualty professional, as I presume most of my
readers are, you, of all people, should know the importance of actually reading
the policies you purchase.*

*That's becoming easier to do as regulators and policy form developers
continue to explore ways to make policies more understandable to the average
reader, as we describe in our cover story.*

*Support for policy rating is another function of advisory organizations
like AAIS.*

*To that end, the 2010 AAIS Main Event executive conference will provide
practical insights on the "real world" considerations insurers face when they
utilize data-based decision making in their underwriting and rating.*

*A highlight of the program will be a presentation by AAIS staff on our
initiative to develop by-peril rating plans. You won't want to miss that.*

*In addition, there will be a special inland marine track on the second day of
the conference for people who are specialists in the line, as well as for P/C
executives and managers who want to know more about inland marine.*

*This conference is a truly important event for AAIS member companies, and
I hope to see you April 11-13 in Fort Myers.*

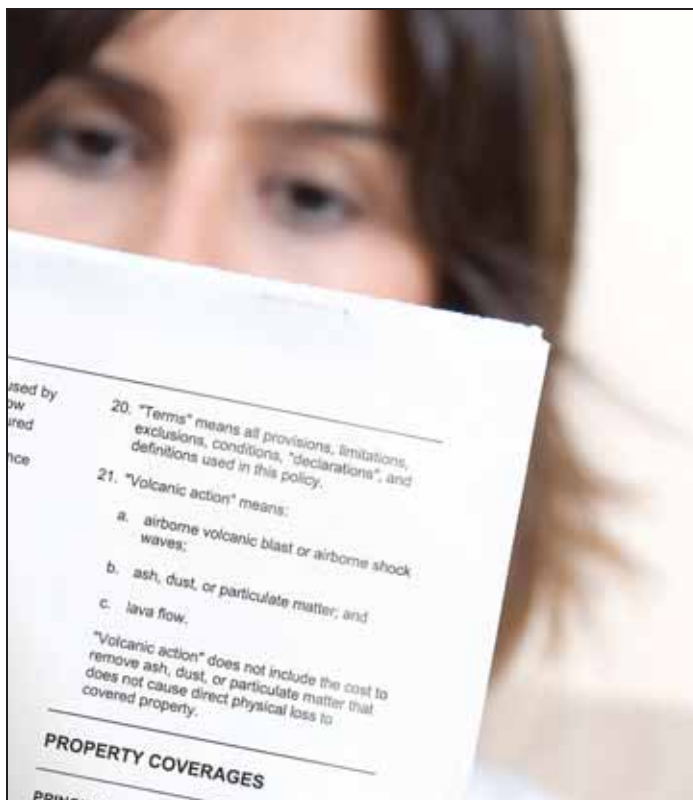
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What makes a policy READABLE?



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It's been more than 30 years since the first standardized "easy read" homeowners policies were developed, yet property/casualty policies continue to be among "the least-read best sellers," as the saying goes.

Whether policies are read or not, state regulators have an abiding concern that they be written in plain, clear language understandable to the average person.

Today, 20 states have statutes or regulations mandating certain levels of "readability" in

personal lines. Only five have them for commercial lines, but three of those five-- Florida, Michigan, and New York--account for a large share of commercial lines business.

Even if most states don't have readability standards, those that do effectively exercise countrywide impact, given that the policy forms developed by carriers and advisory organizations are built on a countrywide base. A stringent state standard can become, in effect, a national standard.

Moreover, the National Association of Insurance Commissioners (NAIC), maintains a working group on readability, and some states have their own counterpart working groups.

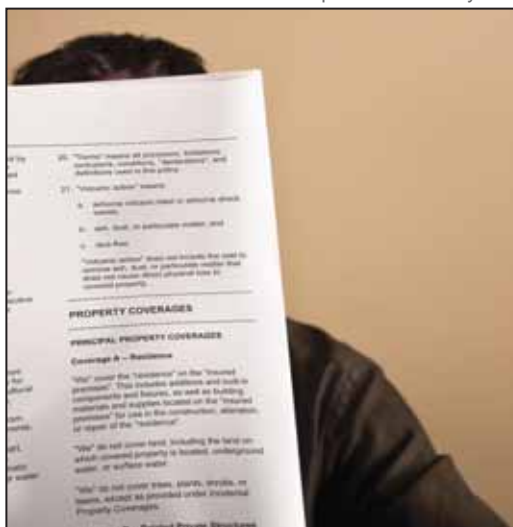
Larris Larsen, AAIS assistant vice president for compliance, was recently named a member of a P/C readability working group of the Wisconsin insurance department.

Objective

Thanks to readability standards, P/C policies are generally easier to read and understand today than they were 35 years ago, even as the properties and liabilities they insure have become more complicated and technical.

What's clear to one person may not be clear to another, of course, and it's not easy to come up with an objective standard for what makes a policy "readable."

The standard typically used for readability guidelines in those states that have them is the "Flesch" score, a number between 0 and 100 derived primarily from the number and length of words in the sentences of a passage. The



“ Insurance policies inherently deal with complicated legal concepts.”

— Thomas Mallin, President and CEO
Property Loss Research Bureau

higher the Flesch score, the easier a passage is to read, supposedly. (Flesch score calculators are available as features of Microsoft Word and other word processing programs.)

However, Larsen says that, “higher Flesch scores do not automatically result in more understandable policy language.”

“The scoring formula favors words of no more than two syllables and short sentences,” he says. “However, the use of short words and sentences does not ensure readability.”

To illustrate his point, Larsen shows that an exclusion in an AAIS agricultural form got a Flesch score more than double its original simply by changing the format of six words, with little overall impact on readability (see sidebar on page 5).

“Higher Flesch scores can be achieved without actually improving the understandability of the policy language,” Larsen says.

Content

That would come as no surprise to Thomas Mallin, president and CEO of the Property Loss Research Bureau, an organization that reviews policy forms and endorsements for clarity.

“It is easy,” he says, “to construct a document that scores high on a reading-ease formula but is composed entirely of properly punctuated nonsense syllables.”

More importantly, says Mallin, “reading-ease tests don’t take the content of the material into account.

“Insurance policies inherently deal with complicated legal concepts.”

The application and restriction of coverage has become increasingly complicated over the past decade, says Larsen, as insurers and advisory organizations have grappled with a growing number of concerns: mold, terrorism, electronic transmissions, new types of motorized vehicles, and more.

“It has become more important than ever to use very exacting language,” Larsen says. “Words of few syllables and short sentences are sometimes not sufficient for specifying the extent of coverage.”

Format

Rather than relying on readability scores, Larsen, Mallin, and others emphasize the format and organization of a policy as more important factors in making it comprehensible to readers.

In a 2006 paper, attorney Louis Long identified “conspicuity” of policy provisions as a critical factor in making policies understandable that was largely overlooked by regulators. (Long is with the Pittsburgh-based firm Pietragallo Bosick & Gordon LLP.)

“Conspicuity is a measure of the visual distinctiveness of a particular text,” he wrote. “It can be ascertained by evaluating the document design (e.g., format, typography,

graphic cues, layout) to identify how well they are orchestrated to render the text visibly present in the eye of a reader.

“Conspicuity plays a critical role in whether the reader notices the information deemed to be important.”

Exposure

Perceived problems with the organization of policies has led to some unanticipated exposures in recent years.

In 1999, the Oregon Supreme Court ruled that a pollution exclusion in a dwelling property form did not apply because, by

“ It has become more important than ever to use very exacting language. Words of few syllables and short sentences are sometimes not sufficient.”

— Larris Larsen
AAIS Assistant Vice President for Compliance

including the exclusion in a section entitled “Perils Insured Against,” the policy did not meet statutory requirements for the placement and formatting of restrictions on coverage.

Ultimately, that ruling led to new regulations in Oregon mandating descriptive headings and complementary formatting. Formatting based on those regulations has been incorporated into forms provided for all states under the AAIS Boatowners, Businessowners, Homeowners, *Inland Marine Guide*, and filed inland marine programs.

The importance of policy formatting was reinforced in a 2004 case, *Haynes vs. Farmers Insurance Exchange*.

In that case, the California Supreme Court ruled that a lower limit for permissive users of an auto could not be enforced because it was not in a place where someone reading the policy would logically expect to find it.

Continued on page 28

Readability Scores: An imperfect measure

The “readability” of an insurance policy is often measured by use of a standardized reading ease scale (see main article).

But, as the example below shows, the reading score for a passage can change dramatically with a few modifications, but with no apparent improvement in how easy the passage is to understand.

In Example 1 below, the provision earns a “Flesch” score of 15, indicating low readability.

But by simple breaking out five of its terms, as seen in Example 2, the Flesch score jumps to 40, more than double, with no change in actual wording and content.

Example 1

The following is added to item 2., Exclusions, under Coverage L -- Bodily Injury Liability and Property Damage Liability.

This insurance does not apply to “bodily injury” or “property damage” arising out of the use of any premises, site, or location for purposes of farm-related education, promotion, recreation, entertainment, or tourism that is undertaken for money or other compensation.

However, this exclusion does not apply to farm-related education, promotion, recreation, entertainment, or tourism activities that are described on the “declarations”.

Example 1

The following is added to item 2., Exclusions, under Coverage L -- Bodily Injury Liability and Property Damage Liability.

This insurance does not apply to “bodily injury” or “property damage” arising out of the use of any premises, site, or location for purposes of farm-related:

1) education:

2) promotion:

3) recreation:

4) entertainment; or

5) tourism

that is undertaken for money or other compensation.

However, this exclusion does not apply to farm-related education, promotion, recreation, entertainment, or tourism activities that are described on the “declarations”.

Works in Progress

“Your work” and “faulty workmanship” exclusions get some new scrutiny

The “subcontractor exception” to the “your work” exclusion is one of the most litigated provisions of policies that provide general liability coverage for contractors and artisans.

Insurers are accustomed to courts finding coverage under policies that was not intended.

It’s rare that insurers find themselves fighting to maintain coverage that some of them, at least, intended to provide.

But, that’s the case in regard to exceptions to “your work” and “faulty workmanship” exclusions in policies that provide general liability coverage.

Insurers that write contractors and artisans may have thought that their insureds were protected for faulty workmanship by subcontractors, but recent court cases have thrown that into doubt.

As a result, several insurers have filed endorsements seeking, in effect, to preserve the coverage. AAIS has provided sample endorsement language to one member company that requested it, but does not contemplate filing action at this time.

Once again, the line between “business risk” and “fortuitous loss” is being re-examined.

Background

The “subcontractor exception” to the “your work” exclusion is one of the most litigated provisions of policies that provide general liability coverage for contractors and artisans.

Before the exception was introduced, GL coverage for artisans and contractors was written on the premise that it could not serve as a performance bond for workmanship.

Accidental damage to other property, arising from negligence of the insured, could be covered as the type of fortuitous loss contemplated under GL coverage. But damage

to or flaws in work done by or on behalf of the insured was to be retained by the insured as a “business risk.”

That changed somewhat in the mid-1970s with the introduction of the “broad form property damage endorsement” by the Insurance Services Office (ISO), then based in New York City, now in Jersey City, N.J. That endorsement introduced an exception to the “your work” exclusion for damage arising from work of an insured’s subcontractor.

The exception was incorporated into standard general liability policies in the mid-1980s, but the intent has apparently not been universally accepted by insurers.

What’s an insurer to do when it objects to certain applications of standardized wording?

Regulators may not accept more restrictive alternatives. Even if they did, agents and brokers may balk at selling policies that did not include a standard provision.

In the case of “your work” exceptions, some carriers have challenged coverage for claims over subcontractor work. Among other things, insurers argued that “your work” exceptions violated legal standards of insurance by, in effect, creating a warranty for the work of subcontractors.

Those objections were, for the most part, overruled on the basis of the plain reading of the exceptions. But another line of attack may hold more promise for carriers seeking to limit the application of your-work exceptions.

Occurrence

A more recent argument holds that the faulty work of a subcontractor, in and of itself,



does not meet the definition of “occurrence” needed to trigger general liability coverage.

As of 2007, some courts had agreed, although not a majority, according to Tampa-based attorneys R. Steven Rawls and Rebecca Applebaum, co-authors of an article on the topic found at www.IRMIONline.com.

“Several jurisdictions adhere to the position that faulty completed work is not an occurrence,” they wrote. “These jurisdictions similarly find that . . . the general contractor has accepted the subcontractors’ work and incorporated it into its own finished product.”

Even in those jurisdictions with a more restrictive reading of the “your work” exception, however, there was a good chance a court would find coverage for *damage to other property* besides that being worked on by a subcontractor.

Thus, it came as something of a shock when a lower court in Pennsylvania ruled in December 2007 that there was no distinction between insuring a subcontractor’s faulty work and damage to other property arising from that work.

The court upheld the insurer’s decision to deny coverage, and the Pennsylvania Supreme Court essentially upheld the ruling by declining to hear an appeal of the case.

“The practical effect of [the case] has been to preclude coverage under Pennsylvania law for the foreseeable consequential damages that are caused by faulty workmanship,” wrote attorney Randy Maniloff, of the Philadelphia firm White and Williams LLP, in December 2008.

Endorsements

Another practical effect of the ruling is to prompt a series of company filings in Pennsylvania. They implement endorsements that explicitly state that the term “occurrence” includes property damage to “your work” arising from work performed on the insured’s behalf by a subcontractor; property damage is included in the “products-completed operations hazard.”

According to Tony Leist, AAIS assistant vice president, commercial lines, carriers are preparing the optional endorsements to allow agents to provide their contractor customers with coverage they have come to expect.

By putting the coverage into an endorsement amending the definition of “occurrence,” carriers can choose for themselves whether to grant the coverage or not.

“Several jurisdictions adhere to the position that faulty completed work is not an occurrence.”

— Attorneys R. Steven Rawls and Rebecca Applebaum

For those companies that want to exclude exposure to claims arising from subcontractors, AAIS provides two endorsements for doing so under its Artisans, Businessowners, and Commercial Liability programs.

One endorsement amends the “your work” exclusion by deleting the subcontractor exception entirely; the other deletes the exception only for locations or projects identified on a schedule that accompanies the endorsement.

Inland Marine

AAIS faces a different situation regarding two of the construction classes for inland marine insurance: Installation Floater and Riggers Insurance.

Installation floaters cover loss to property that is being installed at a location; riggers insurance covers loss to property that is being hoisted into position. One or both of the coverages might be used to insure, for example, an air-conditioning unit being hoisted and installed on top of a building.

Under both classes, coverage is traditionally written as open-perils first party property coverage, and the coverage for property of others is triggered regardless of whether the insured is at fault. (The AAIS Riggers Insurance forms also include a form for covering legal liability, however.)

As with most first-party forms, the AAIS base forms for Installation Floater and Riggers Insurance include an exclusion for “faulty, inadequate, or defective . . . workmanship,” among other causes of loss.

Recently, some AAIS affiliates have

expressed concern that the exclusion, if interpreted broadly, would substantially reduce coverage under the two classes. As it is, most losses under installation floaters or riggers insurance are the result of some error or miscalculation by the insured.

Some form of the exclusion is needed to preclude coverage for damage caused by a defect in the property that is being hoisted or installed, says Robert Guevara, AAIS vice president of inland marine.

Still, he adds, “I understand how agents and claims adjusters might read this exclusion too broadly.

“Since most losses involve operator error, applying the exclusion to errors during installation would eliminate most claims and the need for the coverage.”

The answer, he says, may be to revise exclusions so they continue to exclude coverage for losses arising from defects of the insured property itself, but provide coverage for losses that result from accidents that occur when hoisting or installing it.

AAIS affiliated companies in affected lines will be notified by bulletin of filing action addressing “your work” and “faulty workmanship” exclusions. ■

Equipment Breakdown in Construction

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If you imagine a sparkling new building or renovation as a crown, the crown jewels would be the equipment installed to heat it, cool it, or perform other functions for the structure itself or the enterprise that occupies it.

It is, then, easy to imagine the chagrin—to put it mildly—that would follow a loss to a project after machinery or equipment explodes or bursts.

At worst, such an event could produce a catastrophic loss to life and property. At best, a project will be delayed as the stricken equipment is removed and replaced and other damage repaired.

And, the property losses might not be insured if equipment breakdown coverage is not in place.

In the absence of equipment breakdown coverage, an equipment loss would have to be absorbed by the contractor or project owner, or subjected to costly, contentious, and time-consuming property and/or liability claims among different parties.

Standardized

Standardized equipment breakdown coverage is now available for construction projects through endorsements provided in the Builders Risk section of the AAIS *Inland Marine Guide*. Equivalent endorsements are slated to be released in the *Guide's* Installation Floaters section.

The *Inland Marine Guide* is an industry leading resource of forms, rating procedures, underwriting guidelines, and other information for the traditionally nonfiled classes of inland marine insurance. (*Guide* forms and rating procedures are filed, however, in certain states that do not exempt inland marine insurance from filing requirements.)

Builders risk is the form of insurance that covers buildings under construction or renovation. Coverage applies to the structure or part of a structure being worked on, and

“ Most equipment breakdown exposures in construction are weighted toward the end of a project.”

— Lisa Phillips
HSB manager of product design

materials to be incorporated into the work, and typically ends when the property owner occupies the unit.

Installation floaters cover property that is being installed in a structure, such as an HVAC unit or other types of fixtures. Coverage applies to the property being installed, and typically ends when the installation is complete and the owner takes control of the property.

Collaboration

AAIS’s inland marine equipment breakdown endorsements were developed in consultation with The Hartford Steam Boiler Inspection & Insurance Co. (HSB), a leading provider of equipment breakdown reinsurance.

AAIS and HSB have collaborated in the past on the development of equipment breakdown coverage under AAIS personal, commercial, farm, and output programs.

AAIS equipment breakdown coverages can be used with any equipment breakdown reinsurer, however.

“Equipment breakdown losses during construction projects are not all that different from those in finished structures,” says Lisa Phillips, HSB manager of product design. “But the hazards and exposures are different.”

According to Phillips, equipment breakdown losses in construction are very often related to the new and untested nature of equipment in a new setting.

Besides power surges, she says, the principal causes of accidents within covered equipment on jobsites are improper wiring, installation, and calibration of equipment, incompatibility of the equipment with other components of the structure, and lack of knowledge about the equipment’s operation and maintenance.

“Most equipment breakdown exposures [in construction] are weighted toward the end of a project,” she adds, “since this is when most systems are first started and tested.”

AAIS and HSB offer special presentation following IMUA meeting

A construction project can be seriously delayed and/or thrown off budget if important equipment being installed breaks down during construction. Who bears the loss for that?



The morning after the conclusion of the 2010 IMUA Annual Meeting, two inland marine experts will discuss the growing importance of equipment breakdown insurance on construction projects.

The presentation will take place **Wednesday, May 19**, at the Kingsmill Resort, Williamsburg,

Va., site of the IMUA conference.

Attendance is free of charge to all IMUA members; breakfast will be provided. To **reserve a spot**, contact Sheila Morris, AAIS manager of inland marine, at sheilam@AAISonline.com, or by calling 800-564-AAIS, ext. 286.

Lisa Phillips, product design manager for Hartford Steam Boiler, will discuss how to identify and underwrite equipment breakdown exposures on jobsites.



As product design manager, Lisa is responsible for developing and maintaining equipment breakdown policy language for HSB’s direct and reinsurance assumed business. Before taking her current position in 2008, Lisa worked as a policy analyst, underwriter, and claims adjuster for HSB.

Robert Guevara, AAIS vice president of inland marine, will describe new equipment breakdown coverage forms developed in consultation with HSB for the Builders Risk and Installation Floater classes in the AAIS *Inland Marine Guide*.



Bob has been with AAIS since 1992, and has 18 years’ experience as an inland marine manager at the branch, regional and home office level for companies such as CNA and Zurich American.

“ Testing coverage can now be provided as part of the more comprehensive equipment breakdown coverage.”

— Robert Guevara
AAIS vice president
for inland marine

Given that, equipment breakdown losses in construction often result in a delay in completion of a project; there is less time to make up for a delay. As a result, additional construction and “soft” costs typically result.

Endorsement

The equipment breakdown coverage endorsement introduced in the AAIS Builders’ Risk forms in 2008 provides standard equipment breakdown coverage for losses arising from “accidents” within covered equipment, defined as equipment that generates, transmits, or utilizes energy, or which operates under vacuum or pressure. To be covered under the endorsement, such equipment must be described as covered property in the base builders’ risk form.

The endorsement covers direct physical damage by an accident to a covered project or structure, including materials to be incorporated in the structure, up to a limit stated on an accompanying equipment breakdown schedule, or up to the base policy limit, if selected by the insurer.

If delay in completion coverage is endorsed onto the base builders’ risk policy, it can be extended to equipment breakdown losses, up to the delay in completion limit or a separate delay limit on the equipment breakdown schedule.

Testing

The AAIS Builders’ Risk equipment form also includes coverage for losses due to “testing,” described in the form as the “start-up, performance, stress, pressure, or overload testing of covered property,” including, but not limited to, covered equipment subject to the equipment breakdown coverage.

Testing coverage has long been built into builders risk and installation floater forms, but the new AAIS forms take a different approach.

“Testing coverage can now be provided as part of the more comprehensive equipment breakdown coverage, or it can be provided in

the traditional sense by another new endorsement drafted for that purpose,” says Robert Guevara, AAIS vice president for inland marine and the principal developer of the *Inland Marine Guide* forms.

Under the equipment breakdown form, testing coverage is provided up to the equipment breakdown limit selected; under the stand-alone testing endorsement, coverage is provided up to a limit identified on the endorsement.

Limitations

The AAIS equipment breakdown endorsements include three provisions designed to help insurers control their exposure to equipment breakdown.

A “suspension” condition allows the insurer to suspend equipment breakdown coverage if it discovers covered equipment to be in or exposed to a dangerous condition.

In addition, there are two exclusions, one for any losses arising from defects, errors, or other conditions involving data or software, and another for losses arising from the “misalignment or miscalibration” of covered equipment.

However, both of those exclusions include exceptions preserving coverage for loss, damage, or expense arising from an accident within covered equipment.

“Buildings are ‘smarter’ today, and computers are more prevalent in the systems that become a permanent part of the buildings,” says Phillips at HSB. “It is not the intent of equipment breakdown coverage to pay for data and software losses, except when an accident results.”

As for the misalignment or miscalibration exclusion, Phillips explains that “many pieces of equipment can stop functioning for the reasons outlined in the exclusion without suffering physical damage.

“We have found insureds submitting these types of claims, and this clarification will help in the claims process.” ■



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sales@garvin-allen.com www.garvin-allen.com



Chinese Drywall

A threat to commercial insurers-- and to free trade

You may have read that 14 U.S. commercial insurers have been served with a complaint related to coverage for defective drywall. You might say that free trade itself is on trial.

No matter what is litigated or settled in U.S. courts, the case is overshadowed by the specter of Taishan Gypsum Co. failing to answer a summons from a U.S. court.

Taishan is owned by the government of the People's Republic of China, and it is the largest Chinese manufacturer of drywall accused by many in the U.S. of causing ailments in humans and damage to property.

Taishan's stance, to date, makes real a fear that many had anticipated: What happens if the ultimate source of a loss is inaccessible? How is the loss then shared?

Problem

Large amounts of drywall were imported from China during the U.S. housing boom of the 2000s and installed in housing throughout the U.S., particularly in the Southeast.

Around the middle of the decade, people in homes with Chinese drywall began to complain of headaches, watery eyes, sore throats, and other symptoms, and that copper wires and air-conditioning coils were becoming tarnished and corroded.

Still, it is not entirely clear to what extent "Chinese drywall" is a hazard to humans and property.

Two reports issued by the U.S. Consumer Product Safety Commission (CPSC) in late 2009 are a study in contrasts.

One, done in conjunction with the U.S. Environmental Protection Agency, said that reportedly elevated levels of certain chemicals associated with drywall imported from China did not pose a risk to health or property. The elevated levels were found in homes with and without Chinese drywall.

A week later, however, another CPSC-commissioned study reported that there was a link between the presence of drywall imported from China and corrosion of metal components in homes.

The second report also reported that the chemicals appeared "below irritant levels" for humans in the homes studied, but added that "it is possible that the additive or synergistic effects of these and other compounds in the subject homes could cause irritant effects."

If chemicals emitted from drywall are a problem, the problem may not be limited to drywall imported from China. A suit filed in Florida claims that sulfide gases similar to those allegedly emitted by Chinese drywall were also emitted by drywall manufactured in Canada by a U.S. company.

Damage

While the physical effects of defective drywall are still to be determined, its economic effects are clear.

Problems blamed on drywall forced one major Florida developer, WCI Communities, into bankruptcy and forced another, Lennar Homes, to replace drywall in scores of homes.



Hundreds of other developers and contractors are likely to face claims in the coming months and years.

There are reports that homeowners have filed claims under their homeowners insurance policies, presumably for property damage (corrosion) arising from a peril not excluded (presuming that most homes affected are insured for open perils).

There are no reports of judgments against homeowners carriers at this early stage, and homeowners insurers have several lines of defense against such claims:

- “Wear and Tear” exclusions explicitly exclude building property coverage for “latent defect, inherent vice, or any quality . . . that causes it to damage or destroy itself.” Also excluded is “rust or other corrosion . . . “
- “Errors, Omissions, and Defects” exclusions explicitly exclude coverage for losses that result from defects or inadequacy in workmanship or materials.
- Pollution exclusions have been broadly interpreted in recent years to exclude coverage for any type of irritant.

Vulnerabilities

There may be vulnerabilities to these defenses, however, according to Charles Miller of the Insurance Law Center, Berkeley, Calif.

In a report to the recent winter meeting of the National Association of Insurance Commissioners, Miller said that wear and tear exclusions may not apply if the drywall is not damaging itself but other property.

He added that many courts have found that pollution exclusions in homeowners policies apply only to environmental damage as traditionally understood.

Even if Miller is correct, homeowners insurers would only be responsible for repairing or replacing property damaged by an insured peril. Unless there is truly a stunning verdict, homeowners carriers should not be on the hook for wholesale replacements of defective drywall.

The Insurance Information Institute notes, however, that homeowners insurers could face more substantial claims if large numbers of homeowners abandon homes with defective drywall. If that happens, there could be an increase in the number of ensuing losses due to fire, theft, vandalism, and other causes.

A recent class action suit related to defective drywall named more than 600 defendants, including lumber suppliers, property management firms, and real estate agents, as well as builders.

“ Forcing the builders and other defendants into financial ruin will accomplish nothing for the homeowners.”

— Christopher Burton, CEO
National Construction
Warranty Corporation

Also, United Policyholders, an NAIC-funded consumer advocacy group, has suggested that homeowners insurers cover claims arising from Chinese drywall, then subrogate against entities found to be responsible.

Commercial

Clearly, if the U.S. property/casualty industry is greatly impacted by losses arising from defective drywall, it will be in commercial lines.

The potential losses are staggering, as the cost of gutting a house and replacing drywall can be almost as much as the cost of rebuilding it entirely.

Given that most major manufacturers of problem drywall have been unresponsive, the U.S. courts may be left to determine the share of professional, contractual, and general liability to be borne by U.S. building contractors and their insurers. (One China-based company, the internationally owned Knauf Plasterboard Tianjin Co. Ltd., has responded to summonses.)

General Reinsurance reports that a recent class action suit related to defective drywall named more than 600 defendants, including lumber suppliers, property management firms, and real estate agents, as well as builders.

Attorneys H. Lockwood Miller and George Kelman, writing in a publication of the Defense Research Institute, state that plaintiffs' claims in individual suits and class actions “are based on a variety of legal theories, including product liability, negligence, breach of implied and express warranties, breach of contract, violation of consumer fraud laws, fraudulent concealment/misrepresentation, and private nuisance.”

While the claims pile up, there appear to be no definitive rulings to date on how standard liability policies should respond to drywall claims.

In one of the earliest cases, filed in a federal court in Virginia in April 2009, Builders Mutual Ins. Co., Raleigh, N.C., invoked the “your work” and pollution exclusions to deny defense and indemnification coverage to a Virginia developer.

“The off-gassing of sulfur compounds from the Chinese drywall clearly constitutes the ‘actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of pollutants,’” Builders Mutual argues in its pleadings. “The compounds, which are known to be contaminants and irritants, clearly come within the definition of pollutants.”

In response, the developer is alleging bad faith by Builders Mutual. To date, there has been no ruling.

Causes

Perhaps the biggest act in the drama will take place in the U.S. District Court for eastern Louisiana. That’s where the WCI Drywall Trust, created to assume the drywall-related liabilities of a developer bankrupted by the problem, has sued the 14 commercial insurers.

The complaint, lodged on behalf of owners of WCI-built homes, claim bodily injury and property damage, which would trigger a response under general liability policies.

In addition, a homeowners’ class action suit against WCI and other developers argues that the drywall rendered their homes “essentially uninhabitable,” raising the question whether there might be personal injury exposure for loss of use and enjoyment of private property.

Standard general liability policies limit such personal injury coverage, however, to “invasion of the right of private occupancy” committed by or on behalf of an owner, landlord, or lessor of the premises.

Ultimately, the question in the courts will come down to this: Were the artisans, contractors, and developers who installed defective drywall negligent? Surely they would



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be today if they installed drywall without inquiring into its properties, but can that standard be applied to a time when no one suspected such a problem?

Sharing

What happens if insurers prevail by making the case that responsibility for the effects of defective drywall properly belong to builders and contractors as a business risk?

They may well be tapped anyway for contributions to public programs for correcting the problem.

“Forcing the builders and other defendants into financial ruin will accomplish nothing for the homeowners,” writes Christopher Burton, CEO of the National Construction Warranty Corporation, in a proposal for a class action repair settlement for properties with defective drywall.

Burton proposes a settlement that would establish a government agency program to inspect homes and verify repairs that would be backed by a third party national warranty.

Under the proposal, builders, developers, and homeowners, as well as installers, retailers, and distributors of defective drywall, would each have a share of the cost of the remediation program.

If funds are ever recovered from offshore producers of the drywall, homeowners would be reimbursed.

“By setting aside legal interpretations, jurisdictional disputes and policy language, defendants can participate without exposure to excessive legal costs or inflated jury awards,” he adds.

The rub for insurers, however, is that the proposal would tap insurers for each of the participating parties bearing part of the cost.

Will it be worth it? Only time will tell. ■



The
AAIS
MAIN
EVENT



April 11-13, 2010
Sanibel Harbour Marriott
Resort & Spa, Fort Myers, Fla.

Schedule in brief

Sunday evening, April 11
Opening reception

Monday morning, April 12
Breakfast
Guest/Spouse Breakfast
Business Session

Monday afternoon
AAIS Golf Outing
Cruise on the *Princess*

Monday evening
Reception

Tuesday morning, April 13
Breakfast
Business Session

Tuesday morning-afternoon
Guest/Spouse Tour

Tuesday afternoon
Lunch and annual meeting
Roundtable discussions

Tuesday evening
Reception and Dinner

Harnessing Data for Results

How do you measure success? By results.

The 2010 Main Event addresses timely, practical considerations for utilizing data for highly selective underwriting and differentiated rating.

Our keynote speaker Jeanne Harris, will open the conference with a critical assessment of the benefits and limitations of data-based decisions in business today.

Then Joel Brown, vice president of personal lines for State Auto Insurance, and Greg Hansen, actuarial research leader for Westfield Insurance, will describe what their companies learned as they implemented new approaches to underwriting and rating.

In addition, you'll hear from a leading independent agent Angelyn Treutel as she relates how her agency deals with the impact of company rating plans on customer relations, and from a highly regarded former regulator, Mark Boozell, who will tell you how regulators and legislators are reacting to the growing use of new rating variables.

Charles Chamness, president of the National Association of Mutual Insurance Companies (NAMIC), will speak on public policy and regulatory trends at the state and federal level, including the impact of federal health policy on property/casualty insurers.



Jeanne Harris



Joel Brown



Greg Hansen



Angelyn Treutel



Mark Boozell



Charles Chamness

AAIS Action: By-Peril Rating by us, for you

Who would have thought that protection class is much less of a factor in fire loss than long believed? That's just one of the things AAIS actuaries learned as they developed the foundation for AAIS's new and innovative by-peril rating plans, to be introduced in homeowners and carried over to other lines.

Greg Jaynes, AAIS chief actuary, Deborah Summerlin, vice president of insurance lines, and Susan Luecke, assistant vice president for personal lines, will describe how by-peril rating can play a key role in selecting and pricing your risks and, by doing so, help you reach your goals for growth and profitability. You'll learn what the "winners" in today's market are doing to stay competitive.

Among other things, the presentation will include a description of the upcoming AAIS Homeowners rating plan, and research findings that challenge conventional wisdom about rating variables. You won't want to miss this.



Greg Jaynes



Debi Summerlin



Susan Luecke

Your Turn: The Roundtable Discussions

The business program of the Main Event concludes with breakout roundtable discussions led by AAIS staff members. This year's sessions and topics include:

- Executive, led by Paul Baiocchi, president (topics to be determined)
- By-peril Rating, led by Greg Jaynes, Sue Luecke, and Debi Summerlin (see above)
 - Customizing the rating plan
 - Managing renewal impact
 - Managing overall performance of the plan
- Inland Marine, led by Robert Guevara, vice president of inland marine
 - Commercial Output form changes and challenges
 - Changes to the Installation Floater class
 - Revising and simplifying the EDP forms
 - Information on cargo filings with departments of transportation
- Farm & Ag, led by Sherry Taylor, manager of farm and agribusiness
 - Form options, policy language, and filing status of the new Ag Excess/Umbrella Program
 - Future enhancements to the AgGL Program
 - Forms structure and coverage features for a new Agricultural Property Program
 - Emerging environmental, political, and other issues



Sherry Taylor

Tuesday, April 13 Inland Marine track

This year's Main Event is adding a special track on Tuesday for inland marine specialists and for P&C executives who want to know more about the line.

Inland Marine at 'C-level'

An overview of current market conditions and the impact of inland marine on company operating results.



Jerry Theodorou

Jerry Theodorou,
Conning & Company

Patrick Carroll, Gen Re



Patrick Carroll

Construction Rehab Projects: A window into Inland Marine

The construction classes account for the largest premium volume in inland marine, and almost every insured account undertakes a construction rehab project at some time.

This session features two inland marine experts describing exposures for rehab projects, and explaining how AAIS's Builders Risk forms help you structure coverage for them.



David Mistick

David Mistick,
Circumspex

Robert Guevara, AAIS
Inland Marine roundtable
(see list at left)



Robert Guevara

For information and to register:
go to www.AAISonline.com or call Joe Harrington at 800-564-2247

The long and short of it

Hurricane models serve different ends for different users

“Near term projections do not have sufficient credibility to be used for important insurance applications.”

— Karen Clark

For the second year in a row, one of the principal developers of catastrophe modeling has questioned one of its most recent applications.

Karen Clark, founder of AIR Worldwide and now principal of her own firm, recently issued her second annual report criticizing the accuracy and utilization of near-term hurricanes employed since the devastating hurricanes of 2004 and 2005.

Shaken by the unprecedented losses incurred during those years, the three major “cat modelers”—AIR, EQECAT, and RMS—introduced near-term hurricane models in 2006 designed to estimate property damage from hurricanes for the period 2006-10.

In contrast to long-term models, which draw upon up to a century’s worth of data on the frequency of hurricanes and their landfall, near-term models rely more heavily on data from warmer periods comparable to the recent past.

“Four years into the five-year projection period, the near term models have not performed well as predictive tools,” Clark writes in her latest report on the topic. According to Clark and others, the near-term models predicted damages of around \$50 billion from hurricanes in 2006-09; instead, they amounted to less than \$14 billion.

“Near term projections do not have sufficient credibility to be used for important insurance applications such as product pricing and establishing solvency standards,” Clark adds.

“The actual results of the last four years indicate that relying exclusively on the near-term models to determine a rate can bring an extra level of instability and volatility to an already challenging pricing exercise.”

Cat modeling firms have disputed her report, with RMS claiming that “probabilistic forecasts” are not intended to predict what will occur in a given five-year period, but to estimate the predicted level of hurricane activity over many such periods.

AAIS use

AAIS members can have confidence in the hurricane modeling used to support its loss costs for catastrophic wind-hail in certain states, says Greg Jaynes, chief actuary.

AAIS uses only the long-term hurricane models, he says, principally because that is all regulators will accept from primary companies and their rating organizations.

“Long-term models produce the most stable results, and bureau rating information needs to be stable,” he says.

Primary carriers can still utilize near-term hurricane modeling in their underwriting, Jaynes notes.

“You can use it to help decide what to write and what not to write,” he says. “It can play an important role in exposure management.”

Customers of AAIS member companies may still see the impact of near-term hurricane modeling, however, in the share of their premium devoted to reinsurance costs.



While regulators prohibit primary carriers from using near-term hurricane models for ratemaking, those models are utilized by unregulated reinsurers, and the share of a rate filing attributed to reinsurance costs is generally approved.

Reinsurance

“Reinsurers and capital providers, as well as rating agencies, usually emphasize the most conservative set of assumptions for the near term,” explains Tony Sammur, president of Gen Re Intermediaries.

“Reinsurers cover extreme events and must be able to withstand ‘black swan’ scenarios,” he says. “Near-term modeling is more suitable for that goal.”

“The question is not whether the insurance industry can operate over 150 years,” says Andy Castaldi, senior vice president for catastrophe perils at Swiss Re. “It’s whether it can operate the next day after an event.

“The near-term models look at the frequency and severity of tropical storms in the climate conditions you’re currently in,” Castaldi says, adding that the earth is currently in a cycle of warmer ocean surface temperatures, which generally create more tropical storms.

“When you try to manage your accumulation of risks, you want to look at the probability of something as close to reality as possible,” he says. “I’d want to know what my ceiling for losses is, not my floor.”

All that said, Sammur adds that “modeling firms never really represented their processes or results as being precise predictors.

“We advise our clients to understand each model’s strengths and weaknesses, and to manage risk accumulations in light of projections from multiple hurricane models.” ■

“ Long-term models produce the most stable results, and bureau rating information needs to be stable.”

— Greg Jaynes
AAIS chief actuary



By Russ Sutter, principal
Towers Watson, St. Louis, Mo.

GUEST ESSAY

Tort costs may be heading up

This is the latest in a series of guest columns by professionals in organizations that have become associate members of AAIS. For information on becoming an AAIS associate member, contact Rick Maka, director of marketing, at rickm@AAISonline.com, or by calling 800-564-AAIS.

This particular column is excerpted from Towers Perrin's latest annual report on U.S. tort liability costs, completed in December 2009, before the firm completed its merger with Watson Wyatt to become Towers Watson.

The 2009 Update on U.S. Tort Cost Trends represents the 13th study of U.S. tort costs published by Towers Perrin.

The first study was completed in 1985. The most recent study, incorporating results through 2007, was published in November 2008.

This update provides results from 1950 through 2008 and projections through 2011, has not been funded nor subject to pre-release approval by any outside organization and was conducted entirely by Towers Perrin.

The purpose of this study is to quantify the costs, not support any particular point of view regarding those costs. Any connotation that an increase in tort costs is undesirable is unintended. Further, we examine only one side of the U.S. tort system - the costs.

No attempt has been made to measure or quantify the benefits of the tort system, or conclude that the costs of the U.S. tort system outweigh the benefits, or vice versa.

Tort costs tabulated in this study reflect all of the various outcomes from an alleged tort.

The tort claim dispute resolution process may be thought of as a continuum. An event causes one party to believe it has suffered damages as a result of the negligence of another party. From that point, the parties attempt to come to a resolution.

However, the two sides often do not easily agree on either the degree of negligence or the amount of damages.

The dispute may be resolved in a number of ways:

- Before a lawsuit is filed, by mutual agreement or through arbitration;
- After a lawsuit is filed, but prior to a trial; or
- As a result of a verdict in a trial (as well as potential subsequent appeal).

TABLE 1: Growth of U.S. Tort Costs and GDP

	Ave. annual inc. in tort costs	Ave. annual inc. in GDP
1951-1960	11.6%	6.0%
1961-1970	9.8	7.0
1971-1980	11.9	10.4
1981-1990	11.8	7.6
1991-2000	3.2	5.4
2001	14.7	3.2
2002	13.4	3.4
2003	5.5	4.7
2004	6.0	6.6
2005	0.4	6.3
2006	-5.6	6.1
2007	2.1	4.8
2008	1.1%	3.3%
58 Years (1951-2008)	8.9%	6.9%

Parties may elect to settle their dispute at any point along this continuum to avoid additional expense or the potential exposure they might face by taking the process to the next stage.

Key findings

U.S. tort costs increased by 1.1% in 2008, as shown in Table 1.

While personal tort costs increased at a rate commensurate with inflation, commercial tort costs fell slightly in 2008.

The U.S. tort system cost \$254.7 billion in 2008, which translates to \$838 per person, versus \$836 per person in 2007. Overall economic growth in 2008 was 3.3%.

As such, the ratio of tort costs to gross domestic product (GDP) shrank in 2008, marking five consecutive years of a decline in the ratio.

Since 1950, growth in tort costs has exceeded growth in GDP by an average of approximately two percentage points.

By many measures, 2008 was a tumultuous year. Here is just a sampling of significant benchmarks:

- The Dow Jones Industrial Average fell 34%.
- The S&P 500 index fell 38%.
- The Nasdaq composite fell 41%.
- The national average price of gasoline went from \$3.11 a gallon in January, up to a high of \$4.25 during the summer, then fell below \$1.70 later in the year.
- The unemployment rate rose from 4.9% in January to 7.2% in December.
- Real GDP growth (i.e., inflation adjusted) was negative for the first time since 1991.

Stock market indices continued to fall during the first two months of 2009, but have recovered significantly since early March. The unemployment rate continued to rise during 2009 and exceeded 10% in October 2009.

Beyond these volatile moves, there was also the takeover of Bear Stearns, the failure of Lehman Brothers and the government bailouts of Fannie Mae, Freddie Mac and AIG.

Finally, late in 2008, the magnitude of the Bernard Madoff scandal became apparent.

Despite the chaos in the financial markets, the tort cost environment in the U.S., in total, was relatively benign.

The increased cost of gasoline led to a decrease in miles driven, putting some downward pressure on both personal auto and commercial auto costs.

Medical malpractice trends continued to be stable.

While there was certainly upward pressure on directors and officers liability costs, overall, this element has been a small component of total U.S. tort costs.

Future implications

TABLE 2: CPI Relative to “Social Inflation”

Years	Average CPI	Average “Social Inflation”
1974-1983	8.4%	5.5%
1984-2008	3.1%	1.4%

We are forecasting growth in U.S. tort costs of 3.0% in 2009.

The continued weakness in the economy will contain auto liability costs again in 2009.

Continued on page 28

Green coverage endorsement filed under Commercial Output Program

AAIS has filed a new optional Green Coverage Endorsement and accompanying schedules under the Commercial Output Program (COP).

The endorsement extends insurance under the COP's property and income coverage parts to three categories of coverage:

- Green Building Coverages, which cover certain costs incurred to comply with "green" construction certification standards developed by organizations promoting environmentally friendly construction.

These include costs incurred to restore indoor air quality, recycle debris, restore vegetative roofs, recertify a structure as green, and replace water or electricity that is lost when onsite renewable energy or water conservation equipment is damaged.

- Non-Green Building Coverages, which cover the costs to upgrade conventional but damaged personal property, finishes, plumbing systems, lighting systems, HVAC equipment, and roofs with property that meets green standards.

These coverages apply only for buildings and structures that do not have a green certification.

- Green Income Coverages, which cover the income cost for the extension of a restoration period due to materials or procedures required to achieve a certification.

This section also covers loss of income incurred when there is damage to renewable energy equipment that supplies power to a public utility.

Unpublished Kansas ruling addresses key definitions under contractors' equipment

In December, users of the AAIS *Inland Marine Guide* received a review and analysis of a ruling by the Kansas Court of Appeals that addresses potential exposure under a contractors' equipment policy.

In the case, the appeals court overturned a summary judgment by a lower court that found no theft coverage under a contractors' equipment policy for stolen air conditioners.

While the insurer argued that the air conditioners were inventory rather than equipment, the appeals court ruled that those categories are not exclusive of each other, and that the air conditioners otherwise qualified as "equipment" used in the insured's operations.

The appeals court opinion is unpublished, meaning that it cannot be used as a precedent. In light of that, AAIS does not plan immediate changes to its Contractors' Equipment forms to respond to the ruling, but the implications of the case will be considered during the next round of general revisions to those forms.

Commercial Lines endorsements exclude information-related liability

AAIS has filed new commercial liability endorsements to exclude coverage for illegal recording and distribution of information.

A new "Information Distribution and Recording Violations Exclusion" was filed countrywide under the AAIS Artisans, Businessowners, Commercial Liability and Commercial Umbrella programs, with a proposed effective date of July 1, 2010.

The mandatory exclusion expands upon and supplants a current optional exclusion entitled the "Telephone Consumer Protection Act (TCPA) of 1991, CAN-SPAM Act of 2003, and Other Information Distribution Violations Exclusion."

In addition to excluding coverage for losses arising from violations of the TCPA and CAN-SPAM Act, the latest endorsement excludes coverage for violations of the U.S. Fair Credit Reporting Act and the Fair and Accurate Credit Transaction Act. The exclusion also extends to any



liability loss arising from the violation of a state or federal law restricting the collection, distribution, or transmission of information.

Other mandatory endorsements are being filed under the AAIS Artisans and Commercial Liability programs.

These would make the endorsed policy excess over any other insurance available to the named insured for premises or operations, completed work, or products liability, if the named insured is an additional insured under the other policy.

Aviva Canada is AAIS's first Canadian Affiliate for the *Inland Marine Guide*

Aviva Canada, Scarborough, Ont., is the first Canadian company to sign up to use the AAIS *Inland Marine Guide*.

Inland marine insurance has been written in Canada since the 19th century, but the line did not receive the intensive development there that it did under unique regulatory conditions in the U.S.

While the policy forms and rating procedures in the *Guide* are developed for the U.S. market, its wordings, rating considerations, and underwriting guidelines can be useful references for companies operating anywhere.

AAIS staff offers webinar on agricultural insurance

Two AAIS staff members will conduct a web seminar on agricultural insurance at 1:30 p.m. Eastern time on Thursday, March 18.

Kirk Hansen, AAIS director of education, and Joseph Harrington, director of corporate communications, will discuss how coverage forms developed by AAIS address property and liability exposures arising from the mechanization and commercialization of American agriculture.

The web seminar is one in a series offered by the Academy of Insurance, established this year by the Insurance Journal. For information and to register for the seminar, go to www.ijacademy.com.



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Web-based rating worksheet for difference in conditions

A new web-based rating worksheet for “Difference in Conditions (DIC)” coverage is available on *AAISdirect* for users of the *AAIS Inland Marine Guide*.

DIC policies provide property coverage for flood, earthquake, and other perils not typically covered under commercial property policies. They are also used to provide excess coverage for such perils if covered in underlying policies, but DIC policies necessarily exclude coverage for fire and standard extended perils. (Otherwise, they would not conform to the Nationwide Definition of inland marine insurance.)

The new DIC rating worksheet was developed using “.net” technology, and provides the following:

- Automatic calculation of loads, charges, and premium;
- Quote summaries prior to printing;
- Ability to save quotes for up to one month; and
- Form fields to document risk features (exposures and loss controls).

Maple Data Technologies develops AAIS application for rating system

Maple Data Technologies, Manalapan, N.J., has developed the first AAIS application for the company’s “R8” (pronounced “rate”) insurance rating system.

R8 is a rating system that can be utilized through a stand-alone web-based interface or integrated into existing company software.

When users provide information on a risk in a defined format, R8 automatically identifies the necessary rates, factors, discounts, and formulas. It then performs calculations and provides final rates.

Users can view and administer rates, accept or reject published changes to rates and algorithms, and modify rates and formulas as needed to support business processes.

Alternatively, R8 can be used to incorporate rating plans and/or rating information from various sources into company rating systems.

The first AAIS applications of the R8 infrastructure, released in January 2010, are for the AAIS Agricultural Output (AgOP) and Agricultural General Liability (AgGL) programs. Maple Data Technologies anticipates developing applications for other AAIS programs in the coming months and years.

For information on Maple Data Technologies and the R8 system, contact Nicholas Teetelli, CEO, at nicholas.teetelli@maple-data.com or by calling 732-863-5523.

ECCA adds two AAIS affiliates; expands service to others



ECCA Payroll + Business Services, Erie, Pa., has added two AAIS affiliated companies for its “Mutual Expert” rating and policy management software:

- Wall Rose Mutual Ins. Co., Aliquippa, Pa., which offers AAIS-based homeowners, mobile-homeowners, farmowners, farm properties, dwelling properties, and personal/premises liability policies.
- Hannahstown Mutual Ins. Co., Saxonburg, Pa., which offers the lines listed above, plus commercial liability, commercial property, businessowners, and home-based business coverage. Hannahstown Mutual has added agency access via Mutual Expert’s “Web Window.”

Two other AAIS affiliates have added new features to their ECCA service:

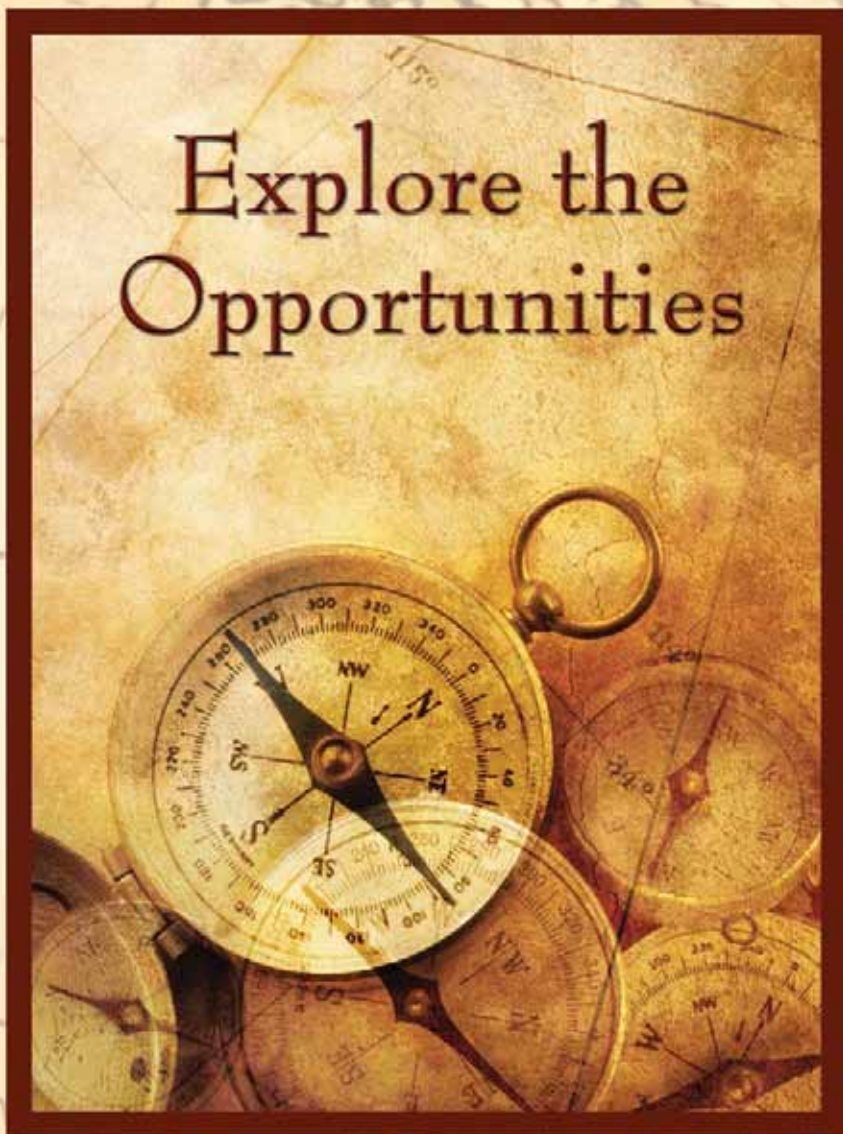
- Juniata Mutual Ins. Co., McAlisterville, Pa., added a document management system interface between Mutual Expert and DocFinity and agency access via Mutual Expert’s “Web Window.”
- Windsor-Mount Joy Mutual Ins. Co., Ephrata, Pa., also added agency access via Web Window plus a document management interface between Mutual Expert and ImageRight.

ECCA is an associate member of AAIS.

For information on associate membership, or to affiliate with AAIS for use of any of its programs, contact Rick Maka at rickm@AAISonline.com or by calling 800-564-AAIS, ext. 222. ■

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READABLE policy, continued from page 5

In an April 2005 publication on the case, General Reinsurance proposes several guidelines for formatting policies to meet the “Haynes test”:

- An informational declarations page, including all coverage limits;
- Informational endorsement listings with descriptive titles, not just form numbers;
- Logical placement of provisions in the policy; and
- Coverage restrictions that are clearly identified and highlighted, with relevant terms explicitly defined.

Contrast

Reading ease formulas, the principle statutory guidelines for “readability,” do not account for the organization of a policy, however.

Stated conversely, Mallin says “there are no demerits under the formulas for scattering coverage limitations over several sections of a policy.”

“AAIS believes that understandability is more important than calculated ‘readability,’” says Larsen.

“While we understand that Flesch scores provide a supposedly objective standard, we believe other factors, such as the arrangement of provisions, are more important for making policies more understandable.”

As a member of the Wisconsin working group on readability, Larsen will be in a good position to promote a more comprehensive view of “readability” than simple reliance on readability scores.

Given that the Wisconsin commissioner sits on the NAIC’s readability working group, Larsen’s insights may resonate nationally. ■

Tort costs continued from page 23

In medical malpractice, while some recent reforms have been overturned or challenged, the trends appear to be remaining modest.

Costs will likely rise in directors and officers liability, particularly for financial institutions.

In addition, employment practices liability (EPL) costs are expected to rise by more than inflation, as layoff activity will likely lead to an increase in allegations of improper actions by employers.

Looking longer term, we see two aspects of late 2008 activity that may have greater impacts on tort costs.

The first is inflation. Spending by the U.S. government has increased dramatically, with sizable growth in the country’s debt and annual deficit.

While inflation remains relatively tame in 2009, we see the potential for a return to inflation levels of the 1970s in a few years. Tort costs will likely increase along with that growth.

In addition, data over the last 35 years show a correlation between monetary inflation (defined as the change in the Consumer Price Index ([CPI]) and social inflation (defined as the change in the average tort cost per person, after adjusting for CPI changes), as shown in the Table 2.

The second aspect is the change in the U.S. presidency and administration from Republican to Democrat.

From 1981 to 2008, in all but two terms (1993-2000), the U.S. was headed by a Republican president. While the presidency itself may not directly influence tort costs, the president’s judicial appointments may have a more meaningful impact.

This 28-year period reflects a shift in judicial attitudes regarding the rights of plaintiffs versus defendants in litigation.

Given the recent change in administration, we envision the possibility of a new era involving an opposite pendulum shift in judicial attitudes and tort cost growth. As a result, we are forecasting higher levels of tort cost growth in both 2010 (4%) and 2011 (6%).

For more information on Towers Perrin’s tort cost studies, please contact Russ Sutter at (314) 719-5834 or russ.sutter@towersperrin.com. ■



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