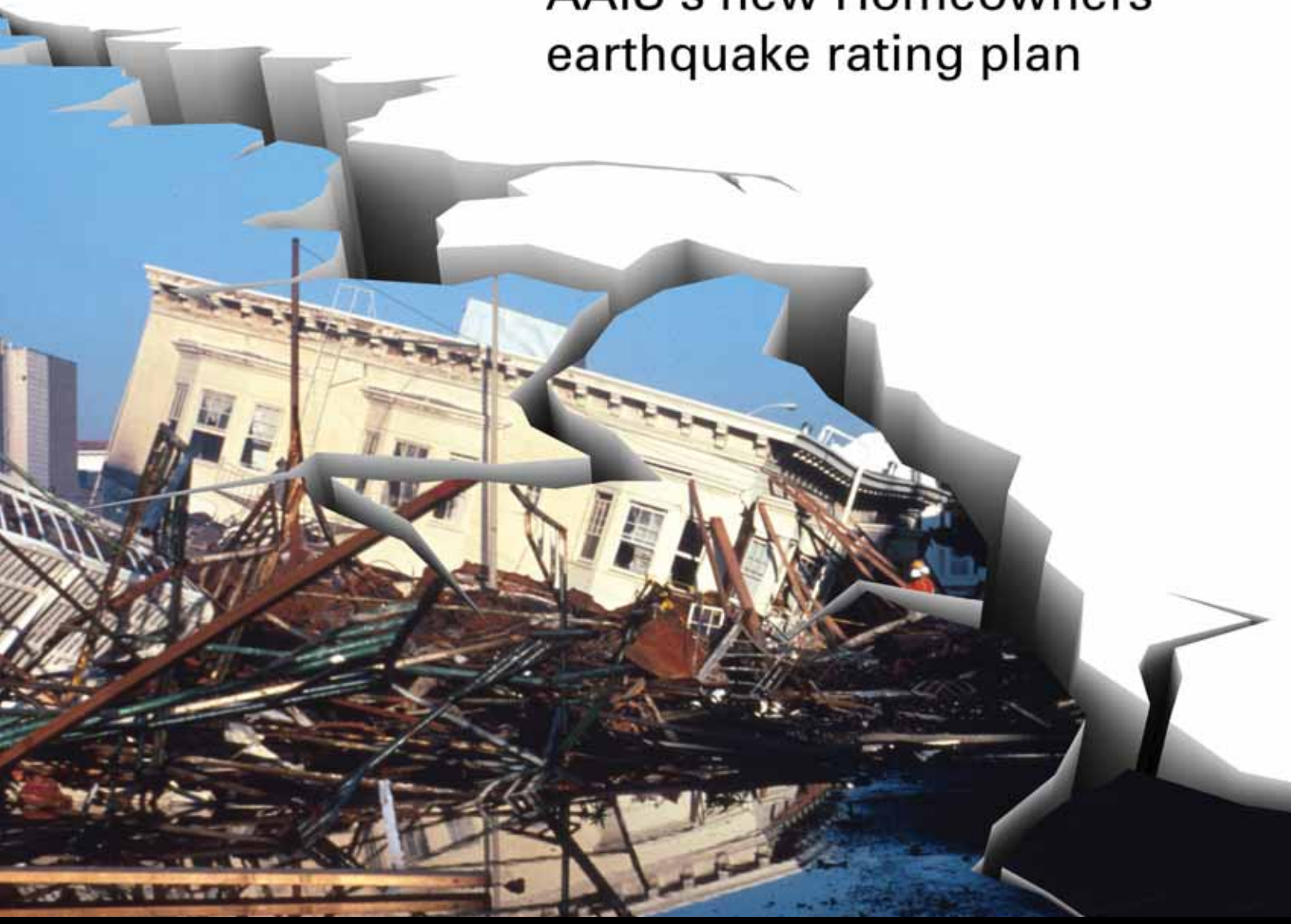
AMERICAN ASSOCIATION OF INSURANCE SERVICES AAIS

Viewpoint

Fall 2009

Tremors and numbers

AAIS's new Homeowners earthquake rating plan



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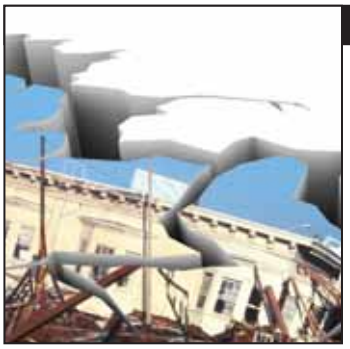

Tremors and numbers
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Articles in *Viewpoint* provide general discussion about topics in property/casualty insurance and AAIS products and services. The content of the articles and accompanying exhibits is not intended to provide definitive information regarding use of AAIS products and services, and in no way alters, supplants, or supersedes what is written in AAIS policy forms, manuals, bulletins, or other forms of information provided as part of our advisory services. Nor does the content of *Viewpoint* articles indicate any official AAIS position on insurance or other issues, unless specifically noted.

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From the president

The growing strategic use of data is creating exciting new opportunities for AAIS and its member companies.

This issue of Viewpoint spotlights two recent developments that demonstrate AAIS's commitment to using data to help our member companies:

- *Our new Homeowners earthquake rating plan, which combines modeled data and AAIS actuarial expertise in an easy-to-use procedure for rating earthquake exposure more accurately ; and*
- *Our license of the "Pretium" software platform from the world-renowned actuarial consulting firm, Watson Wyatt. Pretium will allow us to use the capabilities of SAS statistical software to identify and develop new rating variables.*

As a licensed statistical agent for many years, AAIS has a great deal of experience collecting and processing insurance statistical data submitted by our affiliates.

While traditional statistical data will remain central to our operations, we are also acquiring other types of data and developing a repository of data and analytical tools for research, underwriting, risk assessment, ratemaking, and other purposes.

As we go forward in this regard, AAIS will be utilizing increasingly more sophisticated methods to analyze large amounts of data and extract important intelligence from it. Our focus is to identify factors that are truly predictive of loss and isolating them from statistical "noise" that is irrelevant or redundant.

All of this serves our one, overriding mission: To help companies compete.

Paul Baiocchi, CPCU
President and CEO

A year ago, *Viewpoint* readers were informed that one of our AAIS colleagues, Nathan Westby, was being deployed to Afghanistan as a captain in the Illinois National Guard.

We're happy to report that Nate returned safely after an arduous year supporting Afghan police forces, and is back at work as a senior programmer analyst in our information services department. Fortunately, Nate's unit suffered no deaths, but one member was wounded. To date, 18 Illinois guardsmen have been killed in Afghanistan. We are grateful for Nate's return, and our thoughts and prayers go out to the families of those who did not.

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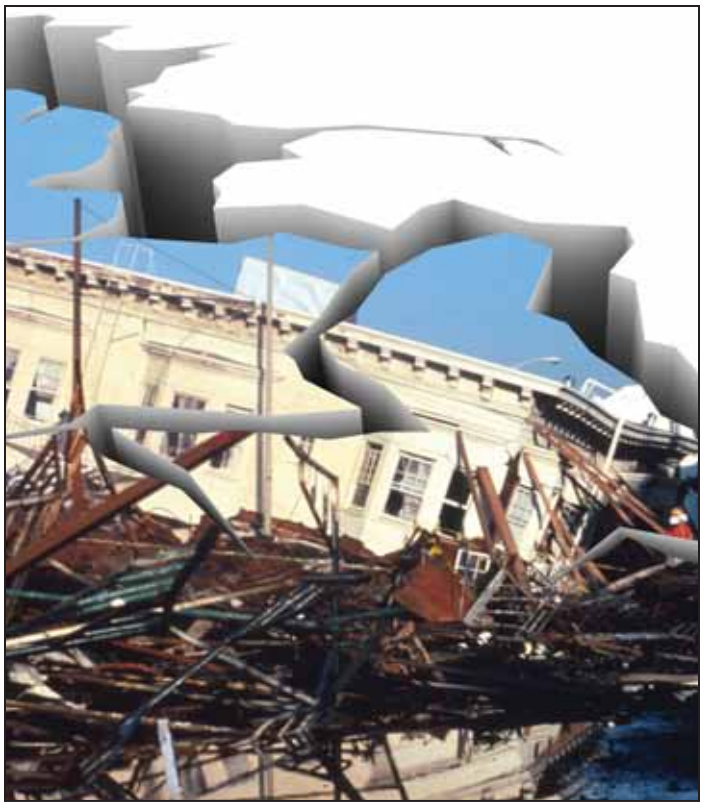
Tremors and numbers

AAIS's new Homeowners earthquake rating plan



Because of the low frequency but high severity of earthquake losses, homeowners insurers have long found it uniquely difficult to rate earthquake coverage.

In most states, historical loss data, on its own, provides little or no indication of what losses might be if an earthquake struck.

Things have changed, however, with the growing sophistication of catastrophe models. By applying mathematical algorithms to data on seismic conditions and building characteristics, these models can project the level of losses likely to occur in defined areas from earthquakes of certain magnitudes.

Modeled data lies at the core of AAIS's new Homeowners earthquake rating plan, but that's only the beginning.

> "This new rating plan includes features not found in other standardized programs."
>
> *— Greg Jaynes*
> *AAIS chief actuary*

AAIS actuarial staff has built on that data to develop loss costs and rating factors that will allow most carriers to price earthquake exposure more precisely than they have ever been able to do.

That, in turn, could make earthquake coverage a lot more attractive to homeowners who need the coverage more than they think, but who might pay less than they anticipated.

This opportunity for enhanced spread of risk for a catastrophic peril is available to all insurers, whether they currently use AAIS programs or not.

The latest Homeowners earthquake rating plan is available for use by any insurer as a self-contained manual supplement of rules, rating zones, loss costs, premium modification factors, and supplementary rating information.

The plan features state-specific loss cost base amounts and rating factors that vary by rating zone to reflect a risks's location and type

New homeowners earthquake rating simple but precise

While the new AAIS Homeowners earthquake supplements expand the number of price points for policies within a state, they do so while maintaining a relatively simple procedure for rating policies.

- For each state, the **supplements provide six base loss costs**, to be chosen as applicable: one for most owner-occupied forms; one for tenants and unit-owners forms; one for additional building coverages and options; one for higher personal property limits; one for higher loss of use limits, and one for association deductible and loss assessment coverage.
- For owner-occupied forms, the **building property base loss cost is multiplied by the building property limit, then modified** by a "frame factor" (if the residence is of frame construction), an "HO 0005" factor (if the policy is based on that form), and a deductible factor (per zone).

  The **results for the owners forms are modified** by factors based on number of stories, age of home, and in some cases, loss mitigation features.
- Similarly, **other applicable base loss costs are multiplied by limits** for related private structures, ordinance/law coverage, and tenant's improvements, and by any increases in limits over standard ratios for personal property or loss of use. (Under the tenant's form, the personal property limit is used.)

  The **results are modified** by factors for frame construction (if applicable) and deductible.
- The premium charges developed in the steps above are added together.
- Similar procedures are used to arrive at modified loss costs for association deductible and loss assessment coverage under unit-owners forms.

In all, the new AAIS earthquake rating procedure utilizes six tables, none of them bigger than half a page, yet, taken together, they can establish hundreds of price points per state.

of construction, as well as the policy form, amount of insurance, and deductible.

"This new rating plan includes features not found in other standardized programs," says Greg Jaynes, AAIS chief actuary.

"Among other things, we have developed premium credits for frame construction, which is generally more flexible than masonry construction and, therefore, more resistant to earthquake damage. These 'frame factors' vary by earthquake zone for greater accuracy.

"We've also introduced rating factors for the age of a structure and the number of stories, as well as premium credits for certain loss mitigation features on older homes."

Cat model

AAIS utilizes the U.S. earthquake catastrophe model developed by EQECAT, Inc., Oakland, Calif., to generate the modeled data used to develop the base loss costs for the plan.

EQECAT is one of the world's first and leading developers of catastrophe modeling applications. Its U.S. earthquake model has undergone independent review by the U.S. Geological Survey, California Geological Survey, and Pacific Earthquake Engineering Center, and the California Earthquake Authority has declared it to be "state of the art" and suitable for public rate filings.

> "Homeowners carriers of all sizes can benefit from this innovative and practical approach to rating earthquake coverage."
>
> *— Paul Baiocchi, AAIS president and CEO*

"In general, the use of modeled data has produced little change on aggregate levels of loss costs for states overall," says Jaynes, "but they provide a better spread of earthquake pricing among high, moderate, and low risks for earthquake loss within states."

Among other things, the use of modeled data has allowed AAIS to expand the number of earthquake zones (territories) within each state.

According to Jaynes, the biggest impact in this regard has come in states where one might not expect it.

"The impact of the new earthquake zones in California is not dramatic," he says, "because the range of earthquake

exposure in that state has long been recognized as being from moderate to high.

"The impact is more pronounced where there are pockets of moderate to high earthquake risk in states with generally low risk."

Balance

Among the requirements of the new earthquake plan, says Jaynes, is that it provides for a greater segregation of risks without creating an unwieldy set of risk categories that would be difficult for many carriers to implement.

"We didn't want to turn 20 manual pages into 80," Jaynes explains. "So, we looked at the initial results and applied the '80-20 rule.' What factors really make the most difference?"

The result is a series of new state-specific earthquake manual supplements that include:

- Six tables of base loss costs and rating factors, also available as data sets in Microsoft Excel and XML format ;
- Step-by-step instructions for all AAIS Homeowners policy forms, including coverage for an association deductible and loss assessment, if earthquake coverage is provided under a unit-owners form; and
- Zone assignments by ZIP Code.

For companies affiliated with AAIS for use of its Homeowners Program, the manual supplements are being filed countrywide with proposed effective dates ranging from Jan. 1 through July 1, 2010.

A generic sample earthquake manual supplement is being developed for review by interested companies not currently using the AAIS Homeowners Program. To inquire about reviewing a copy, contact Rick Maka, director of marketing, at *rickm@AAISonline.com*, or by calling 800-564-AAIS.

"Homeowners carriers of all sizes can benefit from this innovative and practical approach to rating earthquake coverage," says Paul Baiocchi, AAIS president. ■

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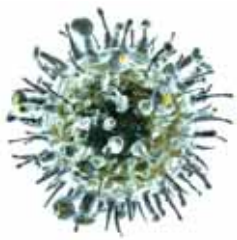


Quarantined from coverage

New commercial lines exclusions address communicable diseases and disease-causing organisms

Just as viruses, bacteria, and other disease-causing organisms evolve into newer, sometimes more virulent forms, there is an evolution, as well, in the insurance provisions for addressing them.

For more than two decades, standardized homeowners and other personal liability forms have had built-in exclusions precluding coverage for bodily injury arising from transmission of a communicable disease.

These exclusions were developed in the wake of widespread exposure to the HIV virus that causes AIDS and to other sexually transmitted diseases. Property/casualty insurers did not consider injury arising from physical intimacy to be the type of fortuitous occurrence intended for coverage under liability policies.

"The communicable disease exclusions in personal lines were initially conceived of as 'one on one' exclusions," says Deborah Summerlin, AAIS vice president of insurance lines. "They were a reflection both of changing morals and a growing tendency to sue for injuries."

For some time, the AAIS communicable disease exclusion was implemented as a restriction in the definition of bodily injury in personal lines forms. In that manner, it was incorporated into AAIS farm liability forms, and it continued to apply solely to injury to humans arising from communicable diseases.

Starting in 2006, the AAIS Homeowners communicable disease exclusion was removed from the definition of bodily injury, stated as a separate exclusion applying to transmission of a communicable disease by an insured, and extended to exclude property damage coverage, in addition to bodily injury.

Among other things, that approach excludes liability coverage for a transmission of a communicable disease to animals.

Agriculture

Communicable diseases receive more detailed treatment in the AAIS Agricultural General Liability (AgGL) Program, filed countrywide starting in 2008. The AgGL is the first standardized general liability program developed specifically for agricultural risks.

As commercial forms, the AgGL base forms do not have communicable disease exclusions built into its base forms, although they do include built-in exclusions for the transmission of livestock diseases, and for property damage arising out of "the presence of disease organisms."

A communicable disease exclusion applying to human bodily injury is available by endorsement, however, and an equivalent exclusion is built into the personal liability coverage available as an endorsement option.

Several features of AgGL's communicable disease exclusions illustrate the expanding scope of such exclusions, especially as they relate to agriculture:

- The AgGL exclusions apply to bodily injury, property damage, and personal and advertising injury, indications that losses to livestock and other animals, as well as contamination of the property of others (loss of use) are not covered.
- The AgGL exclusions apply to losses

caused by an insured, an insured's property, and property in the insured's care custody or control.

Taken together, these provisions indicate that, for agriculture, the communicable disease exclusions apply broadly to communicable diseases transmitted by humans, animals, and farm substances that could harm humans or animals or render property unusable.

"This is the first time we used such a detailed and explicit exclusion, because we needed to address a range of possibilities," Summerlin says.

"A disease could be transferred by a person to another person or animal, by an animal to a person or another animal, and by any type of property to other property."

The latter concern refers to, among other things, the tracking of contaminated soil from one farm to another, a critical concern in the control of foot-and-mouth disease.

Commercial

AAIS's latest communicable disease exclusions are being filed as endorsement options under commercial lines programs that provide liability coverage.

These exclusions are being filed countrywide under the AAIS Artisans, Businessowners, and Commercial Liability programs, with a proposed effective date of Feb. 1, 2010 in most states.

Like the AgGL exclusions, the commercial lines communicable disease exclusions apply broadly to the "actual or alleged" transmission of a communicable disease by a person, an insured's property, and property of others in the insured's care, custody, or control.

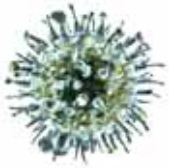
Also like the AgGL, the commercial lines exclusions eliminate coverage for bodily injury, property damage, and personal and advertising injury; again, the endorsements anticipate and exclude coverage for claims of violating another's right to enjoyment of property, a personal injury offense.

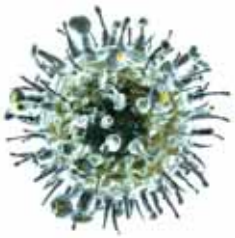
"Commercial liability forms do not routinely exclude coverage for communicable disease," Summerlin says. "In the absence of such an exclusion, policies based on those forms might cover the liability of a commercial insured whose employee may spread a disease in the course of his or her duties."

According to Summerlin, the leading impetus for the introduction of communicable disease exclusions in commercial lines is the

"Communicable disease exclusions in personal lines were initially conceived of as 'one on one' exclusions."

— Deborah Summerlin
AAIS vice president of insurance lines





widespread anxiety over the possibility of a flu pandemic.

"Insurers' wonder if their insureds will somehow be liable for bodily injury or even property damage arising out of the spread of a disease from their premises or operations," she says.

AAIS commercial lines affiliates will have a choice between two types of communicable disease exclusions: one that has an exception (preserving coverage) for an insured's products, and another with no exception.

Summerlin explains that "a communicable disease exclusion that extends to all products may be a serious restriction of coverage for the insured that processes, manufactures, or otherwise handles food and other products intended for consumption by humans or animals."

"For example," she says, "some insurers may not want to deprive an insured restaurant of coverage for the transmission of e coli in food, even if they want to eliminate coverage for disease transmitted by other means."

The products liability exception to the exclusion also extends to products for "topical use," such as cosmetics.

"The sample virus or bacteria exclusion for liability doesn't depend on the transmission of a disease."

— Deborah Summerlin
AAIS vice president of insurance lines

Virus

In addition to the filing of communicable disease exclusions, AAIS is also developing a sample endorsement companies could use as the basis of a proprietary exclusion for liability arising from a virus or bacteria. The virus or bacteria sample also includes an exception for products liability.

The sample exclusion would be available under all AAIS programs that include commercial liability coverage, but companies would have to file the endorsement themselves.

The "Virus or Bacteria" exclusion for liability coverage is modeled, in part, on exclusions for first-party property losses arising from viruses or bacteria. Those exclusions were filed countrywide as optional endorsements under AAIS farm and commercial lines programs, starting in 2006.

The property exclusions state that coverage is excluded for loss, cost, or expense caused by, resulting from, or relating to any virus, bacterium, or other microorganism that is capable of causing disease, illness, or physical distress.

In addition, the property exclusions explicitly apply to any loss, cost, or expense arising from denial of access to property because of any virus, bacterium, or other microorganism.

"In 2006," says Summerlin, "there was concern that contamination of insured property might shut down a business and that policies might be interpreted to provide coverage for a resulting business income loss, even if no property suffered direct physical damage.

"The property exclusions for virus and bacteria also addressed some of the terrorism concerns related to the use of anthrax and other biological agents," she adds.

According to Summerlin, the virus or bacteria exclusions for property exposures were considered clarifications of the original intent of property policies, and were approved by regulators with little resistance.

Sample

Implementing a virus and bacteria exclusion for commercial liability coverage won't be as easy, however. Hence, AAIS will make the liability exclusion available as a sample, and await regulatory opinions on the acceptability and breadth of such exclusion.

Unlike its property counterpart, the virus or bacteria exclusion developed for liability coverages may represent a restriction in coverage.

Regulators may be reluctant to accept such a restriction unless a potential source of claims can be demonstrated to be a massive, unanticipated exposure that would threaten the solvency of numerous companies or force coverage to

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Green liabilities

Assessing the impact of green construction on commercial general liability exposures

In two previous articles, *Viewpoint* analyzed the potential impact of "green" construction on the principle of indemnity in property insurance, and on loss adjustment under builder's risk policies.

(See, respectively, Summer 2008, "The Greening of Property Insurance," and Summer 2009, "'Green' Coverages Come to Builders' Risk Insurance.")

This article seeks to round out *Viewpoint's* coverage of green coverage issues by exploring the potential impact of green construction on general liability insurance.

"Green" construction refers to the fast-growing trend among property owners, designers, and builders to create structures with specific features designed to make them more energy efficient with a beneficial impact on the natural environment.

Developers of green projects generally seek to have them certified as "green" by organizations that use point systems to establish levels of green certification. Two of the best known of these certifications are the:

- Leadership in Energy and Environmental Design certifications granted by the US Green Building Certification Institute, which certifies buildings as meeting a "silver," "gold," or "platinum" standard.
- Green Globes rating system used by the Green Building Initiative, which awards structures one, two, three, or four Green Globes.

Points under these rating systems are awarded for major structural features and for other amenities, such as the presence of bicycle racks. A building's rating depends on the total number of points earned across several categories.

States and municipalities are contributing to the green construction trend by incorporating green features into building codes or offering tax incentives for property owners to earn a green certification.

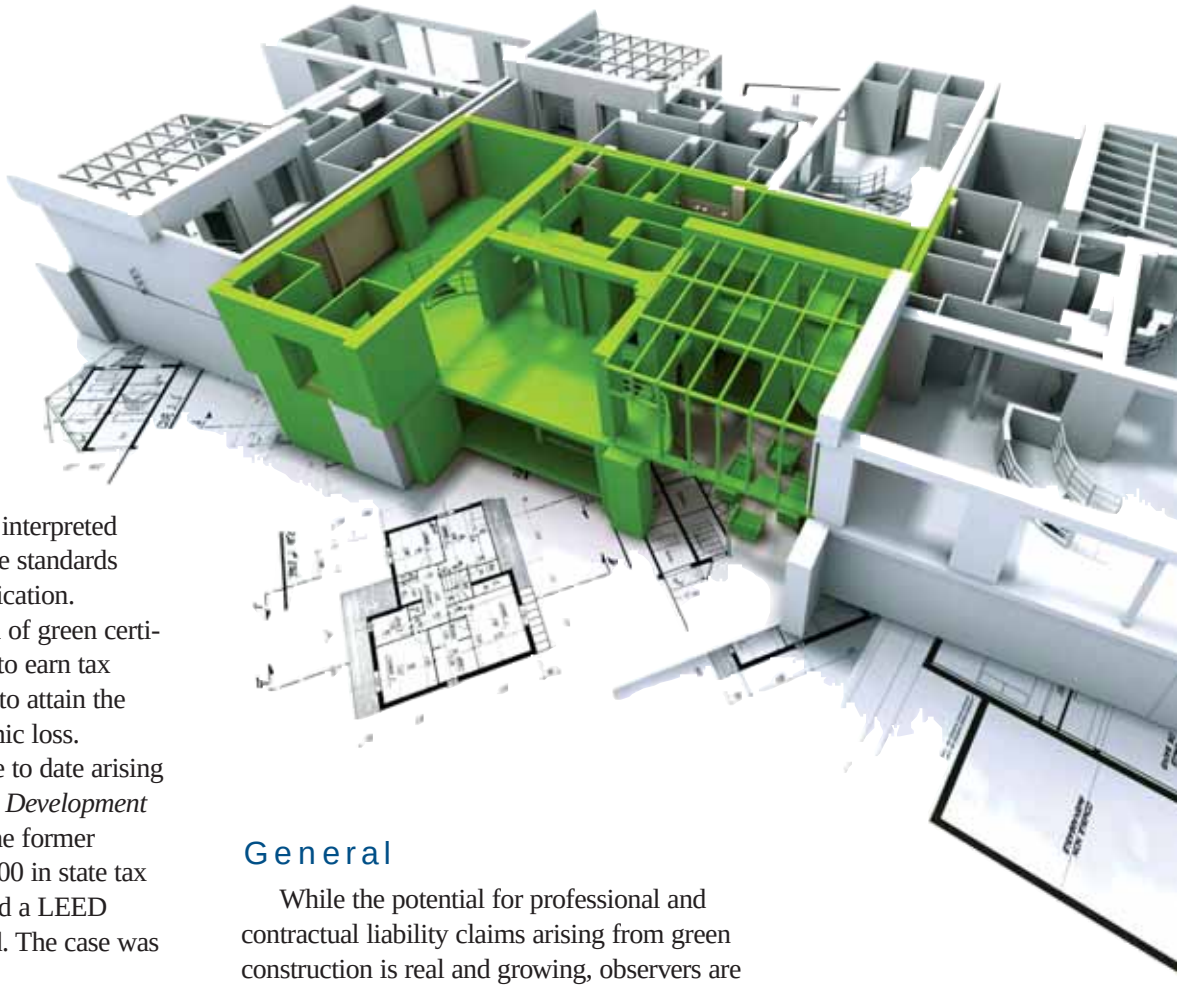
The role that the green rating systems play in the valuation of green buildings is central to the liability insurance issues arising from green construction.

Professional

Observers agree that third party certification for green buildings will contribute to vastly expanded professional liability for architects and contractors.

According to Chicago attorney Gary Cole, himself a licensed architect, "unfulfilled expectations" will be the leading cause of green-related litigation between project owners, on the one hand, and those who design and build green structures, on the other.

"'Unfulfilled expectations' is a simplified way of referring to some manifestation as a breach of contract," Cole writes in his "Green Goblin" web series. "Breaches of contract can arise by violations of expressed terms or implied terms."



According to Cole and others, a casual statement or ambiguous contract provision that expresses a commitment to produce a green building can be interpreted as a warranty that it will meet the standards for a certain level of green certification.

In some cases, a certain level of green certification is required for a project to earn tax credits or other benefits. Failure to attain the rating would result in an economic loss.

The best-known liability case to date arising from green construction is *Shaw Development v. Southern Builders*, in which the former sought compensation for $635,000 in state tax credits lost after a project to build a LEED silver-level building was delayed. The case was settled out of court.

Professional liability policies generally exclude coverage for breach of a warranty or loss of economic damages.

However, according to Cole, there may still be an exposure for the professional liability carrier if an architect or contractor holds himself out as a specialist in green construction, and that assertion is used to hold them to a higher standard of care.

Negligence in failing to meet a standard of care is more commonly covered under professional liability policies.

Meeting such a standard is complicated by the fact that green certification involves the use of innovative materials and innovative processes for installing them. What's green today won't necessarily be green tomorrow, or at least the same level of green, as the standards change.

General

While the potential for professional and contractual liability claims arising from green construction is real and growing, observers are less sure that green construction will lead to appreciable growth in exposure under commercial general liability policies.

"It's hard to envision how green construction would result in any type of bodily injury claim that would not be otherwise covered under a standard CGL or workers compensation policy," says Richard Cohen, a Buffalo, N.Y., attorney who addressed green construction liability and other issues at this year's CPCU Annual Meeting in Denver.

"If a contractor uses a 'green' material such as bamboo and it collapses, causing injury, this could be covered under a CGL policy and arguably, results from green construction," Cohen says in remarks to *Viewpoint*. But, he adds, that is no different from a bodily injury claim resulting from any other type of construction.

"This is not the type of 'green' claim we are normally thinking of, such as breach of contract for failure to obtain LEED certifi-

"It is difficult to envision a true general liability claim because the claims and damages are economic and contractual in nature."

— Richard Cohen
attorney

cation, or loss of marketability," he says. "It is difficult to envision a true general liability claim [between property owners and contractors] because the claims and damages are economic and contractual in nature, limiting the applicability of a CGL policy."

As for contractual liability, Cohen says that CGL coverage for contractual liability is generally limited to insured contracts where a policyholder assumes the tort liability of another party.

"Even if you assume that a contract claim from failed green construction constitutes a tort claim, there is a strong possibility that 'your work' or 'your product' exclusions would apply to preclude coverage," he says.

Damage

General liability for damage to green property is potentially a different matter, however, as green property has value not only for its physical properties and mechanical operations, but for its beneficial impact on the environment.

"What if something physical happens to a green building that compromises its green design or green materials, but the property may still be usable in the traditional sense?" asks Cole. "What are the legal and insurance ramifications, especially if the property was certified and that certification was required for tax breaks?"

Similarly, someone may try to claim personal injury if their use or enjoyment of a green property is impaired by the actions of another.

"There could be claims like that," says Linda Giffin, senior vice president of Argo Insurance, which has developed proprietary policies for insuring the professional and general liability exposures of architects, engineers, and contractors involved in green construction.

"It's all unknown. That's part of the problem. It's all so new."

— Linda Giffin
senior vice president
Argo Insurance

According to Giffin, anyone found liable for damaging green property would have to pay to restore it with "like kind and quality," and that "quality" could include meeting a green certification standard--even if that standard had been changed since the damaged property was first installed.

"It could be just like the liability for meeting building ordinance costs," she says.

Novelty

"That's certainly a legal argument you can make with a straight face," says Shari Shapiro, a Philadelphia attorney and a LEED-accredited professional who serves on the Delaware Valley Green Building Council.

"Still, I do not believe green building practice will create new forms of property damage," Shapiro says. "You'll find novelty in [construction] practices and products, not novelty in the type of property damage claims."

That could change, says Shapiro, if green property damage claims lead to other types of companion claims.

"Could you claim that a loss to green property included a loss to reputation?," she asks."That's where a real novelty of claims would come in."

Claims like these are still in the realm of speculation. Should they become real, however, all general liability insurers, not just those writing green projects, could be subject to the exposure.

"It's too simplistic to say that [property damage liability] is all going to be the same as it was," says Cole."There are too many things in play."

"It's all unknown," says Giffin at Argo Insurance. "That's part of the problem. It's all so new." ■

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One of its signature products is "Pretium," a comprehensive predictive modeling software platform that allows actuaries to test and develop predictive factors quickly and cost-effectively.

More than 500 insurers throughout the world use Pretium, about 40 of them in the United States.

And, now, AAIS is one of them.

AAIS recently signed a license with Watson Wyatt to utilize Pretium for its initiative to develop rating plans that will rate individual property perils and liability claims, and combine them to produce a final loss cost. The initiative is being undertaken first in the AAIS Homeowners Program, and will later be expanded to other lines.

"Pretium brings multivariate modeling and sophisticated geographical spatial analyses to AAIS," says Roosevelt Mosley, a consulting actuary for Pinnacle Actuarial Resources, Bloomington, Ill.

"These applications are being used by insurers to help identify profitable segments, fine-tune marketing initiatives, and incorporate customer response modeling," Mosley says. "Pretium streamlines the analysis process for faster and more efficient modeling."

As a complement to its license with Watson Wyatt, AAIS has also signed a license with Pinnacle to provide support service for Pretium.

Data

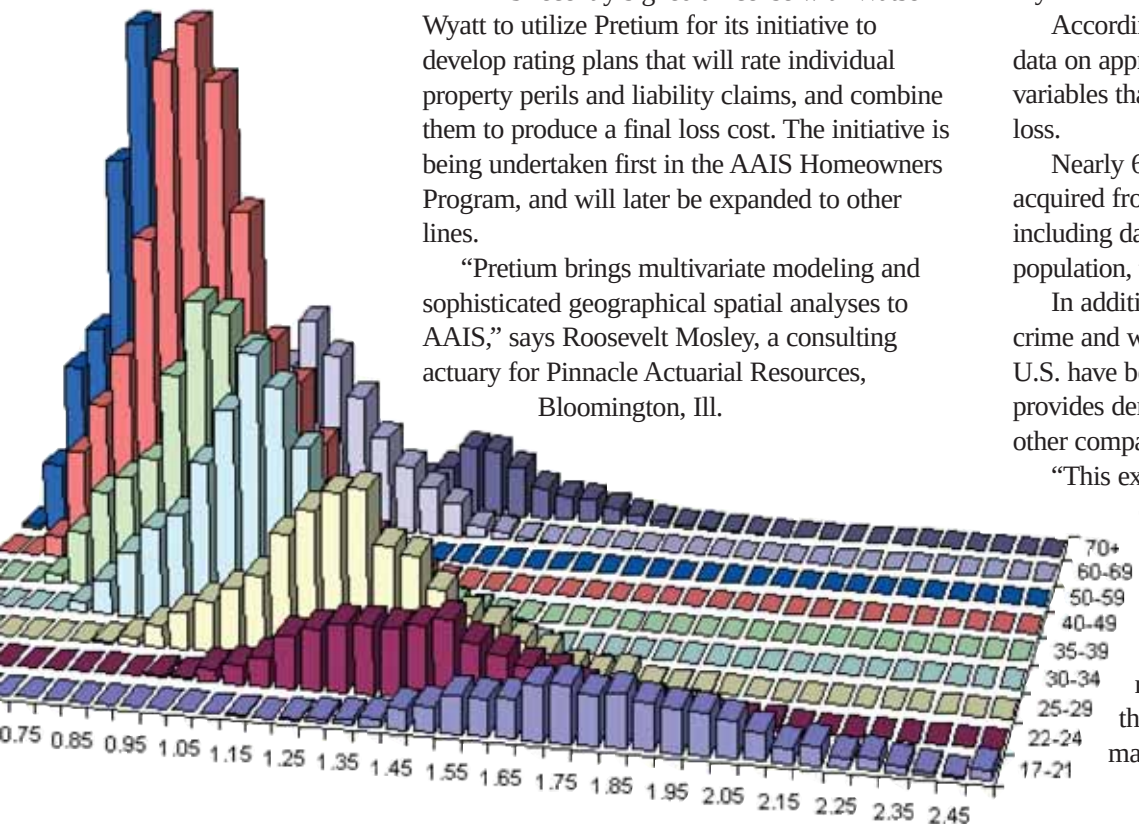
The licensing of Pretium is one aspect of a larger AAIS initiative to utilize predictive analytics on behalf of its member companies, says Paul Baiocchi, president.

According to Baiocchi, AAIS has acquired data on approximately 100 different potential variables that can be tested for predictability of loss.

Nearly 60 categories of data have been acquired from the U.S. Census Bureau, including data for geographic areas on housing, population, transportation, and other categories.

In addition, nearly 40 categories of data on crime and weather conditions throughout the U.S. have been acquired from a firm that provides demographic and industry data to other companies.

"This external information enriches our data resources," says Baiocchi. "Combined with our robust data base of traditional insurance statistical data, this new information will enable AAIS to respond to companies of all sizes that are seeking more refined information for rating policies."



"It is central to our mission of helping companies compete," he adds.

Capability

The role of Pretium in that mission, Baiocchi says, will be to allow AAIS actuaries to efficiently test a series of variables to determine if and how they are uniquely significant in predicting loss.

"Insurance data is often 'noisy,' and can present problems for the accurate analysis of risk and behavior," says James Tanser, global leader of Watson Wyatt's Pretium and predictive modeling teams.

"Pretium has been designed to cope with the problematic data often found, and will identify and correct several common problems."

According to Tanser, Pretium operates as a separate program alongside the SAS statistical application, essentially telling the SAS what to do without requiring complex code.

"While many of the techniques in Pretium are standard for the insurance industry, Pretium includes some unique functionalities not found in rival software," Tanser says.

"In particular, Watson Wyatt has extended the functionality of SAS by writing two procedures for it that are available only to Pretium users," he adds. "These allow for faster application of generalized linear modeling and spatial smoothing."

Rate impact

Once final models and new indications have been developed, Pretium helps analyze the impact they will have on current and potential customers.

"Will any segments receive large premium increases?" Tanser asks. Are cross-subsidies present in the indications?

"Pretium allows users to understand the impact of rate changes at a policy level," he says. "This allows managers to fine-tune the final selected rates."

Understanding customer behavior is increasingly important in pricing, Tanser adds, and many insurers are combining models of customer behavior with models of risk, something Pretium can help them do.

"Pretium will allow us to analyze new rating variables and old rating variables to a degree that couldn't be done before," says Greg Jaynes, AAIS chief actuary. ■

By Kathy Donovan,
senior compliance counsel,
Insurance Compliance Solutions
Wolters Kluwer Financial Services

GUEST ESSAY

2009's Legislative and Regulatory Activity Puts Increased Demands on Insurers

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.

Clearly, 2009 has been an especially active year for those who monitor legislative and regulatory activity at the state and federal levels. Judging from the current climate, it appears this trend will continue as we look ahead to the coming year.

From January through September 2009, Wolters Kluwer Financial Services' determined that more than 11,000 pieces of legislation with potential effects on the insurance industry had been introduced in Congress and the state legislatures.

This is more than an 80% increase over the same period in 2008, and approximate 60% more over the same period in 2007. While this activity was spread across different types of insurance, it is interesting to note that approximately 30% would affect all lines, while almost 20% specifically addressed property/casualty issues.

Consumer protection initiatives continued to play an important role in 2009, and P/C insurance was not exempt.

Earlier this year, legislation to restrict or prohibit the use of credit information in underwriting or rating was introduced in nearly half the states. While most of these bills failed to win final passage, two that did exemplify the types of consumer initiatives we have seen:

- Indiana HB 1246 prohibits insurers from including a late payment with a medical industry code in the credit information used for underwriting and rating. (This adds to an existing list of restrictions on the use of negative credit information.)
- Illinois HB 418 provides that an insurer must notify an applicant or insured if the carrier uses credit information to deny, cancel, or non-renew a policy of personal insurance. The consumer must also be given an opportunity to explain the reason for any negative credit information.

The Illinois bill also requires insurers that use credit information in underwriting or rating to re-underwrite and re-rate a personal insurance policy at annual renewal if requested by an insured or the insured's agent. (The law lists specified circumstances when this is not required.)

Rate and form filing issues were also addressed in some states.

Connecticut's personal lines flex-rating law was extended to July 1, 2011. Under the law, personal lines rates can take effect on the date they are filed, as long as they do not produce an increase or decrease greater than 6% in the state-wide aggregate for all coverages subject to the filing. This flex-rating provision, which combines rating flexibility and consumer protection, was originally scheduled to expire on July 1, 2009.

While Connecticut focused on personal lines rate flexibility, Michigan reversed a long-standing policy on the filing of homeowners and auto forms. Effective July 1, new or revised personal automobile forms were required to be filed for approval; the same mandate took effect Sept. 1 for homeowners.

This reinstitution of "prior approval" of personal auto and homeowners forms reversed, for those lines, a regulatory policy instituted in 1997 that exempted propriety forms from filing requirements. Forms filed by AAIS and ISO on behalf of their members continued to be subject to filing requirements after 1997, and are not affected by the latest change in policy.

Cancellation and non-renewal issues also played a prominent role in states this year. Maryland enacted four bills on this topic. Two of them are noteworthy:

HB 165 establishes permitted reasons for midterm cancellation of personal, homeowners, commercial, or motor vehicle liability insurance. An additional reason, "Conviction of Arson," is now permitted for use by homeowners insurers.

HB 162 requires an insurer to notify a named insured of any increase in premium for commercial or workers' compensation insurance not less than 45 days before the effective date of a policy renewal. The law provides that a reasonable estimate of the increased premium is acceptable.

Apart from these new requirements in Maryland, Minnesota is taking a "pre-emptive" position in establishing cancellation processes for new business.

Effective Jan. 1, 2010, Minnesota HF 1853 requires insurers to provide written notice to all homeowners indicating, in bold print, "THE INSURER MAY ELECT TO CANCEL COVERAGE AT ANY TIME DURING THE FIRST 60 DAYS FOLLOWING ISSUANCE OF THE COVERAGE FOR ANY REASON WHICH IS NOT SPECIFICALLY PROHIBITED BY STATUTE."

However, the Minnesota law provides that the insurer or its agent can refer applicants to the insurer's website, if the statement is posted there, as long as the applicant is notified that he or she can request a written copy of the notice.

Given the wide range of legislative and regulatory activity affecting the insurance industry in 2009, whether it is credit scoring, rating, underwriting, or claims, there appears to be no waning of interest in insurance regulation. And with 2010 just around the corner, the industry should continue to expect to see other states evaluating similar proposals next year.

The volume and breadth of activity requires diligence by insurers to monitor legislative and regulatory activity and implement processes to comply with new directives.

As senior compliance counsel for Wolters Kluwer Financial Services' Insurance Compliance Solutions group, Kathy Donovan monitors regulatory activity and assists in content management for property/casualty and life/health compliance tools, incorporating regulatory requirements to help meet insurers' needs. She is also the primary contributor to Wolters Kluwer Financial Services' Compliance Corner, an online source for insurance regulatory trends.

Kathy holds a J.D. from Suffolk University Law School, an M.B.A. from Babson University, and a B.S. from Suffolk University. She has provided expert commentary on compliance issues for various publications, including Insurance Networking News, National Underwriter, Insurance Compliance Insight, and Claims. ■

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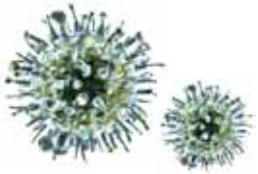
This meeting, the successor to the former AAIS annual conference, is devoted to product-related issues of strategic importance to P/C insurers. The business program will address emerging exposures and other topics at a level targeted toward CEOs and heads of operational units.

AAIS had a record turnout for its 2009 Main Event and interest is already strong for 2010. Pencil in the date now, and watch for more information in *Viewpoint* and other AAIS communications.

For information on our conference hotel, go to http://www.sanibel-resort.com



Quarantined Continued on page 19

be priced at unacceptably high levels.

That's important because, today, the effects of a pandemic are widely feared but largely unknown, at least in the United States.

Also, the sample liability exclusion, drafted to be a counterpart to the property exclusion, applies more broadly than communicable disease exclusions.

"The sample virus or bacteria exclusion for liability doesn't depend on the transmission of a disease," Summerlin says. "It addresses liability that arises from exposure to any microorganism capable of causing disease or physical distress.

"And, while the sample exclusion is primarily intended to address premises-related exposures, its application is not limited to locations owned, operated or controlled by the insured."

Summerlin expects AAIS's new communicable disease exclusion to be widely approved by regulators, and that many AAIS affiliates will opt to implement those rather than file the virus or bacteria exclusion independently.

Insurers willing to be among the first to test regulatory tolerance for the virus or bacteria liability exclusion can use the AAIS sample as the basis for a counterpart to the virus or bacteria exclusions filed and approved for property

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AAIS Compliance Guide expanded and updated

A revised, expanded edition of the AAIS *Compliance Guide* was released in October.

The *Compliance Guide* is a comprehensive resource of information on rate and form filing requirements, plus other regulatory compliance information, for all 50 states, the District of Columbia, and Puerto Rico.

The latest edition of the guide has been expanded with two new sections:

- A "Confidential Filings Request" section has been added to provide an overview of state requirements for filed materials to be considered confidential; and
- A "Sample Letters" section has been added to provide information that companies could include in their letters when seeking to adopt an AAIS filing.

Among the revisions to existing content is an updated list of states that require filings to be made using "SERFF," the System for Electronic Rate and Form Filing developed by the National Association of Insurance Commissioners (NAIC). There is also information on states that have adopted the NAIC's policy coding matrix and/or implemented electronic funds transfer ("EFT").

Also, an updated section on "Applications, Binders, and Certificates of Insurance" is included with the permission of ACORD, Inc.

The *Compliance Guide* is provided for no additional charge to all AAIS affiliated companies. Non-AAIS companies interested in purchasing the Compliance Guide will find an order form online.

Punitive damages exclusion developed for Yacht coverage

AAIS recently released a new punitive damages exclusion in the Yacht section of the *Inland Marine Guide*.

The new exclusion was developed in response to a recent U.S. Supreme Court ruling, which held that injured crew members may be entitled to punitive damages even when there is coverage for their injuries under the Jones Act, a 1920 law that allows injured merchant sailors to sue vessel owners.

While the ruling specifically addresses liability under the Jones Act, the possibility exists for punitive damages associated with liability losses covered under the *Guide's* Yacht forms. The latest exclusion was developed to address that.

A punitive damages exclusion is currently available under the AAIS Boatowners Program, the country's first standardized program of policy forms and rating information for insuring small, privately owned watercraft.

For information on affiliating with AAIS for use of the *Inland Marine Guide* or Boatowners Program, contact Rick Maka, director of marketing, at *rickm@AAISonline.com*, or by calling 800-564-AAIS, ext. 222.

Robert Guevara speaks on builders' risk at CPCU annual meeting

Robert Guevara, AAIS vice president of inland marine, presented an overview of builders' risk insurance at the 2009 CPCU Society Annual Meeting and Seminars, held Aug. 28-Sept.1 in Denver, Col.

In his presentation, Guevara explained the distinctions between policy forms covering scheduled jobsites, those providing blanket coverage for unscheduled jobsites, and those providing coverage for renovation and rehabilitation projects.

He also explained AAIS's new distinction between "additional construction expenses" and "additional soft costs," as well as the "green" coverages introduced as endorsement options in July 2009.

Those features are found in the

Builders' Risk section of the AAIS Inland Marine Guide to policy forms, rating procedures, and other information for the traditionally nonfiled classes of inland marine insurance.

AAIS to file revised loss estimates supplements for Commercial Liability

AAIS has filed a revised Commercial Liability loss estimates supplement, otherwise known as information for '(a)' rated risks. The supplement has been filed in 27 states that require it to be filed and made available in others; the effective date in all states will be June 1, 2010.

The supplement provides estimated loss information for approximately 360 classifications for which there are no loss costs in the most recent version of AAIS's countrywide Commercial Liability manual. (The manual includes over 1,170 risk classifications in all.)

The latest loss estimate supplement includes a new feature indicating the relative degree of credibility for loss estimates provided under each class. Companies affiliated for the AAIS Commercial Liability Program can use the AAIS loss estimates in developing their own risk-specific rating information.

Revised forms and schedules issued in the *Inland Marine Guide*

AAIS recently issued revised forms and accompanying schedules in the Miscellaneous Forms and Miscellaneous Floaters classes of the *Inland Marine Guide.*

The forms and schedules being revised are those for Irrigation Equipment Coverage, Scheduled Property Coverage, and Mobile Equipment Coverage.

Under each of the three revised forms, language has been added specifying that the debris removal

Continued on next page

coverage extension applies to the costs for demolishing and clearing damaged property, and removing the debris.

In addition, each new form supplants the term "Newly Purchased Property" with "Newly AcquiredProperty," to address property that has been obtained through leases and other means, in addition to purchase.

Other revisions have been made to each form individually.

Wisconsin institutes disclosure requirement for auto med pay and UM/UIM coverage

An emergency order from the Wisconsin Office of the Commissioner of Insurance implements a new disclosure requirement for companies writing commercial general or umbrella liability insurance with auto coverage limited to non-owned and hired autos.

Under the order, insurers must disclose to applicants and insureds whether a commercial general liability (CGL) or umbrella policy covering only non-owned/hired autos provides coverage for auto medical payments, uninsured motorists, or underinsured motorists. The disclosure must be made in writing either on an application form or included with the delivery of a policy.

But, under the regulation, insurers are not required to provide uninsured/underinsured (UM/UIM) motorist coverage or auto medical payments coverage on CGL or umbrella policies which limit auto liability coverage to non-owned and hired vehicles.

In light of the regulation, AAIS will continue to provide non-owned/hired auto liability coverage endorsements under seven of its programs, but those endorsements do not have policy language, rules, or rating information for UM/UIM or auto medical payments coverage.

Those programs are: Agricultural General Liability, Artisans, Businessowners, Commercial Liability, Farmowners, Homeowners, and Mobile-Homeowners (in the last three, the endorsements are for the Home-Based Business Coverage Part).

The AAIS Commercial Umbrella, Farm Umbrella, and Personal Umbrella programs include endorsements that provide UM and/or UIM coverage if:

- Auto coverage, other than hired and non-owned auto coverage, is included in the underlying insurance; and
- The umbrella UM/UIM coverage is accepted by the insured.

Regarding coverage for medical payments, the Wisconsin order refers to the type of "med pay" typically found in auto policies, which is coverage for injury to permitted occupants of an insured auto. AAIS policies do not offer this type of coverage, and program users will have to disclose that.

(The med pay coverage in AAIS policies is the type found in standard non-auto liability policies; it pays for relatively low-cost injuries to third parties, whether the insured is liable or not.)

Non-highway vehicles now subject to Illinois insurance requirements

AAIS has submitted filings in Illinois to address a new state law affecting liability coverage for the use of non-highway vehicles.

An Illinois statute, effective Jan., 1, 2010, makes any person operating a non-highway vehicle on a public road subject to the state's mandatory motor vehicle insurance requirements.

The AAIS filings will address liability coverage under forms that provide personal and/or farm liability coverage, including the AAIS Home-Based Business Coverage Option.

The Illinois Department of Insurance has advised AAIS that the filings will not be reviewed until internal issues have been resolved,

For now, new policy provisions are proposed to exclude coverage for liability that arises out of a non-highway vehicle being operated on a public road, with an exception for a vehicle crossing a road lawfully.

Also, in some lines of insurance, the exclusions would not apply to "implements of husbandry" (e.g., tractors). ■

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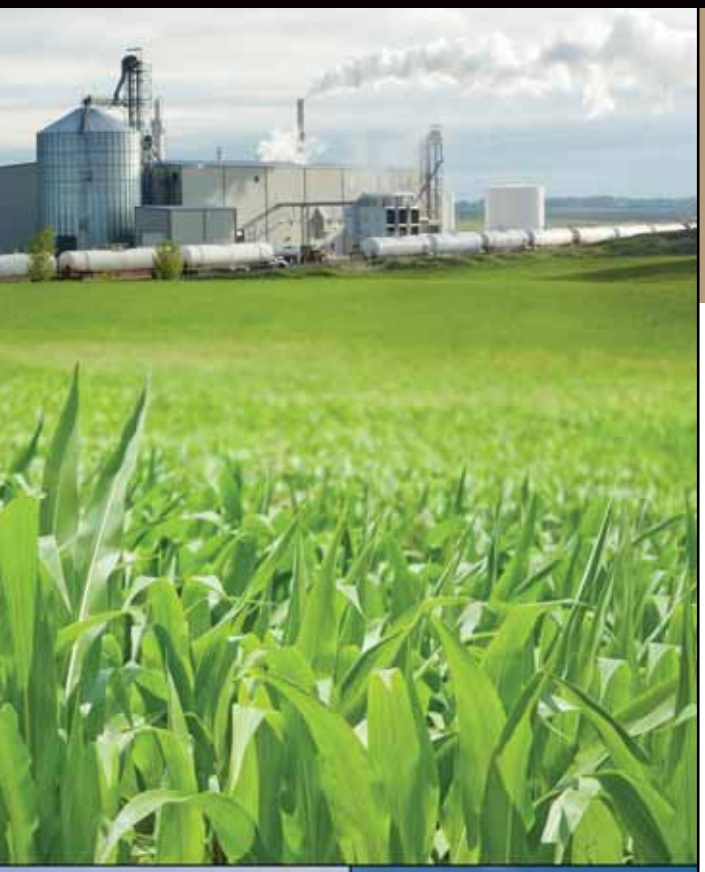

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- Broad commercial property and inland marine coverage built into its base form, and a wide range of coverage options, including equipment breakdown and crime
- Supplemental coverage limits determined individually through dec page entries
- A flexible 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,
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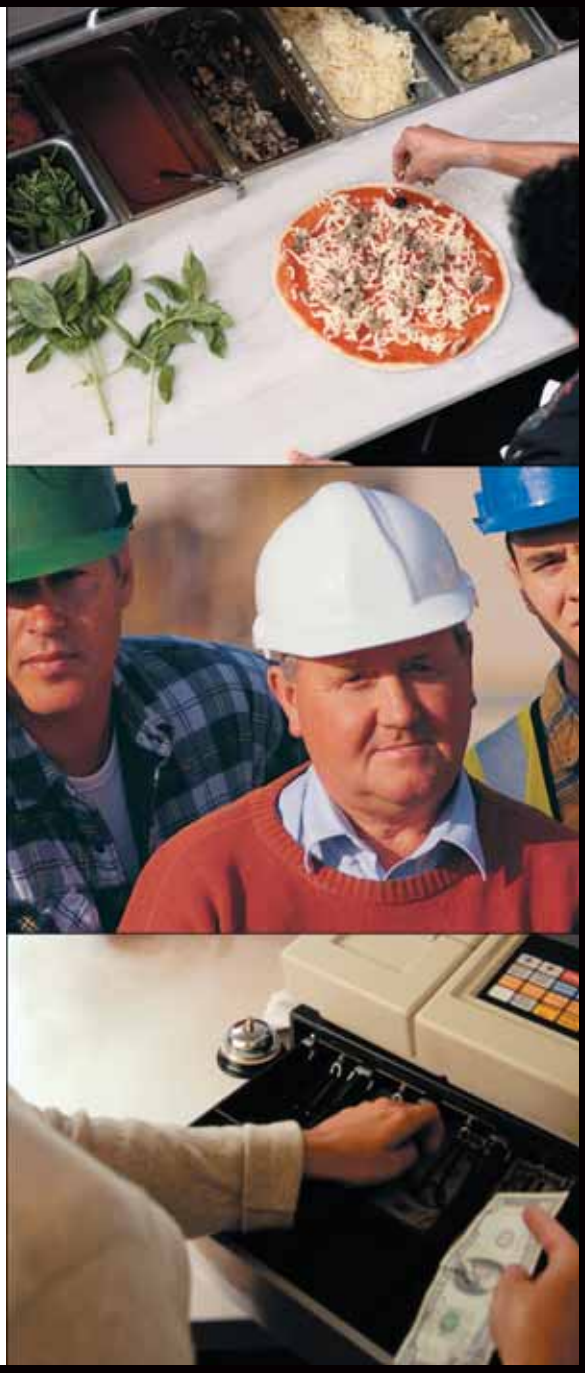
For information, contact Rick Maka at *rickm@AAISonline.com*, or by calling 800/564-AAIS.



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