6 – Determining Amounts Payable

**1 – Determining Replacement Cost and Actual Cash Value**

**Objective**: Explain how replacement cost and actual cash value are determined

When handling property claims, claim reps must know how to determine the value of the lost or damaged property. An insurance policy will specify which valuation methods apply to the particular types of property for which a claim has been made.

While there are other property valuation methods, the two most common are:

* Replacement Cost – the cost to repair or replace property using new materials of like kind and quality with no deduction for depreciation
* Actual Cash Value (ACV) – Cost to replace property with new property of like kind and quality less depreciation.

Often, these two methods coexist in the same policy – for example, a homeowners policy may cover the dwelling and structures for replacement cost while personal property is covered for ACT.

**Replacement Cost**

**Replacement cost is the cost of replacing lost or damaged property with new property of like kind and quality, or its functional equivalent, at current prices.** Even if the property is several years old, or if its replacement cost now exceeds its original purchase price, the insured is entitled to the current cost to replace the property. However, policy provisions and legal requirements can limit valuation.

Even if an item of property is no longer manufactured, replacement cost can still be determined. Sometimes, a particular model or style of an item is no longer made and has, in a strict sense, become irreplaceable. But this does not make the object’s value unlimited. If the object can no longer be purchased, the replacement cost for property of like kind and quality should be paid. For example, if a particular style of armchair or appliance with certain features is discontinued, an item of like kind and quality will probably be available, often from the same manufacturer. The original item’s replacement cost can be based on the existing model’s cost. Settlement on this basis is usually acceptable to the insured, as long as the claim rep does not try to settle on the basis of an inferior object.

**Alternatively, some policies may be written using a functional valuation approach** to provide replacement on a functional equivalent basis.

**Functional Valuation approach – a valuation method in which the insurer is required to pay no more than the cost to repair or replaced the damaged or destroyed property with property that is its functional equivalent**.

This type of replacement cost is used on older, more ornate buildings. To insure them for actual replacement cost would be very expensive because of outdated construction methods and materials. Functional equivalent replacement cost provides coverage for the cost to repair or replace using current construction methods and materials. For example, Victorian-style homes have plaster walls and ceiling. The current replacement for such homes’ walls and ceilings would be drywall.

**Actual Cash Value**

**Loss settlements based on ACV (replacement cost less depreciation) are common with personal property under homeowners policies** and with both personal property and buildings under commercial policies. **Many policies do not define “actual cash value”. Various explanations of the term exist, and the courts have had a major role in defining it**.

**Replacement Cost Minus Depreciation**

Most property has its highest value when new. It therefore loses value, mainly because of age and use. In this context**, ACV is best expressed as, and is usually determined by, replacement cost minus depreciation**. Determining depreciation is more difficult than determining replacement cost. Depreciation represents any loss of value, and numerous factors affect the rate and amount of loss of value.

* **Straight Line Depreciation** – this method measures a piece of property’s steady, predictable deterioration. Example, a refrigerator’s depreciation over its useful life. **If the current cost (new) is $500 and it has a useful life of ten years, it will depreciate $50 per year ($500 /10 years). If the refrigerator is 3 years old at the time of the loss, the depreciation amount (3 x $50) = $150** 
  + **Cost New $500 / 10 # of useful life = $50**
  + **Age at loss 3 years 3 X $50 = $150 (amount of depreciation)**
  + **Payment would be Replacement cost $500 - $150 Depreciation = $350**
* **The Accelerated Depreciation** – this method is used for items that depreciate at a more rapid rate than indicated by straight-line depreciation. Accelerate depreciation may be applied when an item depreciates rapidly when first purchased and then more slowly in subsequent years. Motor vehicles, electronics, computer equipment, and power tools all depreciate on an accelerated basis.
* **Decelerated Depreciation** – some items do not depreciate but instead appreciate or gain in value. Other items may depreciate little, it at all, until a given time period has passed and then lose value rapidly. Object subject to decelerated depreciation usually have an expiration date. Examples, Food medicine, and batteries are examples of items subject to decelerated depreciation.

**Physical wear and tear causes loss of value, but other factors such as age and obsolescence can result in loss of value and should be identified in computing depreciation**.

**Physical Wear and Tear (same as Straight Line Depreciation)**

Physical wear and tear is the most obvious cause of loss of value. Physical wear and tear usually occurs at a steady rate throughout an item’s life and can be calculated as a fixed amount, or a percentage, per year. For example, if a television is expected to last 8 years, it would lose one-eighth (1/8th) of its value or 12.5% every year. Fire years of age, it will have lost 5/8th of its value, or 62.5% (5 x 12.5%) of its value. This amount of depreciation is subtracted from the current replacement cost to determine ACV. If the television’s current replacement cost is $1,000, a five-year old TV’s ACV is $375 ($1,000 - $626 depreciation).

* **Replacement cost $1,000 / 8 Years = $125**
* **the depreciation is $125 x 5 = 625;**
* **the ACV payment will be $1,000 - $625 = $375**

The rate at which a particular item is depreciated depends on what it is and how it is used. For example; clothing depreciates faster than furniture. Also, building’s structural elements have widely different lifespans. A roof might predictably wear out every 20 years, whereas an element of the frame carpentry might last indefinitely.

To assist their claim reps in determining the proper amount of depreciation to use in ACV calculations, insurers provide either software programs or depreciation manuals that indicate various items’ average expected life. The manuals are useful as long as they are consulted as guidelines only. The present an average life for various items, but variation does occur. Claim reps must also consider the circumstances under which the particular property has been used. These circumstances might indicate a longer or shorter expected life than the average life. **Insurers also provide guidelines for the maximum amount of depreciation to be taken on an item**. Claim reps must also be aware of any state laws, regulations, or court decisions that could affect how ACV is determined.

**Age and Obsolescence**

An object’s age usually corresponds closely to its extent of physical wear and tear, but age might also be considered as a separate factor affecting depreciation. Age alone, however, should not cause an object to lose a large percentage of its value. If the object is functionally sound, it should retain most of its full value.

Although age alone should not disproportionately affect depreciation, obsolescence might cause some object to lose their value. **Obsolescence is the loss of value caused by changes in technology or fashion**. An object can lose value through obsolescence even though it has incurred no real wear and tear. Additionally, obsolescence can occur suddenly, regardless of an object’s age – for example, fashions change very quickly. Likewise, advances in technology and reductions in manufacturing costs have quickly rendered items only a year or two old obsolete.

**A term commonly used to explain depreciation is betterment.** An object’s amount of depreciation is identical to the amount of how much better, or more valuable, a new object is compared to the older object. Generally, an insured who receives a new object would be better off than would someone who has an older model of the same object. When the property is insured for ACV, the amount of the loss settlement does not reflect the betterment that would be covered if the property were insured on a replacement cost basis. Explaining ACV can often help the insured understand why depreciation is calculated and deducted from the damaged property’s replacement cost.

**Except when replacement cost cannot be determined, calculating ACV as replacement cost minus depreciation is usually appropriate. Nevertheless, two other approaches to ACV are important because of the support they have received from the courts. They are market value approach and the broad evidence rule**.

**Market Value**

Some courts have ruled that ACV means fair market value. **An item’s market value is the amount at which a knowledgeable buyer under no unusual pressure would be willing to buy an item and a knowledgeable seller under no unusual pressure be willing to sell it**.

Market valuation is particularly useful when an object has no real replacement cost; that is, when no other object of like kind and quality exists, as with antiques, works of art, and other collectables. Additionally, **market value can be useful with older buildings made from construction materials and methods that are no longer in use**. Some features of older construction add to the property’s value, but other features detract from it. A market valuation of the property would include both types of features.

Real property’s market valuation includes both the land’s value and the structures value. Property insurance policies usually apply only to the covered buildings and structures, making the land’s value irrelevant to determining the amount payable for an insurance claim. (An exception would be a property policy for a golf course that covers damage by a covered cause of loss to the golf course’s grounds). Generally, damage to, or destruction of, the building does not affect the land’s value. Therefore, any change in the property’s value following a loss must result from changes in the building’s value. The market value determination of loss to a building can be calculated using this formula:

**Market value of loss to building** = **MV of entire property before loss – MV of entire property after loss**

The formula applies when the value of the land is unaffected by loss to the building. Sometimes, however, for various reasons, the land’s value may either increase or decrease after a building is destroyed. In such cases, the assistance of a real-estate appraiser may be needed.

**Requiring the use of market value can in some cases harm the insured by artificially devaluing the property**. Most items of personal property immediately and dramatically lose market value when they are taken from the retail store where they were purchased. Soon they have no market value at all. Example, a claim rep cannot maintain that a one-year old suit bought for $250 and still in good condition has virtually no value, event though it has virtually no market value. In this case, calculating ACV as the replacement cost minus depreciation is much fairer to the insured and should be used to calculate the suites ACV.

**The Broad Evidence Rule**

**The broad evidence rule has resulted from court-determined case law and explicitly requires claim reps to consider all relevant factors when determining ACV**. Claim reps should, however, already be considering all relevant factors when determining ACV by market value in a well-functioning market or by appropriately applying the replacement cost minus depreciation formula. The Broad Evidence Rule arose when courts stipulated that claim reps must consider more than just depreciation or market value when determining ACV.

**The broad evidence rule might appear to be the most flexible and complete approach to determining ACV**. However, both the market value and the replacement cost minus depreciation approaches, when properly understood and applied, can be as accurate and fair.

**2 – Other Valuation or Loss Settlement Provisions**

Objective: Explain how the amount payable for a property claim is determined under the following: agreed value; pair or set; selling price; invoice price; original cost

Although replacement cost and actual cash value (ACV) are the main property valuation methods used in homeowners and commercial property policies, a particular policy may apply other valuation or loss settlement provisions to certain types of property or loss situations. **To avoid making mistakes when determining the amount payable for a property loss, claim resp need to be aware of when these provisions might apply and look for them when reviewing coverage forms and endorsements. Valuation or loss settlement provisions other than replacement cost and ACV include these:**

* **Agreed value**
* **Pair or set**
* **Selling price**
* **invoice price**
* **Original cost**

**Agreed Value**

**The loss settlement method known as agreed value requires the insurer to pay a previously agreed-upon amount for a total loss of property that is subject to this method**. This loss settlement method is distinct from the Agreed Value optional coverage of the Building and Personal Property Coverage Form, also referred to as the BPP, which can be purchased to suspend coinsurance in commercial property coverage forms. A key difference is that when the BPP’s Agreed Value optional coverage suspends coinsurance, it doesn’t alter the replacement cost or ACV loss settlement provisions that apply under the same policy.

The agreed value loss settlement method, on the other hand, is commonly used when insuring an item of property whose ACV or replacement cost would be difficult to determine either before or after a loss occurred. **This would apply to items such as fine arts, antiques, and commercial watercraft**. While agreed value loss settlement provisions are more commonly found in inland marine, ocean marine, and other specialty policies, these are some instances in which claim reps who handle routine homeowners or commercial property claim can encounter the provisions:

* A family’s boatowners policy may cover the insured boat on a agreed value basis
* A valuable papers and records coverage endorsement attached to a commercial property policy might cover irreplaceable items, such as manuscripts or archival documents, on an agreed value basis
* A scheduled personal property endorsement to a homeowners policy may insure one or more of the items or classes of property designated in the endorsement’s schedule on an agreed value basis.

The ISO Scheduled Personal Property Endorsement (With Agreed Value Loss Settlement) (HO 04 60), for example. Classes of property that can be insured under this endorsement include jewelry, furs, cameras, musical instruments, silverware, golf equipment, fine arts, postage stamps, and rare and current coins. Insureds can purchase this endorsement to cover the scheduled (listed) items on an open perils basis, instead of the usual named perils basis, and to cover the scheduled items for amount of insurance that are not subject to the Coverage C special limits of liability that would otherwise apply.

When a claim for coverage under this endorsement, even if a scheduled item has sustained only partial damage, the insurer must pay the agreed amount for that item but has the right to take the damaged property and sell it as salvage. The losses claimed under this type of endorsement are often total losses because the items have been stolen. Many of the scheduled items are valuable and are often worn or used away from the residence premises, making them a common target for thieves.

To enable the insured to keep the damaged property after receiving payment of its agreed value, the endorsement contains a Buyback of Surrendered Property Provision stating that the insurer will, at the insured’s request, sell the damaged property back to the insured for a price that the insured and insurer agree on.

In many cases, a scheduled personal property endorsement does not provide agreed value loss settlement for all eligible classes of property. For example, the ISO Scheduled Personal Property Endorsement (HO 04 61) provides agreed value loss settlement for fine arts only. The other classes of property are covered on an ACV basis, up to the amount of insurance scheduled for each item of property. If the insured has purchased replacement cost settlement for Coverage C in an endorsement, then the Scheduled Personal Property Endorsement also provides replacement cost coverage for scheduled items, subject to the per-items limits, subject to the per-item limits shown in the schedule.

**Pair or Set**

Many property policies contain a pair or set clause. A common example of this type of clause is the Loss to a Pair or Set provision that appears in ISO homeowners forms:

* Repair or replace any part to restore the pair or set to its value before the loss or
* Pay the difference between actual cash value of the property before and after the loss

Often, the value of property is severely diminished when part of a set is damaged or lost. If the jacket of a suit is damaged, the claim rep will probably be unable to locate a matching jacket. If one of the fore 3-year old pairs of drapes in a dining room is damaged, a match could be difficult to find. However, **if a creamer in a silver tea set is damaged, it might be a stock item that is easily replaceable, and the pair or set clause would enable the claim rep to settle the claim by obtaining the matching creamer. Replacing the damaged item would restore full pre-loss value to the set.**

**As a result, claim reps shouldn’t consider a pair or set a total loss simply because a portion of it is damaged. Instead they must investigate whether it’s possible to restore the pair or set to its pre-loss condition**.

When a pair or set is scheduled and insured for an agreed value, the policy may contain a pair or set clause like this that takes the opposite approach:

If the scheduled article or property is a pair or set, or consists of several parts when complete, we will pay the full amount shown in the scheduled for that pair, set or complete article. At our request, you will surrender that article or property to us it not lost or stolen.

**Selling Price**

The BPP states that the value of “stock” the insured has sold but not delivered is its “selling price less discounts and expenses you otherwise would have had”. In the BPP, stock is defined as “merchandise held in storage for sale, raw materials and in-process or finished goods, including supplies used in their packing or shipping”.

Normally, a retailer’s or wholesaler’s inventory of goods held for sale is insured for replacement cost or ACV (which, for current unused stock, might be similar). Selling price include the normal business markup above the insured’s cost.

**When a manufacturer is insured under the BPP, it can purchase an endorsement titled Manufacturer’s Selling Price (Finished “Stock” Only), which insures finished stock manufactured by the insured for its selling price, whether or not it has been sold (less discounts and expenses the insured otherwise would have had)**.

**This endorsement is often purchased by manufactures because business income insurance normally excludes loss resulting from the destruction of finished goods manufactured by the insured**. **The Manufacturer’s Selling Price Endorsement, because it compensates the insured for the profit that the insured would have made on the finished goods had no loss occurred, pays the part of the loss that business income excludes**.

Some insurers offer selling pride valuation for a retailer’s or wholesaler’s entire inventory, not just on property that has been sold by the insured but not delivered. **If a retailer or wholesaler with selling price valuation of its entire inventory also has business income insurance**, the claim rep needs to recognize that the insured’s markup on the damaged inventory could be covered under both he BPP and its business income insurance because the exclusion of finished goods in business income forms applies only to finished goods manufactured by the insured.

If duplicate coverage for the insured’s markup on inventory exists under coverage forms contained in the insured’s own policy, the insurer will pay no more than the actual amount of the loss, in accordance with the insurance Under Two or More Coverages provision in the ISO Commercial Property Conditions (CP 00 90) form or a similar provision in a non-ISO form. IF the direct physical loss coverage and the business income coverage are written by different insurers, the insurers will look to the Other Insurance provision in the Commercial Property Conditions form or a similar provision in a non-ISO form.

**Invoice Price**

**Annual transit polices and trip transit policies commonly use invoice price as the basis for valuing shipments between a seller and a buyer**. The invoice price is the selling price of the goods. It’s shown in the sales invoice, a document that shows the details of the sale, including the price and quantity of the goods sold.

With valuation at invoice price, the amount of loss can usually be determined quickly and without dispute by referring to the invoice. Most policies that call for valuation at invoice price state that freight and other charges that have been either paid or guaranteed to the carrier will also be paid if the insured property is lost or destroyed.

**Original Cost**

**The original cost of a covered building or personal property is usually irrelevant for settlement purposes. However, an important exception can occur in loss settlement on a tenant’s improvements and betterments**.

For example, a business that leases space in an office building (and is therefore a tenant of the building) is insured under a BPP that covers Your Business Personal Property only. The office building and all its contents are destroyed by a fire. The tenant business, in turn, makes a claim for both loss of business personal property and loss of insurable interest in the use of tis improvements and betterments to the building.

The BPP covers the insured’s use interest in improvements and betterments under Your Business Personal Property, but the BPP Valuation condition addresses valuation of a tenant’s improvements and betterments in different ways, depending on the circumstances.

**If the tenant property repairs or replaces the improvements, the tenant’s insurer is obligated to pay the ACV or replacement cost if the tenant is purchased that option for Your Business Personal Property**. IF the tenant does not repair or replace the improvements promptly, the tenant’s insurer is obligated to pay only a pro rata portion of the original cost, and the ACV or replacement cost is not relevant to loss settlement.

For example, suppose improvements costing $100,000 were installed on June 1, 2010 and the insured’s lease was due to expire on June 1, 2020, with no renewal option. On June 1, 2018 the improvements were destroyed and were not replaced. The tenant had invested $100,00, expecting to use the improvements for 10 years. However, only 8/10ths had passed at the time of the loss. Because 8/10ths of the original cost had been “used up”” at the time of the loss, the insurer paid only 2/10th of the original $100,000 cost - $20,000, to cover the loss of the tenant’s remaining use interest.

If the building owner or anyone else pays for repair or replacement of the property improvements, the tenant’s insurer has no obligation under the policy to pay anything for the improvements.

**3 – Applying Coinsurance and Other Insurance-To-Value Provisions**

**Objective**: Given a claim for direct physical loss under a commercial property, businessowners, or homeowners policy, apply the policy’s coinsurance provision or a similar type of insurance-to-value provision to determine the amount of loss payable.

Claim reps need to know how to apply a **coinsurance (an insurance-to-value provision providing that if the property is underinsured, the amount that an insurer will pay for a covered loss is reduced**) provision or a similar type of **insurance-to-value provision (in property policies that encourages insureds to purchase an amount of insurance that is equal to, or close to, the value of the covered property)** as part of determining the amount payable for a covered property loss.

To encourage policyholders to purchase insurance to value, commercial property coverage forms commonly contain a coinsurance provision and, as an alternative to coinsurance, an agreed value option to suspend coinsurance. Businessowners policies and homeowners policies typically contain an insurance-to-value provision that is similar to coinsurance, but the reductions in coverage for underinsuring property are less severe.

**Commercial Property Policies**

The coinsurance provisions and agreed value option contained in the ISO Building and Personal Property Coverage form, also referred to as the BPP, are similar to the insurance-to-value provisions commonly used in other commercial property coverage forms.

**Coinsurance**

The BPP coinsurance provision requires the insured to carry insurance equal to at least a specified percentage of the covered property’s actual cash value (AVE) or replacement cost, depending on which valuation option applies. The coinsurance percentage is shown in the declarations. **If the amount of insurance carried is equal to or greater than the required percentage of the property’s value, the insure will pay covered losses in full (subject to any applicable deductible) up to the limit of insurance. If the amount of insurance carried is less than the required percentage, loss payments are reduced proportionately. This reduction in the loss payment is the coinsurance penalty**.

If the amount of insurance carried does not meet the coinsurance requirement, the amount the insurer will pay – up to the applicable limit of insurance – is calculated using this formula

**Loss payment = (Amount of insurance carried/amount of insurance required X Loss) – deductible**

The amount of insurance required is the property’s ACV (or replacement cost, if that option has been chosen) immediately before the loss occurred multiplied by the coinsurance percentage show in the declarations.

|  |  |
| --- | --- |
| ACV of covered bldg at time of loss | $200,000 |
| **Limit of Insurance** | **$140,000** |
| Coinsurance Percentage | 80% |
| Amount of loss | $40,000 |
| Deductible | $500 |
| **Amount of Ins Required** | 80% of $200,000 = **$160,000** |

Loss payment = ($140,000 / $160,000 X $40,000) - $500

= (0.875 X 40,000) - 500

= 35,000 – 500

= $34,500

With the BPP, the deductible is subtracted after the loss payment has been calculated. Some non-ISO policies call for subtracting the deductible from the loss before multiplying the loss by the ratio of amount carried to amount required, which results in a slightly higher recovery.

The coinsurance provision is applied separately to each specifically insured type of property covered under the policy, such as the insured’s building; the insured’s business personal property; and property of others in the insured’s care, custody, or control.

For example, assume that Naomi operates a large restaurant in a building she owns. The building is specifically insured for $1,000,000 and her business personal property is specifically insured for $2,000,000. The insurable value of each individually is $2,500,000 a covered loss resulted in $400,000 damage to the building and $400,000 in damage to her business personal property.

The coinsurance is applied separately to Naomi’s building and business personal property, and Naomi is subject to a coinsurance penalty on the building loss. Even if Naomi had a $2,500,000 limit on her business personal property, which is more than needed to comply with the coinsurance requirement on her business personal property, she would still incur the same coinsurance penalty on the building coverage.

Similarly, if a landlord’s BPP specifically insured five different buildings with a separate limit of insurance applying to each building, the coinsurance provision would be applied separately to each building loss if all five buildings were damaged by a hurricane.

**The coinsurance provision applies to the total of all covered property only when one limit of insurance, referred to as blanket insurance, applies to all covered property**. Blanket insurance covers the following with one limit of insurance (1) one type of property in one or more separately rated buildings or (2) two or more types of property in one or more separately rated buildings.

For example, Naomi might have purchased a $3,000,000 limit of insurance covering both her building and her business personal property.

The BPP states that the deductible will be applied only once per occurrence. Therefore, if two or more specifically insured types of property – such as building and business personal property – are damaged in one occurrence, the deductible, once applied in full to the building loss, cannot then be applied to the business personal property.

Even when insurance meets coinsurance requirements, the amount paid for a loss cannot exceed the applicable limit of insurance shown in the policy declarations, subject to these exceptions.

* One or more of the additional coverages in the policy may provide amounts of insurance that apply in addition to the limit of insurance shown in the declarations. A coverage endorsement attached to the policy may have the same effect
* The limit of insurance shown in the declarations may be automatically increased by an inflation guard provision, a peak season endorsement, or another endorsement that has the same effect

Some commercial property policies, called **flat policies** (without coinsurance clause) are not subject to coinsurance. When an insured wishes to carry an amount of insurance known to be considerably less than the covered property’s actual value, some insurers will delete the coinsurance provision and charge a rate that is substantially higher than the usual 80% coinsurance rate.

**Agreed Value Optional Coverage** (optional coverage that suspends coinsurance condition)

**The coinsurance provision can be suspended conditionally by a method known as agreed value**. A common example of the agreed value approach is the Agreed Value optional coverage in the BPP. To activate this option, an amount that the insurer and insured agree on is entered under the Agreed Value heading in the declarations for each category of property (building, business personal property, or both) to which the option applies. **This option enables the insured to remove the uncertainty as to whether the amount of insurance carried complies with the coinsurance provision**.

With this option in force, the insurer and the insured have agreed in advance that the agreed value stated in the declarations is adequate for coinsurance purposes. Because the agreed value option suspends the coinsurance provision, insurers underwrite this option carefully. Ordinarily, the insured must provide a signed statement of values for the insured property.

**To obtain the benefit of the agreed value option -suspension of coinsurance – the insured must select a limit of insurance that equals or exceeds the agreed value.** If the limit of insurance equals or exceeds the agreed value, losses will be covered in full up to the limit of insurance. But **if the limit of insurance is less than the agreed value, the amount of loss payment is calculated using this equation**:

**Loss payment = (limit of insurance / agreed value X Loss) – deductible**

Coverage under this option extends until the agreed value expiration date shown in the declarations or expiration date of the policy, whichever occurs first. This is why a policy written on an agreed value basis typically shows a coinsurance percentage in the declarations, even though it won’t come into play in most cases.

**Businessowners Policies**

At one time, most businessowners policies (BOPs) didn’t have a coinsurance provision or any other insurance-to-value provision. Today, many BOPs contain an insurance- to-value provision – but less strict than the coinsurance provision found in most non BOP commercial property policies.

The insurance-to-value provision contained in the Loss Payment provision of the ISO Businessowners Coverage Form (BCF) is the basis for this discussion. The comparable provision in some insurer’s proprietary BOP forms may differ, so it’s important, as always to review the provisions of the particular policy before determining the amount payable for a claim.

The BCF provision differs from the usual coinsurance provision in several ways, including these:

* The BCF provision applies only to property insured on replacement cost basis. Losses to property insured on an ACV basis are not subject to the provision. (The BCF, unless amended, covers buildings and business personal property on a replacement cost basis, subject to exceptions that apply to certain types of property)
* The BCF provision does not apply if the insured chooses to receive an ACV settlement on property that is otherwise covered for replacement cost. In some cases, an insured might receive a higher settlement on an ACV basis. The claim rep should calculate the payment both ways so that the insureds receive the higher recovery to which they are entitled under the policy

**If the limit of insurance on the damaged property at the time of loss is 80% or more of the property’s full replacement cost immediately before the loss**, the insurer will pay the cost to repair or replace the property, after application of the deductible and without deduction for depreciation, but it will not pay more than the **lowest of these three amounts**:

* The limit of insurance that applies to the lost or damaged property
* The cost to replace, on the same premises, the lost or damaged property with property of comparable materials and quality and used for the same purpose. This provision does not require the insured to rebuild on the same premises. But if the insured rebuilds on at a new location, the cost is limited to the cost that would have been incurred if the building had been rebuilt at the original location.
* The amount that the insured actually spends to repair or replace the lost or damaged property

**If the limit of insurance on the damaged property at the time of loss is less than 80% of the property’s full replacement cost immediately before the loss**, the insurer will pay **the greater of these two amounts**, but not more than the limit of insurance that applies to the property:

* The ACV of the damaged property
* A proportion of the cost to repair or replace the damaged property, after application of the deductible and without deduction for depreciation. The proportion is the applicable limit of insurance divided by 80% of the property’s replacement cost.

For example, a building is insured on a replacement cost basis for a limit of $120,000. The full replacement cost of the building is $200,000. The building sustains a partial loss of $100,000 on a replacement cost basis, or $90,000 on an ACV basis

Replacement cost of building $200,000 /80% coinsurance = $160,000 (insurable value)

Replacement cost limit of insurance # 120,000 / 160,000 = .75

.75 X $100,000 loss = $75,000

In these calculations 0.75 is the proportion of the cost to repair or replace the damaged property.

Because the damaged property’s ACV ($90,000) is greater than the amount calculated, the insurer will pay $90,000 on the $100,000 loss. If this had been covered under a BPP with an 80% coinsurance clause the insured would have received the $75,000

The BCF calls for the amount of the loss to be reduced by the deductible before multiplying the amount of the loss by the proportion of the cost to repair or replace the damaged property. The BPP calls for applying the deductible after coinsurance is applied. The procedure in the BCF is more favorable to the insured; it increases the amount that an insured can collect if the amount of insurance is less than 80% of the replacement cost.

Vincente owns a building that is insured under a BCF on a replacement cost bases for a limit of $150,000. The full replacement cost of the building is $215,000. The loss sustained is $60,000 on a replacement cost basis, or $45,000 on an ACV basis. The policy also has a $500 deductible.

Replacement cost of building $215,000 / 80% coinsurance = $172,000

Amount of Insurance $150,000 / $172,000 = .872

Amount of loss $60,000 - $500 Deductible = $59,500

Amount of loss less deductible $59,500 x .872 = $51,884 (which is more than the $45,000 ACV available)

**Homeowners Policies**

**The insurance-to-value provisions contained in homeowners policies** is similar to the same provision in the BCF but **applies only to property insured under Coverage A – Dwelling and Coverage B – Other Structures**, not to personal property. This discussion is based on the loss settlement provision contained in the ISO Homeowners 3 Special Form (HO-3)

Loss Settlement for the dwelling and other structures depends on how the limit of insurance compares with the replacement cost value of the damaged property at the time of the loss:

* **If 80% or more** of the replacement cost, the insurer will pay for the replacement cost of the damage up to the limit of coverage
* **If the limit of insurance is** **less than 80**% of the replacement cost, the insurer will pay the greater of two amounts: the ACV of the damage, or the portion of the cost to repair or replace the damage that the limit of insurance bears to 80% of the replacement cost. This is often **easier to understand as a formula**:

**Loss payment = limit of insurance / 80% X Replacement Cost X Replacement cost of the loss**

Except for small losses, which are generally considered to be under $2,500, the insurer will not pay more than the ACV until repairs are completed. An insured who has not decided whether a structure should be rebuild can see loss settlement on an ACV basis. Should the insured then decide to complete the repairs, he or she has up to 180 days after the loss to notify the insurer of the intent to complete the repairs and make settlement on a replacement cost basis rather than ACV.

Loss Settlement examples:

**Example** – dwelling limit equals or exceeds 80% of the replacement cost. An insured has a home with a $200,000 replacement cost and HO-3 with a coverage limit of $180,000. Lightning strikes the AC unit, it has a $5,000 replacement cost and is 5 years old. The dwelling is insured for more than 80% of the replacement cost (replacement cost $200,000 /$180,000 coverage = 90%)

***Answer: The insured would receive the $5,000 replacement cost to replace the unit***

**Example** – Dwelling limit is less than 80% of the replacement cost; if this same insured has an HO-3 with a Coverage A limit of $100,000 (50% of the replacement cost), the insured’s coverage would be below the 80% replacement cost requirement, and the second loss settlement method would be used. The insured would then receive the greater of the following:

* The ACV of the air conditioner. The ACV would be the $5,000 replacement cost minus depreciation. If a central air condition has a useful life of 10 years and it is now 5 years old, the A/C would depreciate by 50% = $2,500
* The limit is calculated as:
  + $100,000 / (80% X $200,000) X $5,000 = $3,125

***Answer: The insured would receive the greater amount $3,125***

**4 – Applying Property Insurance Limits and Deductibles**

Objective: Apply policy limits and deductibles to determine the amount of loss payable under a property insurance policy

After confirming that a claimed loss is covered, a claim rep must determine the amount of loss that’s payable under the policy. Knowing how to apply policy limits and deductibles is an important part of this activity.

**To determine the amount payable for a covered loss, the claim rep should first review the policy for limits and endorsements or provisions that could either add coverage or reduce it to an amount that’s lower than the policy limit(s).** The rep also must review when to use a policy’s repair or replace option and how to apply the policy’s deductible(s). In addition, the rep must be familiar with state laws that may apply to the loss.

**Policy Limits**

Virtually all property policies are subject to one or more policy limits, also referred to as amounts of insurance, limits of insurance, and limits of liability**. Property policies normally contain this type of provision; “The most we will pay for loss or damage in any one occurrence is the applicable Limit of Insurance shown in the Declarations”.**

For example, assume that the policy limit for Coverage A – Dwelling in a homeowners policy is shown in the declarations at $250,000 and that the covered dwelling suffers a total loss from a covered peril. The most the insurer will pay to the insured for loss to the dwelling is $250,000, even if rebuilding the home cost $255,000

In many claims, **however, the policy limit doesn’t reflect the maximum the insurer must pay**. Various provisions contained in a policy form or its **endorsements can add coverage amount to policy limit(s)** shown in the declarations.

This underscores the need to review the entire policy and all of its endorsements when determining the amount payable for a claim. These are examples:

* **Inflation guard optional coverage** – automatically increases one or more limits shown on the declarations by an annual percentage shown in the declarations
* **A peak season endorsement** – increases the business personal property limit during the period described in the endorsement
* **A homeowners policy endorsement** that increase the policy limits **when there is a total loss to the dwelling and the limit show in the declarations is insufficient to replace the dwelling**. Similar endorsements may be attached to commercial property policies
* **An additional coverage – such as increased cost of construction**, that apples in addition to the policy limit

**Other provisions can reduce the amount payable** so that it’s lees then the applicable limit. **Homeowners** policies, for example, contain numerous special limits of liability that apply to **Coverage C – Personal** Property**. Special limits** – internal dollar limits on certain specified classes of property, regardless of the overall policy limit.

* **$200 on money**, bank notes, bullion, gold other than goldware, silver, other than silverware, platinum other than platinumware, coins medals, scrip, stored value cards, and smart cards
* **$1,500 on watercraft** of all types, including their trailers, furnishing, equipment and outboard engines or motors
* **$1,500 for loss by theft of jewelry**, watches, furs, and precious and semiprecious stones

***Effect of Valued Policy Laws***

*Valued policy laws, which exist in less than half the states, require insurers to pay the policy limit for a total loss to a covered building. In the absence of such laws, claim reps determine the building’s value at the time of the loss.*

*If the value is less than the policy limit, the settlement is based on the buildings value, not the policy limit. However, if a valued policy law applies, the rep must offer to settle the loss for the policy limit, even if the building is overinsured.*

*These laws were enacted to ensure a fair settlement amount based on the insured’s policy limit on which the premium was based. The theory is that if the insured paid for $200,000 in coverage, the insurer should pay $200,000 for a total loss.*

*Most valued policy laws apply only to building and structures. However, a few also apply to personal property.*

*A valued policy law may apply to losses caused only by fire, and one or more other specified perils, or by all perils covered in the policy. Claim reps must check the law in the state where a particular loss occurs.*

**Repair or Replace Option**

In virtually all property insurance policies, the insurer has the option to either repair or replace lost or damaged property instead of paying a claim – and this is strictly the insurer’s choice. The insured cannot insist that the insurer make a cash settlement or repair or replace the property.

Because insurers can opt to repair or replace property with property of like kind and quality, many have business relationships with furriers, jewelers, consumer electronic dealers, and similar merchants that can facilitate property replacement. The volume of business insures do with these merchants enables them to obtain discounts.

Many large replacement service companies also serve the insurance industry and stock many items of personal property. For example, a claim rep may use a fine china replacement service if pieces of an insured’s chine set are damaged and the pattern has been discontinued.

**When determining whether to repair or replace property, insurers often consider expense as well as whether the insured may be trying to profit from the claim. For example, replacing an item might make settling a claim less expensive if the insurer has standing arrangements with wholesale suppliers to replace items of lost property**.

**The repair or replace option also makes it more difficult for an insured to profit from a loss. Insureds who falsify or stage a claim are usually interested in a cash settlement. If the insurer cannot prove that a suspicious claim is false, the repair or replace option at least limits the insurer’s cost of settling the claim**.

**Deductibles**

Most personal and commercial property coverages are subject to deductibles. **Deductibles are important because they require insureds to share in their losses – thereby providing an incentive for them to prevent or minimize losses.**

Deductibles also eliminate the insurer’s obligation to pay for small losses below the deductible amount. The insurer benefits from this by avoiding the administrative costs of small claims, and the insured benefits from reduced premiums.

**Types of deductibles**

**Most homeowners policies have a flat deductible (specified dollar amount) that applies to any covered cause of loss**. However, some insurers also offer a **percentage deductible (expressed as a percentage of the amount of insurance, or the amount of the loss)** in place of a flat deductible. Insurers may event opt for a hybrid approach, using a percentage deductible for designated perils and flat deductibles for all other covered losses.

Most earthquake policies and endorsement have a percentage deductible. In coastal areas, as well as areas where tornadoes and severe storms occur frequently, property policies often contain a percentage deductible that applies to losses covered by windstorm or hail.

Windstorm or hail percentage deductibles in homeowners policies are typically set at 1%, 2%, or 5% of the Coverage A – Swelling limit of insurance shown in the declarations. For example, if an insured’s building suffers $15,000 damage from a covered cause of loss that is insured for $400,000 with a 2% deductible, the deductible would be $8,000.

Loss = $15,000

Dwelling Limit = $400,000

Deductible = 2%

$400,000 X 2% = $8,000

Payment = Loss $15,000 - $8,000 Deductible = $7,000

If the deductible were 5% = $20,000 no payment would be made

Some policies might even have a **split deductible (one deductible for most causes of loss, but a different higher deductible for other specified causes of loss)**. For example, a policy might carry a $1,000 theft deductible and a $250 deductible on all other covered losses. This gives the insured a greater incentive to guard against theft.

**Commercial property policies commonly have a $500 flat deductible**. The deductible can be increased (with a lower premium) or decreased (with a higher premium). Frequently, the deducible is raised to $1,000, or $5,000. Some commercial property policies will also have percentage deductibles.

**In both commercial and homeowners policies, not deductible apples to the Fire Department service charge** additional coverage. In addition, in homeowners policies, no deductible apples to the credit card, fund transfer card, forgery, or counterfeit money additional coverage. However, the limits that apply to these additional coverages are low, such as $500 or $1,000.

**Absorbing Deductibles**

**When the amount of a loss exceed an applicable limit, the excess amount of the loss that’s not covered can reduce (or “absorb”) some or all of the deductible that would otherwise apply. To absorb all of the deductible in a claim, the excess loss must exceed or equal the deductible**.

Some policies allow for absorption of the deductible when applying policy limits. For example, the Building and Business Personal Property Coverage Form’s Deductible provision states in part “If the adjusted amount of the loss exceeds the Deductible, we will then subtract the deductible from the adjusted amount of loss and pay the resulting amount or the limit of insurance, whichever is less.

The provision would come into play, for example, a building insured for $500,000 with a $5,000 deductible sustained a loss valued at $520,000. The insurer would subtract the deductible from the $520,000 adjusted amount of loss before applying the limit of insurance, so the amount of loss payable would be $500,000. If the policy were silent on this point, an insurer might apply the deductible after applying the limit, in which case the amount payable would be $495,000 ($500,000 Policy Limit - $5,000 Deductible).

A similar instance of absorbing deductibles can occur when adjusting a claim involving one or more categories of personal property that are subject to limits (such as Coverage C -Personal Property in a homeowners policy), If the amount of loss for a category of personal property (such as jewelry or silverware) exceeds the applicable special limit, does the excess amount of loss then absorb, or reduce the deductible?

The answer can vary, by policy and insurer, depending on the policy language, the insurer’s interpretation of the policy language, regulations or case law in the applicable jurisdiction, and the insurer’s claims philosophy.

Examples: Jane has a HO-3 Policy with a $250 deductible and special limit of liability for cash $200. Theft occurs at her home:

**Loss Payment**

TV = $580 ACV $580

Cash = $500 $200 (Special Limit)

Mobile Phone = $850 ACV $800

Total: $1,880 $1,580

The total loss sustained is $1,880 but because of the special limit of liability only $200 in cash can be paid.

Jane has suffered a $300 uninsured loss of cash ($500 - $200 limit), which cannot be paid under the insurance policy. Because she has already shared in the loss, no deductible will be applied and she will be paid the $1,580 for the loss (the $250 deductible is absorbed by the excess $300 loss)

Example: The car family has an HO-3 with $500 deductible and a $1,500 special limit on jewelry. Theft:

**Loss Payment**

Diamond Necklace = $1,750 $1,500 (special limit)

Camera = $300 ACV $300

Rifle = $500 ACV $500

Laptop = $600 $600

Total: $3,150 $2,900 (less remaining Ded $250) = $2,650

The cars have an uninsured loss of $250 ($1,750 - $1,500). However, they carry a $500 deductible. The $250 uninsured loss allows $250 of the deductible to be absorbed because it is the insureds share of the loss. The remaining $250 of the deductible must be subtracted $2,900 - $250 = $2,650

**5 – Settlement Involving Other insurance**

Objective: Calculate the amount payable for a described property loss using either the proportional share method or the primary/excess method

In property insurance claims, sometimes more than one insurance policy covers a loss – a situation referred to as other insurance or overlapping coverage. When investigating property losses, claim reps must seek to identify overlapping policies so that these claim can be settled using the methods described in the other-insurance provisions contained in the overlapping coverages.

**Discovering Overlapping Coverage**

Overlapping coverage often occurs inadvertently, such as an insured forgetting to cancel an existing policy after a new one has been purchased. In other cases, overlapping coverage occurs when an item of personal property that is specifically described (“scheduled”) in one policy is also covered as unscheduled personal property in another policy. Another possibility is that the insured has intentionally obtain multiple policies on the same property from different insurers, with the intent to stage a loss and submit a fraudulent claims to all the insurers.

When overlapping coverage occurs inadvertently and with no intent to defraud the insurer, the application of other-insurance provisions prevent the insured from being overcompensated and allows each insurer involve in the overlap to pay no more than its share of the loss. However, when the initial claim investigation reveals overlapping coverage that appears to be part of a fraudulent claim, other-insurance provisions should not be applied to the claim. Instead, the claim should be investigated like other suspicious property claims in accordance with the insurer’s claim procedures.

**When taking statements, a claim rep can ask claimants whether they have other insurance that might cover the claimed loss. Some insureds know that they have overlapping coverages and cooperate with the insurer to identify the other insurance company**. If other insurance for a claim exist, the claim rep should follow company procedure for such situations, including review of the other-insurance provision in the applicable policies to gauge how they will affect the amount payable for the claim.

**Other-Insurance Provisions in Common Property Forms**

A common example of the wording of other-insurance provisions applicable to property coverages in homeowners policies:

If a loss covered by this policy is also covered by:

1. **Other insurance, we will pay only the proportion of the loss that the limit of liability that applies under this policy bears to the total amount of insurance covering the loss (proportional)**

2. **A service agreement, this insurance is excess over any amounts payable under such agreement. Service agreement means a service plan, property restoration plan, home warranty or similar service warranty agreement, even if it is characterized as insurance (primary/excess)**

The method described in part 1 of this provision is often referred to as the proportional-share method, the pro-rata share method, or contribution by limits. The method described in part two is often referred to as the primary/excess method.

The other-insurance provision contained in the ISO Commercial Property Conditions Form (CP 00 90) that’s widely used in commercial property polices calls for the same two methods:

* If the other applicable policy or policies are all subject to the same terms, conditions, and provisions, each insurer’s share is calculated by dividing the applicable policy limit by the total of all policy limits covering on the same basis, and multiplying the total amount of the covered loss by the resulting number
* If the other insurance does not have the same terms, conditions, and provisions as the policy issued by the claim reps company, the insurer pays only the amount of loss in excess of the amount due from the other insurance, whether collectible or not

**Proportional-Share Method**

The proportional-share method is best illustrated by example of how the different insurers’ shares calculated in particular cases.

**In addition to loss payment, policy deductibles are proportionally split in cases of overlapping coverage, when the two (or more) policies have the same deductible. If Company C carries ¾ of the coverage, it would subtract ¾ of the deductible amount from its claim payment. If Company D carries ¼ of the coverage, it would subtract ¼ of the deductible from its claim payment**. When the policies have different deductibles, the splitting of deductibles can be complicated and the involved insurers would need to agree on the method used to split the deductibles.

Proportional-share Examples:

Suppose that Company A has a policy with $40,000 coverage and Company B has $60,00 coverage. The insured suffers a covered loss of $10,000

Company A = $40,000

Company B = $60,000

Total Insurance $100,000 so Company A would pay 40% ($4,000) and Company 60% ($6,000)

Suppose that 2 homeowners policies, both have other-insurance conditions indicating losses must be adjusted using the proportional-share methods. Loss amount $12,000

Company C = $75,000

Company D = $25,000

Total Insurance $100,000 Company C ($75,000/$100,000) = 75% of $12,000 Loss = $9,000

Company D ($25,000 / $100,000) = 25% of $12,000 Loss = $3,000

**Primary/Excess Method**

When a policy calls for the primary/excess method to be used and both insurers coverage the loss agree which insurer is excess and which is primary, the primary pays first, up to the applicable limit of insurance, and the excess insurer pays the remaining amount of loss, not to exceed its applicable limit of insurance.

With primary/excess sharing between two insurers, the excess coverage can occasionally pay the difference in the deductibles under the two policies.

Deductible Example: ABC insurance states that its coverage is excess and has a $100 deductible. XYZ does not have the Other-insurance condition, and its policy has a $250 deductible. For a loss, XYZ would be primary, and its obligation would be to pay the adjusted claim minus the $250 deductible. ABC’s obligation would be to pay the difference in the deductibles, $250 minus ABC’s $100 = $150 ABC would be obligated to pay the difference in the deductibles when, ABC’s deductible is smaller than the primary XYZ’s policy. If XYZ has a smaller or an equal deductible, ABC would have no obligation to pay any part of the claim.

**“Property More Specifically Described” Provision**

In addition to other-insurance provisions, some property policies also contain a separate provision such as this one from the Property Not Covered Section of the ISO Building and Personal Property Coverage Form (CP 00 10):

*Covered Property does not include:*

*1. Property that is covered under another coverage form of this or any other policy in which it is more specifically described, except for the excess of the amount due (whether you can collect on it or not) from that other insurance.*

A photography studio, for example, is under a commercial package policy. This policy includes a Building and Personal Property Coverage form (BPP) that covers the studio’s business personal property. **The package policy also includes a Commercial Articles Coverage** Form that specifically describes the studio’s cameras and other photographic equipment under broader terms of coverage than the BPP.

A camera that is specifically described and insured for a $2,000 limit in the Commercial Articles Coverage Form is destroyed by a covered cause of loss that occurred on the Studio’s premises. The camera is not specifically described in the BPP but qualifies as Your Business Personal Property under that form. However, because of the provision just quoted, the camera is not included as Covered Property under the BPP “except for excess of the amount due” from the Commercial Articles Coverage Form. The insurer would therefor pay the amount due under the Commercial Articles Coverage form, not to exceed $2,000. If the amount of loss exceeded the $2,000, the excess would be paid under the BPP subject to any applicable provisions.

The same type of overlapping coverage situation can occur when the covered property is “more specifically described” in a separate policy issued by another insurer. In the preceding example, the Commercial Articles Coverage Form could have been issued as an Inland Marine policy issued by a second insurer.

**When overlapping coverages are contained in the same policy, the insurance Under Two or More Coverages provision of the Commercial Property form (CP 00 90) is also relevant**:

*If two or more of this policy’s coverages apply to the same loss or damage, we will not pay more than the actual amount of the loss or damage*.

**Resolving Disagreements**

When overlapping coverage exists and insurers disagree on the amounts they must pay, informal negotiation can often resolve disagreements. However, when a significant amount of loss is in dispute and the other-insurance provisions are contradictory or nonexistent, compromise may not be possible and form negotiation may be necessary.

**The first step in a formal resolution of a dispute about overlapping coverage is usually arbitration. Arbitration can be either binding or nonbinding. The policies involved may specify which type o arbitration is to be used in coverage disagreements. If binding arbitration is used, the insurers will be bound by the arbitration decision and the disagreement will be resolved. If the arbitration is nonbinding and if one or more insurer does not accept the result, then litigation will proceed toward a court resolution.**

Regardless of the amount of time negotiations may take, it is important to consider the insured while the negotiations are in progress. The primary insurer or all insurers involved could agree to pay the disputed amount to the insured and then reconcile the amounts due to each insurer at the conclusion of negotiations or litigation.

**Loss practice:**

Policy A $25,000 Limit

Policy B $75,000 Limit

Loss in the amount of $15,000

Policy A : $25,000 / $100,000 = .25% **Will pay $3,750.00**

Policy B: $75,000 /$100,000 = $75,000 **Will pay $11,250**

**6 – The Appraisal Provision**

**Objective**: Explain why the appraisal procedure is required and how it operates, including the claim reps role.

**Most property insurance policies contain an appraisal provision, which provides a way to resolve disputes between the insured and the insurer about the amount of loss**. The appraisal provision has no role in resolving issues other than the amount of loss, so it can’t help with coverage questions or policy interpretation.

**Under the appraisal provision, the claim rep must follow the required appraisal procedure from beginning to end. Sot he claim rep needs to know the procedure and make sure that the appraisal is conducted according to the policy and conforms to the relevant jurisdiction’s regulation**.

**What triggers an Appraisal**

**The appraisal provision states that either the insured or the insurer may demand an appraisal of the loss – so if either party demands an appraisal, the other party must participate**. If the insurer sends a letter to the insured demanding an appraisal, the insured cannot refuse. It would be a violation of a policy condition to refuse, and the insurer could deny the claim based on that violation. However, an insurer that denies coverage altogether waives it right to appraisal.

Some states have imposed amendatory endorsements that make the appraisal procedure voluntary or nonbinding or have completely removed the appraisal provisions from policies. Claim reps should check the jurisdiction’s rules before demanding an appraisal.

**Appraisers’ Qualifications and Selection of Umpire**

The appraisal provisions states that each party will choose a competent appraiser within a specific time frame. Either party can question the qualifications of the other party’s appraiser. For example, if an insured selects an unlicensed carpenter as an appraiser for a fire claim, the insurer could likely contest the selection.

If one party object to the competency of an appraiser but the other party uses that appraiser anyway, the objecting party could contest the appraisal in court. To avoid this, each party must use great care when selecting an appraiser.

**The appraisers should be competent and the must also be impartial**. An example of an appraiser who doesn’t meet this standard is a contractor who agreed to perform the repairs on the insured’s property before being selected as the insured’s appraiser. The contractor wouldn’t be impartial because his or her business may depend on the appraisal. This doesn’t mean that the insurer and its appraiser must never have dealt with each other in the past – it just means that the appraiser can’t be economically dependent on the insurer. Also, a claim rep shouldn’t select an appraiser because of gifts or favors received from the appraiser.

**The appraisal provision states that the two appraisers must chose an umpire**. Although this usually isn’t a problem, **if the appraisers can’t agree on an umpire,** either party may request that the selection be made by a court in the jurisdiction.

**The Appraisal Procedure**

The appraisers must “separately set the amount of loss”. They should inspect the damaged property and provide their own calculations of the amount of loss. Different appraisers will often select different repair techniques and determine different costs. However, the two appraisers should try to agree on the scope of damage, including whether property should be repaired or replaced and its quantity (dimensions and amount) and quality.

If the two appraisers agree on the amount of loss, they’ll submit a written report of an agreement to the insurer, and the amount they’ve agree on will be the amount of loss. However, appraisers often disagree, so the appraisal provision request that they submit their differences to the umpire. The loss amount will then be the amount that any two of three parties agree to.

**Once the amount of loss is set, it’s binding on all parties unless state law says otherwise**. An appraisal can still be challenged, but usually only fraud, collusion, or mistake of law are valid grounds to challenge an appraisal. Challenges are sometimes based on the contention that the appraiser was incompetent or that questions about coverage existed. But in most cases, if the appraisers and the umpire were selected properly, the award will stand.

The insured and the insurer each pay their own appraiser and share the cost of the appraisal and umpire equally.

**Waiver and Estoppel**

Throughout the claims process, the claim rep should tell the insured about any policy condition the insurer might enforce. Failing to do so could waive the insurer’s right to enforce a condition. If the insurer decides to demand an appraisal, it must advise the insured in a demand letter that uses exact policy language. Then the insurer must promptly follow all the rules of the appraisal provision and jurisdiction. Any rule violate might prevent the insurer from being able to enforce the appraisal provision.

For example, if the insurer demands an appraisal and the Insured properly names its appraiser within the 21 day limit required by the policy, but the insurer doesn’t name its appraiser in the required time frame, the insured could refuse the appraisal.

**Precondition to Lawsuit**

Because the appraisal provision is a policy condition, either party must comply with it before being able to file a lawsuit. For example, assume that the amount of loss is disputed and the insurer demands an appraisal, and the insured refuses the appraisal and files a lawsuit against the insurer. While each state has different laws and courts that can differ in their rulings, the parties generally must comply with the policy conditions before filing a lawsuit. So in this example, the insured would probably lose its case. Alternatively, if the insurer denies coverage, it will have waived its right to demand an appraisal.