

Enough' Insurance is Often Not Enough

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In the past few weeks, the most destructive wildfire in Colorado history claimed two lives, burned nearly 30 square miles and totally destroyed more than 350 homes. Like almost all homeowners everywhere in the United States, nearly everyone who lost their house to this massive disaster will have home insurance — but, at least three-quarters of those homeowners are about to learn to their surprise) that they have far less insurance coverage than it will cost to rebuild their homes.

It happens every time. Across this entire nation, across all neighborhoods, classes, and communities, and despite homeowners routinely wanting to have and believing they have full insurance, about three-quarters of Americans are underinsured by tens of thousands — often hundreds of thousands — of dollars. There is a way for an individual homeowner to protect themselves, and a way for State Departments of Insurance to broadly solve the issue. Both depend on first understanding how the problem arises.

Insurance “values” homes for less than it costs to rebuild them. Many homeowners have at least a vague understanding of what their home is worth if the home was up for sale. Most homeowners have little understanding of what it would cost to build, or rebuild, the same home — usually a much higher figure. Homeowners typically buy insurance by going to an insurance agent or broker, giving very basic information about the home age, square footage, address), and asking for a quote. Because of the way that most insurance agents or brokers price a home’s value, that quote most frequently approximates the market value of a home, not the rebuild cost of a home. That means the insurance value is low. Both the insurance policy, and the courts if there is later a lawsuit about underinsurance), generally put the “risk” of being underinsured on the customer. The policy often says, and the courts often agree, that the ultimate decision of how much insurance is needed rests on the homeowner, and if the insurance is too little, it is the homeowner’s problem unless the insurance agent or broker or company explicitly took on the responsibility.

Over time, the gap in underinsurance widens. Because most homes are already insured, and year-to-year most homes neither change hands nor are refinanced, most insurance policies are renewals, not new business. An insurance company risks the lion’s share of its business renewals) if it gives a homeowner a

reason to wonder if the customer can get the same insurance cheaper. Nothing will raise that question quicker than raising the premium. Annually revaluing the home usually means the value goes up (home market values rise much more often than they fall). A higher insured value causes a higher insurance premium. In order to avoid raising the premium and risking the renewal, the insurer rarely if ever unilaterally revalues the home as part of the renewal process. In other words, even while construction costs to rebuild the home rise, the amount of insurance coverage does not.

A homeowner's best way to protect themselves is to create a record, in writing (email counts) that the homeowner wants full insurance, and is relying on the agent or broker to be selling full insurance. To do this requires that at every purchase or renewal of insurance, the homeowner says in writing to the insurance agent or broker 1) the homeowner wants to have enough insurance to fully pay to rebuild the house, 2) is relying on the agent or broker to determine what amount of coverage that is, 3) will answer any questions the agent or broker asks in order to provide that quote, and 4) requires that quote from the agent or broker to be in writing. The homeowner then needs to keep that entire set of writing somewhere safe that is not in the house.

Most homeowners will not do this. A broader reform of how insurance is bought and sold is required. What is required is clarity about the amount of insurance being purchased. One route to that would be a yellow cover page — much like the yellow Energy Guide on all appliances — on all new or renewed insurance policies comparing the cost of rebuilding in the neighborhood to the amount of coverage the policy provides. Any State Department of Insurance could require such a cover page. And then the next time disaster strikes, the insurance would be enough.

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See also: *When Enough is Not Enough: Correcting Market Inefficiencies in the Purchase and Sale of Residential Property Insurance*, Kenneth S. Klein, 18 Va. J. Soc. Pol'y & L. 345 Fall 2011).