

Message from the Chairman

by Dale M. Halon, CPCU, CIC



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I've never been reminded so much about the value of my CPCU and continuing education as I am as I write this quarterly column. I am struck by the depth and breadth of the pending legislation that affects the personal lines end of our industry. Specifically, I mean:

Nationally:

- the national "Do Not Call" list
- the pending consideration of FCRA renewal
- the NCOIL sponsored model legislation regarding privacy and insurance scoring
- the consideration of e-mail marketing restrictions
- tort reform

Individual states:

- state "Do Not Call" lists
- agency licensing
- state-specific departures from the NCOIL model legislation
- state-specific e-mail marketing restrictions
- mold and other policy coverage legislation

How the heck do we know what we need to do differently as a result of enacted legislation or regulations? Personally, I read many trade publications and e-mail newsletters about the industry. I feel I have at least a basic grasp of the concepts behind the legislation. Fortunately, it's not up to me to make the decisions.

The educational foundation from the CPCU curriculum is so important to what I do every day in deciphering how the various changes impacting our industry will impact my little corner of the world. Without that understanding, I would not be able to counsel my customers or even share an opinion with

my outside-of-work friends. Every day (well most anyway) I am thankful for the taskmaster in my early career who convinced/forced/cajoled/challenged me to get the designation.

Am I bragging? Yes. You should be, too. You hold a designation that is a symbol of industry professionalism. You are a model for those outside the industry. You are what sets us aside from many other industries. Whether you want to believe it or not you are an inspiration to others who have thought about getting the designation or are in the process of attaining it. In other words, you're the best type of leader—one who leads by example. Thank you for doing so.

Getting the designation was tough for all of us. Living up to it is tough in a different way. I urge all of you to continue the quest for higher knowledge in any way you can. As a member of the Personal Lines Section, you have the opportunity to expose yourself to other professionals and several ways to sharpen your skills, both technical and leadership skills. Let me suggest a couple:

- Be active in your local chapter.
- Write an article for a section or local chapter newsletter (it's not as hard as you think).
- Share ideas or become involved with the section leadership committee.
- Attend the Annual Meeting and Seminars in New Orleans this year.
- Read, read, read, and discuss your opinions and perspective with others.
- Be proud of your industry.

Lastly, encourage others to do what you did. We are always in need of more professional leaders.

I hope you all had a good summer. I'm hoping it lasts longer than last winter did. ■

Cell Phone Bans for Drivers: Wise Legislation?

Part 1

by Robin K. Olson, CPCU

■ **Robin K. Olson, CPCU**, of International Risk Management Institute, a frequent contributor to *Personally Speaking*, recently released this article about a topic that can affect us all—cell phone usage by auto drivers. We will run this article in two installments. In this issue Olson spells out the facts and the problems. In an upcoming issue of *Personally Speaking*, he will discuss various solutions. We would like your opinions or business experiences with this issue; write, call, or e-mail the editor.

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During the past few years, a growing debate has arisen concerning whether the use of cellular phones by drivers leads to more accidents. One study indicates that driving while talking on the phone increases the risk by four.¹ Another study shows that driving while distracted, such as adjusting the radio, engaging in a heated discussion with a passenger, or talking on the phone, may cause between 20 and 30 percent of all United States automobile accidents.² Other studies, based on driver simulation tests, conclude that people have difficulty multitasking.³

In addition to standard driving and cell phone studies, several neurological studies have focused on mapping and monitoring the human brain during singular and multiple cognitive tasks. Yet another way of examining this problem is via cost/benefit analyses. One major study indicates that the costs of a ban on cell phone usage by drivers vastly outweigh the benefits.⁴ The assumptions and conclusions of these studies, however, have been challenged by still further studies.

While uncertain about which studies to believe, regulators have attempted to craft legislation to address this problem.

This legislation is often ill-conceived, based on anecdotal evidence, and difficult or impossible to enforce. Alternative solutions need to be developed, implemented, monitored, and fine-tuned. In addition, it is necessary to review current regulation and problems associated with it, such as enforcement issues and freedom of speech concerns. Thus, the debate over cell phone usage while driving focuses on the issues of the validity of cell phone and driver distraction studies, cost/benefit analyses, current regulation, and alternative solutions outside strict regulations.

Assessing the Problem

Automobile accidents are a major cause of death in the United States and are the single most common cause of death among children and young adults.

According to the U.S. National Highway Traffic Safety Administration (NHTSA), more than 6 million police-reported automobile accidents occurred in 2001, which constitutes 1 every 5 seconds.⁵ On average, a person was injured in one of these crashes every 10 seconds and a person was killed every 12 minutes. The NHTSA estimates that the annual cost of automobile accidents is \$230 billion.

Cell phone usage has skyrocketed in the United States during the last 20 years. There were only a few thousand cell phones in 1983.⁶ According to the Cellular Telecommunications and Internet Association (CTIA), cell phone usage has shown a steady increase as follows:⁷

- 9 million in 1992
- 38 million in 1996
- 97 million in 2000
- 134 million in 2002

Furthermore, the NHTSA estimates that approximately 73 percent of subscribers use their cell phones while driving.⁸

Given the large increase in cell phone ownership, and the estimate of usage while driving, an increase in automobile

accidents might be assumed. However, no such increase has been observed.

According to the NHTSA, the 1983 fatality rate per 100 million miles traveled was 2.6. This rate declined to 1.5 in 2001, a reduction of 42 percent. For injury-related accidents, the rate in 1988 was 169 per 100 million miles traveled. In 1999 the rate was 120, a 30 percent decline. In 2001 it fell further to 109, a 9 percent drop in 2 years. In short, automobile accident deaths and injuries continue to drop. This decrease may be due, in part, to improved seat belt usage, tougher driving under the influence (DUI) of alcohol or drugs laws, and automobile safety features. However, there is certainly no evidence to suggest that increased cell phone usage has significantly affected the automobile accident injury or death rate.

Cell Phone and Driving Studies

There are a host of studies focusing on the usage of cell phones while driving. One of the most highly publicized reports appeared in the *New England Journal of Medicine* in 1997. The researchers, Donald Redelmeier and Robert Tibshirani, used an epidemiologic methodology to study whether using a cell phone while driving increased the chance of an auto accident. They studied 699 drivers with cell phones who were involved in automobile collisions that resulted in substantial property damage. To improve accuracy, they analyzed each person's cell phone calls on the day of the collision and during the previous week by accessing detailed billing records supplied by the cell phone providers.

The researchers examined more than 26,000 cell phone calls made during the 14-month study. They found that the risk of collision when driving while using a cell phone was four times higher than without using the phone. The risk was similar for different ages, genders, and socioeconomic standing, although drivers without a high school diploma experienced the highest relative risk. In

addition, hands-free cell phones were not found to be safer than hand-held phones.

Surprisingly, this four-fold risk was similar to the hazard of driving with a blood alcohol content at the legal limit.

However, the study also found that cell phone usage in cars allowed drivers to make emergency calls quickly. Some of the drivers in the study used their phones only after the accident, thus avoiding any increased hazard and utilizing the benefits of the phone.

Recognizing some of the limitations of their study, the researchers urged prudence to lawmakers.

We caution against interpreting our data as showing that cellular telephones are harmful and that their use should be restricted. Even if a causal relation with motor vehicle collisions were to be established, drivers are vulnerable to other distractions that could offset the potential reductions in risk due to restricting the use of cellular telephones. Regulations would also mean reducing benefits; in Canada, for example, half a million calls to 911 emergency services are made from cellular telephones each year.⁹

The researchers clearly recognize the complexity of this issue and understand that there are no simple answers.

This study was challenged on many fronts, particularly concerning the parallel conclusions about driving while using a cell phone and driving while under the influence of alcohol or drugs. A few months later, Redelmeier and Tibshirani clarified their earlier conclusions on this point. They stipulated that “the overall risks of driving while intoxicated are much greater than those associated with cell phone usage.”¹⁰ The researchers recognized that a blood alcohol level greater than the legal limit posed much higher hazards than cell phone usage. They also granted that “alcohol stays in the bloodstream for several hours, whereas a typical cell phone call lasts only 1 or 2 minutes.” The authors clearly recognize that the two risks are not on the same level.

In 2001, Redelmeier and Tibshirani again clarified their earlier study. They specified in the *Canadian Medical Association Journal* that the four-fold risk factor increase “was not calculated in comparison to the risk of collision under ideal circumstances of no distraction . . . the increase was relative to the risk of collision when the driver drove with his or her usual background distractions.”¹¹ The researchers emphatically recognized that a multiplicity of factors can cause an automobile accident.

Neurological Studies

A neurological study published in 2001 appeared to support Redelmeier’s 1997 study. Carnegie Mellon University scientists studied images of the brain at work and concluded that humans cannot converse on cell phones without distracting the brain from the task of driving.¹² Using noninvasive techniques to see inside the brain, scientists read sentences to 18 people while they were performing a complex visual information-processing task. The researchers concluded that listening to someone speak consumes some of the resources that would otherwise focus on a complex visual task. They specified that “the fundamental implication is that engaging in a demanding conversation could jeopardize judgment and reaction time if an atypical or unusual driving situation arose.” The scientists further argued that hands-free phones would not help since the conversation itself is what distracts the brain.

A 2001 University of Utah study involved 64 undergraduate students engaged in driver simulation sessions.¹³ The study assessed the effects of cell phone usage while driving and found that when drivers are deeply involved in cell phone conversations, using either a hand-held phone or a hands-free device, they were twice as likely to miss simulated traffic signals. This type of use constituted a higher hazard than listening to the radio, a compact disc, or a book on tape. This study suggests that active involvement in a cell phone conversation adversely affects driving performance by diverting attention to an engaging cognitive task outside driving.

The authors questioned the legislative initiatives that restrict hand-held devices but permit hands-free devices since the latter devices “are not likely to reduce interference from the phone conversation, because the interference is, in this case, due to central attentional processes.” The banning of hand-held phones has occurred in more than a dozen countries, in New York state, and a few cities within the United States.

Another simulated driving study, however, found that driving during a relaxed telephone discussion did not affect performance at all.¹⁴ This study concluded that simply speaking over a hands-free telephone while driving did not impair performance. However, a more difficult, complex conversation may adversely affect driving, and “any prolonged manipulation of the telephone is liable to produce a performance decrement, particularly under conditions that put heavy demands on the driver’s attention and skill.” Other studies have also indicated that hands-free devices may be slightly safer.

These types of laboratory studies have the advantage of being able to carefully control and monitor the administration of a hypothetical risk factor or exposure, such as a cell phone conversation. Driver simulation studies, however, are limited in their ability to assess the effect of cell phone usage on the actual outcomes of greatest concern: traffic accidents and resulting injuries or fatalities.¹⁵ Many analysts argue that driving is an inherently complex and multifunctioning task, with a wide array of variables and unique driving situations all contributing simultaneously to a crash. These are circumstances the studies cannot simulate. As a result, it is unwise to pass legislation based solely on simulated driving studies.

Quantifying Driver Distractions

The driver distraction debate began nearly 100 years ago. In 1905 the debate focused on the safety of windshield wipers

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Cell Phone Bans for Drivers: Wise Legislation? Part 1

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and their seemingly “hypnotic effect” on drivers. When Motorola introduced radios in cars in 1930, regulators from several northeastern states proposed banning them for fear that they would distract drivers. These items, however, are now standard features on automobiles.

The Department of Transportation estimates that driver distractions are a contributing factor in 20 to 30 percent of automobile accidents. However, distractions can be hard to quantify, and the number of accidents due to driver distractions is very difficult to define. What can further complicate matters is that there may be more than one distraction, such as eating while chastising a child in the backseat.

Under the auspices of the American Automobile Association (AAA) Foundation for Traffic Safety, a five-year study was conducted by the University of North Carolina Highway Safety Research Center on the types of driver distractions. Professional crash investigators gathered data at the scene of accidents. They examined the vehicles involved, interviewed the crash victims and

witnesses, and evaluated relevant medical records. They found the following percentages of drivers were distracted by the causes listed in Table 1.

There are, however, several weaknesses inherent in this study. Many people are very reluctant to admit that the cell phone usage contributed to the accident. This concealment may be due, in part, to some negligent drivers believing their culpability is increased if the cell phone usage caused the accident. Also, many cell phones are small and hard to spot, and some drivers utilize hands-free phones, making detection more difficult. Another weakness is that the data was collected from 1995 to 1999, a period of time in which cell phone usage was far below today’s level. In addition, as indicated above, more than one driver distraction can lead to an accident. Situations like these are difficult to quantify. Nevertheless, even if the percentage listed above is moderately adjusted upward to account for some of these limitations, the percentage is still relatively small.



Cost/Benefit Analyses

The cell phone and driving issue has been the focus of several cost/benefit analyses. A 2000 study conducted by researchers with the American Enterprise Institute (AEI) utilized mathematical and econometrical models to estimate that \$25 billion would need to be paid to cell phone users if they were not allowed to use their phones while driving.¹⁶ In other words, what is the worth to drivers, on a cumulative basis, of using their cell phones in the automobile? This figure was based, in part, on price elasticity of cell phone demand, costs of cell phone usage, and percentage of use in cars. Their marketing surveys estimated that 60 percent of cell phone time occurs in driving situations.

Economists used state and national data to measure the benefits of banning cell phone usage by drivers based on deaths, property damage, and injury costs. Their data suggested that approximately 80 fatalities out of 41,000 national fatalities each year are associated with cell phone usage. However, this figure is much lower than the figure found under the 1997 Redelmeier study. Thus, the researchers used a weighted average of the two

Table 1
Types of Driver Distractions

% of Drivers	Cause of Distraction
34.2	Unknown or other
29.4	Outside person, object, or event
11.4	Adjusting the radio, cassette, or compact disc player
10.9	Another occupant
4.3	Moving object in vehicle
2.9	Using other device or object
2.8	Vehicle climate controls
1.7	Eating or drinking
1.5	Using or dialing a cell phone

Source: National Conference of State Legislatures, *Along for the Ride: Reducing Driver Distractions*, 2002

studies: 300 deaths and 38,000 injury-involved accidents annually attributed to cell phone usage. They also utilized earlier NHTSA studies that monetized the economic costs of automobile accidents. After adjusting for inflation and other factors, the AEI study found that the annual costs of all traffic accidents are \$630 billion. The researchers concluded that cell phone usage causes approximately .74 percent of all accidents, and calculated that costs of this use to be \$4.6 billion per year. Thus, banning cell phone usage by drivers would result in benefits or a savings of \$4.6 billion.

As a result, the cost/benefit analysis shows that the net costs of a cell phone ban by drivers is approximately \$20 billion: \$25 billion costs less \$4.6 billion in benefits. However, one factor excluded from this equation is the cost of enforcing a ban on cell phone usage. Law enforcement officers would need to be removed from other assignments to focus on this effort. It is already well documented that law enforcement agencies throughout the country are often unable to adequately enforce the existing laws, due to budget deficits and staff shortages. A cell phone ban would further aggravate these existing problems.

A study at the Harvard Center for Risk Analyses in 2003 estimated that 2,600 deaths are attributable to driver cell phone usage.¹⁷ However, the researchers recognize that the range of uncertainty is immense. For example, the fatality estimate ranges from 800 to 8,000 annual deaths, and they found that injury-related accidents due to cell phone usage range from \$100,000 to \$1 million. Even with higher numbers attributed to this cause as compared to the AEI study, these researchers estimated the costs and benefits are equal, but acknowledged that the range of costs and benefits are extremely broad.

It is interesting to compare the 2,600 deaths figure to other causes of auto-related deaths in the United States. In a May 2001 hearing about this issue before the United States House Subcommittee on Highways and Transit, Robert

Shelton, Executive Director of the NHTSA said “many more people die due to not wearing seatbelts . . . only 71 percent of auto occupants wear seatbelts.” NHTSA statistics also found that alcohol-related crashes result in 17,448 annual deaths, and accidents involving speeding took 11,371 lives. ■

Editor’s note: Part 2 of this article will appear in the next issue of *Personally Speaking*.

Endnotes

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Engineering Exposures to Increase Underwriting Profits

by John T. Gilleland Jr., CPCU, AIS, API, AU, Jason Northrup, CPCU, and Darlene J. Gipson

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Underwriters often refuse applications and policy renewals that could be made acceptable with little effort. This is done in an effort to build a profitable book of business and underwriting territory, the paramount goal of good underwriting. Underwriters who reject more than they accept do not grow their books profitably and encourage their prospects to go to competitors. This is especially true when markets are hard with strict underwriting eligibility/acceptability guidelines. Rejecting applicants and clients coming up for renewals when rates are high is more harmful to growth than when rates are low because rejection during hard markets prevents significant increases to underwriters' written premium totals. This article attempts to encourage and enable underwriters to accept many more applications and policy renewals than they reject, thereby increasing the value of underwriters in our industry.

Introduction

Underwriters (front-line service representatives and desk underwriters) should work to grow their books of business profitably. This means they should find ways to accept more applications and renew more policies than they reject, non-renew, and cancel. They should have production and profitability goals.

Rejecting requests for coverage without making counteroffers is not performance of underwriting *due diligence*. Underwriters should act as risk

management consultants (something a computer program can't do yet) when their customers can be helped profitably. Mutual needs, insurer profit and insured coverage, should be met as underwriters act with diligence. The diligence that is due includes identifying customers' needs and alternative solutions, selecting what actions should be taken and determining who should accomplish the actions, implementing an action plan, and monitoring policies' risk exposures. Underwriters' customers may include agents, customer service representatives, insureds, and applicants.

Unfortunately too many underwriters reject applications assuming agents wanting their applications to be accepted will appeal rejections to acceptable ways. This is not a growth-facilitating paradigm.

Exposure Engineering Due Diligence

Underwriters should be able to answer the following questions with a high degree of certainty each time they underwrite an account:

- Have all relevant questions been asked and answered about all relevant hazards and subjects?
- Does the initial information indicate the risk is acceptable?
- Can we charge an appropriate rate for the maximum potential risk?
- Do the cons outweigh the pros significantly?
- Is the account's profitability deteriorating?
- Will the insured accept modification of our coverage to reduce our exposure? Or will the insured agree to reduce our risk exposure and follow through?
- Will my response to this unattractive exposure compare well with my previous responses to similar unattractive exposures?

This is one of many sets of criteria to consider using to determine if an underwriter has done his or her job after an underwriting decision was made. Answering these questions favorably should encourage underwriters and clients to successfully serve their mutual interests.

Five Types of Engineering Techniques

Using the preceding logic and following the same sequence, there appears to be at least five ways to make many but not all applications and policy renewals acceptable:

- Loss control (prevention and/or reduction) activities should be considered when an applicant has had multiple losses with strong similarities.
- Appropriate coverages should be purchased from other sources so the underwriter's policy will be positioned secondary to more appropriate coverages.
- Changes to the subject's physical condition should be made to reduce or prevent one or more types of losses.
- Policy premiums should be charged (rated) to take all loss exposures into consideration. Rate integrity should be established and maintained.
- Modification of the underwriter's policy's coverage. Endorsing policies at issuance and renewal to prevent unintended coverage should be considered.

Engineering Example

The following five scenarios illustrate how exposures can be engineered so underwriters can say "yes" to applicants and renewing insureds more often. These scenarios show how unattractive exposures can be made acceptable or at least tolerated by using one or more of the five exposure engineering techniques:

- loss exposure reduction
- addition of risk insulation
- physical condition modification
- policy premium modification
- coverage modification

Examples of How Applications Can Be Engineered

Insulation of Flood Exposures

A prospect for HO-3 is eligible and acceptable in every way but one. The subject is in a flood plain that floods almost annually.

Possible Solution: The service representative should issue the HO-3 (which excludes flood coverage), refer the insured to a preferred source for available flood insurance, and require proof of coverage during the policy's discovery period.

Addition of Coverage for a Race Car

A prospect for a preferred auto program is eligible and acceptable in every way but one. He owns a racing car used in NASCAR-type events.

Possible Solution: The service representative should:

- Explain that the racing car is excluded by the insurance policy offered. Suggest that the prospect consult a specialist in motor sports insurance. The prospect's racing association may have a recommendation. If the prospect insists the service representative provide information about sources of coverage, the prospect could be referred to Motorsports Insurance Services at (310) 301-0333 and Gulfway Insurers Motorsports Insurance at (800) 940-5010 after explaining neither organization is endorsed or recommended by the insurer.

Insulation from Aircraft Hangar Exposures

A prospect for a homeowners program is eligible and acceptable in every way but one. She operates an airplane and hangsars the airplane at the subject residence in an attached hangar.

Possible Solution: The service representative should issue coverage for the home with Coverage B for the hangar.

If the hangar is detached from the residence, proof of purchasing hangar insurance should be received during the policy discovery period. The service representative should also document who is insuring the airplane with aviation insurance.

Insulation from Property Damage Exposure

An insured in a homeowners or renters program should be renewed because the risk's exposures are acceptable in every way but one. The insured has had four claims for damage averaging \$1,700 per loss by power surge or lightning in the last five years.

Possible Solution: The underwriter should:

- Explain the policy will be renewed with a deductible exceeding the average claim amount (e.g., \$2,000 or \$2,500).
- Explain to the insured that the deductible can be lowered if the underwriter receives a copy of an appliance registration card showing the insured has purchased enough surge protectors to register the most expensive non-cooking electrical appliances against electrical surges within the next 30 days. Only surge protectors with guarantees of reimbursement in the event of a surge passing through the device should be purchased. The underwriter wants to know that the insured has other coverage in place for this exposure.

Insulation from Liability and Property Exposures

A prospect for HO-3 is eligible and acceptable in every way but one. She has a riding stable on the same acreage as the home.

Possible Solution: The service representative should agree to insure the home's exposure if:

- The stable operation should be covered by appropriate equestrian insurance for liability and property exposures. Try to secure coverage from a source verified easily.
- Proof of equestrian coverage must be received prior to HO-3 issuance or during the HO-3's insurer's discovery period.

Recommended Process

Our experience and the preceding examples suggest experienced risk engineers often do their engineering intuitively without a set pattern or documented process. Their actions reflect their gut reactions to the risk's characteristics and the prevailing underwriting climate. Therefore, their results (e.g., profitability, growth, customer satisfaction) vary widely.

Rookie underwriters would do well to follow the following steps in a disciplined manner until they develop their own reflexive process. Making engineering risks a discipline will go a long way toward helping underwriters increase their territories' written premium amounts at every qualifying opportunity. Here's the steps we recommend:

1. Understand everything that is relevant.
 - Know what your customers need.
 - Know which risk exposures are relevant and how they can best be covered.
 - Know what pitfalls should be avoided and how to overcome them.

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2. Draw conclusions about what would be the best risk management action plan for the customers. Include one or more of the five exposure engineering techniques:
 - loss exposure reduction
 - addition of risk insulation
 - physical condition modification
 - policy premium modification
 - coverage modification
3. Negotiate a win/win agreement.
4. Implement an action plan reflecting what was negotiated.
5. Monitor how well the plan works, how participants perform, and what losses occur.
6. Learn what should be done at the next renewal for this subject and similar risks.

We would like to hear from you. Given the above examples and processes, how would you handle the following scenarios? Write, e-mail, or fax the editor your answers. We will publish your solutions in our next issue of *Personally Speaking*.

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Insulation from Liability and Property Exposures

A prospect for a homeowners program is eligible and acceptable in every way but one. The home is on the same 50 acres as a cattle ranch.

Insulation from Liability Exposures

A prospect for a homeowners program is eligible and acceptable in every way but one. The home is on the same 50 acres as 30 head of cattle, owned by a grazing-rights lessee.

Insulation from Liability Exposures

An insured in a homeowners or renters program should be renewed because the risk's exposures are acceptable in every way but one. A claims adjuster reported to the insurer the insured plans to buy either a Presa Canario-mastiff or a Fila Brasileiro. (Research the breed's characteristics before continuing to negotiate with the prospect.)

Insulation from Liability Exposures

An insured in a homeowners or renters program should be renewed because the risk's exposures are acceptable in every way but one. The insured called stating he will serve a term as a board member at his local private college and he wants "non-profit organization Directors & Officers (D&O) liability" to cover liability incurred from things like employment practices/decisions.

Modification of Coverage and Addition of Other Coverage

An insured in a homeowners or renters program should be renewed because the risk's exposures are acceptable in every way but one. A claims adjuster reported to an underwriter the insured has two businesses in the home:

- The husband sells holistic medicines.
- The wife has an accounting and tax practice.

Use the recommended processes to develop your answers and let us hear from you! ■

IRMI Launches New Personal Lines Pilot Newsletter

Editor's note: Personal Lines Section members have benefited from IRMI articles in the past, and we include the following message in this issue as an "FYI."

International Risk Management Institute, Inc. (IRMI) will launch its newest e-zine, *Personal Lines Pilot*, in August 2003. This free monthly newsletter complements IRMI's manual, *Personal Risk Management and Insurance*, and is designed to keep agents, underwriters, adjusters, and attorneys up to date on the latest news and developments affecting personal lines insurance.

Personal Lines Pilot is available to anyone interested in personal lines insurance and is not limited to current subscribers of *Personal Risk Management and Insurance*. To subscribe, visit www.irmi.com/irmiupdate.asp.

American Association of Insurance Services Conference Report

by Joseph Harrington, CPCU

■ **Joseph Harrington, CPCU**, is communications manager for the American Association of Insurance Services in Wheaton, Illinois.

Editor's note: The following article originally appeared in the Spring 2003 edition of *Viewpoint* magazine, published by the American Association of Insurance Services, Wheaton, IL and is reprinted here with permission.

This article contains excerpts from the *Conference Report* of the American Association of Insurance Services Conference in Monterey, California, April 2003.

These excerpts focus on restoring profitability to homeowners insurance. Experts Richard Dorman, owner of Dorman Consulting, Robert Hertel, ACUITY's personal lines manager, and John DiStefano, personal lines portfolio manager for Preferred Mutual Insurance Company offer their viewpoints on this subject. What are your thoughts? Let us hear from you. E-mail, call, or write the editor.

A New Era

You know things have changed when insurers start giving existing customers incentives to take their homeowners business elsewhere.

At the beginning of the AAIS Annual Conference, AAIS Chairman Richard Zick related how one carrier wanted to shed its homeowners book so badly that it told policyholders they could get dual-policy discounts on auto insurance if they found someone else to insure their homes.

For years, insurers felt powerless to address negative operating results in homeowners. Now that investment returns have slowed, carriers sense that they have no choice but to take strong steps to restore profitability in the line.

Putting the "Who" into Homeowners Underwriting

The key to restoring profitability is to put the "who" into homeowners rating, says

Richard Dorman, owner of Dorman Consulting Associates, Beachwood, Ohio. He gave a presentation on segmenting the homeowners market for rating purposes.

Personal auto has long made use of rating variables reflecting the quality of drivers, he noted, while homeowners rating has relied on traditional variables related to construction, fire protection, and territory.

"We've ignored the 'who' in homeowners," Dorman said. If you took a group of homeowners living in the same development, "virtually all homeowners programs rated them the same, whether there were saints in one house or sinners in another."

The growing use of credit-based insurance scores is the first widespread, systematic attempt to incorporate a rating variable that reflects personal characteristics of occupants, Dorman said.

It may be possible to develop other "who variables" related to the age, sex, and occupation of the insured, the number of children in a household, and the length of residency, said Dorman. However, the value of such factors as rating variables cannot be determined unless companies gather the necessary data and determine if, and how much, they correlate with loss ratios.

For now, Dorman says the use of scoring in homeowners insurance "marks the first time we've really asked 'Who lives in the house?'"

According to Dorman, the correlation of credit score to loss history is even more pronounced in homeowners insurance than in personal auto.

Using data from ChoicePoint, Inc., Alpharetta, GA, a firm that develops scoring models, Dorman demonstrated that individuals making up the worst 10 percent of credit scores in his sample had an overall loss ratio more than three times greater than those with the best 10 percent of credit scores.

Companies that fail to embrace scoring face the prospect of adverse selection and a "pricing death spiral," he added. To

illustrate, he showed how the average score for a client's book of business declined by about 5 percent in the 18 months the client spent considering whether to use scoring.

While that may not seem like much, "this was a huge drop in credit scores" that signaled deterioration in the client's book of business over that period, Dorman said. Customers with higher scores were apparently lured away by competitive pricing of carriers that were using scoring to identify the client's best customers.

"[My client] was about to see a real bad loss ratio because of this," he said. "Adverse selection happens before you realize it; before you see it in your data."

Adoption of credit scoring was one of several initiatives that helped ACUITY Insurance Group, Sheboygan, WI, achieve a combined ratio of 90 in recent years, said Robert Hertel, ACUITY's personal lines manager and a panelist during the session on "Restoring Profitability in Homeowners."

According to Hertel, ACUITY's experience with scoring contradicts some of the conventional wisdom about it in state capitals. ACUITY's experience suggests that scoring is best used to price the difference between two risks, rather than to accept or deny applications.

"I'm a firm believer in using scoring in rating, not underwriting," Hertel said. "High-value homes often have lower scores because [the owners] get themselves into a lot of debt, and we see better scores on older homes."

"Credit scores reflect [likely] future payment history and the ability to maintain a home," added panelist John DiStefano, personal lines portfolio manager for Preferred Mutual Ins. Co., New Berlin, NY

"If an applicant has a cash flow problem, will he be able to replace a 20-year-old roof?" ■

Counterfeit Checks and Theft

by Bill Wilson, CPCU, ARM, AIM, AAM

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Abstract

A Corvette was stolen by a scam artist who gave the insured a counterfeit cashier's check for \$41,500. The bank didn't find out that the check was counterfeit until a week later. The PAP was still in force, but the adjuster denied the claim. She said that, once the insured signs the title to the Corvette over to the criminal, he no longer owns it and has no insurable interest. Is the insured just out \$41,500?

Last September, I wrote an article called "What is 'Theft'? It Doesn't Matter!" (<http://vu.iaa.net>) about an insured who was given a \$29,000 counterfeit cashier's check for a ring. The claim was denied as "voluntary parting" and not theft (even though "theft" includes voluntary parting and despite the fact that the ring was scheduled and it doesn't matter whether it's "theft" or not). Without going into the details here, I encourage you to read that article before continuing since this claim is similar.

Here is the complete claim scenario as reported by a Georgia consumer looking for help:

My 2001 Corvette convertible was stolen by a scam artist that gave us a counterfeit cashier's check for \$41,500. The bank didn't find out that the check was counterfeit until a week later. We still had the car covered on our insurance and now they've said that they won't pay for our loss. We have never made a claim on our insurance in the 10 years we have used them

and as soon as one claim, very important to us, comes up they let us down. They are saying since we signed the title to the Corvette over to the criminal, it gives up any rights to keeping coverage on that vehicle. I need to know if there are any similar cases and if there are any law firms that specialize in this kind of case.

Presuming an "ISO-equivalent" personal auto policy (PAP), coverage is provided for "theft." This term is undefined in the policy. In its broadest interpretation, "theft" is any act of illegally taking the property of others. The insured never sold his car. No legal sale or transfer of ownership ever occurred. Since the insured never effectively sold the car, he still has an insurable interest and, since the car is declared on his policy and covered for theft, he has a valid claim. Is the adjuster saying that if the car is recovered, the insured no longer has any right to it because he "signed the title" over to the crook? This is the type of question plaintiffs' lawyers love to pose to sympathetic juries in bad-faith suits.

I think what has the insurer confused is that this is akin to voluntary parting, which is typically excluded in commercial property policies. However, there is no PAP exclusion for voluntary

parting, trickery, scheme, etc. It's simply a theft. What's interesting is that, when this claim was posed to several agents and adjusters, a couple of them sided with the insurer. One such response said:

Unfortunately, the situation you describe is not considered theft. You parted with the property. (This doesn't mean that what the other party did was not illegal . . . because it is . . . it isn't theft . . . it's called "conversion.") Such losses are not normally covered by insurance.

To quote John McLaughlin of the *McLaughlin Group*, "Wrong!" The statement that "Such losses are not normally covered by insurance" is immaterial. All that matters is what *this* contract says. I'd have to disagree with the above for three reasons:

1. **Conversion is a form of theft.** In the broadest sense, theft is any act of illegally taking the property of others (sometimes referred to statutorily as larceny, though "theft" is generally considered to be even a broader term). Here's how *Black's Law Dictionary* defines it:

Theft. A popular name for larceny. The act of stealing. The taking of property without the owner's



consent. The **fraudulent taking** of personal property belonging to another, from his possession, or from the possession of some person holding the same for him, without his consent, with intent to deprive the owner of the value of the same, and to appropriate it to the use or benefit of the person taking.

It is also said that theft is a wider term than larceny and that it includes **swindling** and embezzlement and that generally, one who obtains possession of property by lawful means and thereafter appropriates the property to the taker's own use is guilty of a "theft."

"Theft" is any of the following acts done with intent to deprive the owner permanently of the possession, use or benefit of his property: (a) Obtaining or exerting unauthorized control over property; or (b) **Obtaining by deception** control over property; or (c) Obtaining by threat control over property; or (d) Obtaining control over stolen property knowing the property to have been stolen by another. [Emphasis added.]

Even from a statutory standpoint, most states have criminal penalties that vary by the type of theft . . . theft by taking, theft by deception, theft by conversion, theft by shoplifting, etc. For example, here's a typical definition: "A person commits theft of property if, with intent to deprive the owner of property, the person knowingly obtains or exercises control over the property without the owner's effective consent." Another example: criminal penalties for conversion in Georgia are governed by OCGA 16-8-4 and this section is titled "*Theft by conversion*."

Could it be any clearer? Theft includes fraud, swindling, deception, etc. In fact, even if someone "obtains possession of property by lawful means and thereafter appropriates the property to the taker's own use," he or she has committed a

theft. So, even if the "purchaser" had given the insured a valid check and later stopped payment on it with the intent of depriving the insured of its possession, a theft has been committed.

Conversion is where someone lawfully possesses property for a specified use, then converts it to his or her own use in violation of an express or implied agreement. Conversion is simply one form of, or one technique of, theft. In the claim cited above, there isn't even a conversion. At no point does the thief ever have legal possession of the vehicle. At the time the counterfeit check exchanged hands, a theft was committed.

2. Some policies specifically exclude conversion, voluntary parting, etc.—but not the standard PAP. It is common in commercial lines for special causes of loss forms to cover theft, but have specific exclusions for certain kinds of theft such as conversion, voluntary parting, scheme, trick, etc. No such exclusion is in the PAP.

3. It doesn't even matter if it was theft. This is a comprehensive claim where coverage is provided on an "all-risks" basis. Certain perils such as theft, flood, vandalism, etc. are specifically defined to be "other than collision" losses. However, this coverage applies to any claim that is not "collision" nor otherwise excluded. Since accepting a bad check (aka "theft") isn't excluded, it's covered. One of our IIBA Virtual University faculty members ran this claim by a Florida trial lawyer he knows who agrees that there is coverage and provides the following analysis:

State Farm Ins. Co. v Valentine, 29 Ohio App.2d 174 (1971)

According to the court:

Where the term, "theft," is used but not defined in an insurance contract drafted by the insurer, it includes any wrongful deprivation of the property of another without claim or color of right.

The court then elaborates, saying:

Although the term, "theft," is often used in a popular sense to mean larceny, the terms are not synonymous. Theft is a broader term than larceny and includes other forms of wrongful deprivation of the property of another.

Specifically, the court overruled its previous decision in *Royal Ins. Co. v Jack* (1925), 113 Ohio St. 153.

The act of MacQueen (Hyde) in securing the Impala by the use of a forged, counterfeited check, could well qualify as larceny by trick under our Ohio statute, but the Supreme Court says that it is also a "theft," as to insurance coverage, if an insurer fails to carefully define the term in the provisions contained in its policy. A "theft," as it seems in the instant case, would make MacQueen (Mott) a thief. It is clearly a "theft" as to the coverage afforded Mrs. Ziesemer.

Another case, not directly on point but by analogy is applicable:

When a car was rented from Hertz by the use of a stolen credit card, the *Florida Supreme Court in Hertz Corp. v Jackson*, 617 So.2d 1051 (Fla. 1993), found a theft had occurred. The case is not exactly on point but I would think there would be coverage. Clearly there was a theft of the car and procurement of the title through false pretenses. A scam is a scam by any other name.

The Supreme Court also stated, "We emphasize, however, that procurement of a vehicle through fraud is but one factor to be considered in determining whether a vehicle has been the subject of theft or conversion." The Supreme Court reviewed the undisputed facts—including the facts that Hertz attempted to recover the vehicle and reported it stolen—and the court concluded, "Given these facts, we find that the vehicle was converted and that a theft had occurred." ■

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