March 6, 1991

SUBJECT: INSURANCE

Circular Letter No. 6 (1991)
March 6, 1991

TO: ALL LICENSED PROPERTY/CASUALTY INSURERS IN THIS STATE WRITING HOMEOWNERS POLICIES OR FIRE INSURANCE POLICIES AND ALL PROPERTY/CASUALTY PRODUCER ORGANIZATIONS

RE: PROPER AMOUNT OF INSURANCE PROTECTION ON DWELLINGS

In establishing the proper amount of insurance when a homeowners policy or fire insurance policy is issued or renewed, it is important to remember the critical distinction between market value and replacement cost. Replacement cost represents what it would take to rebuild the building at its present location. Market value includes non-insured elements of the property, such as land and foundation, and also reflects surrounding real estate market conditions. Claims settlement, coverage and, therefore, pricing should be predicated upon the dwelling's replacement cost -- not the property's market value, mortgage, land, or foundation.

Despite a real estate market downturn resulting in declining market values in some areas in the foreseeable future, inflationary pressures may nevertheless continue to result in rising replacement costs. Homeowners who understand that the home's replacement cost is the crucial factor in loss settlement will be more apt to purchase the correct amount of coverage initially and then to maintain coverage at the proper level upon policy renewals. Insurers as well as producers should assist homeowners and fire insurance policyholders in determining up-to-date replacement costs.

Insurers and agents should explain to consumers how and why coverage limits are set at policy inception and, further, the basis of any adjustments at renewal Policyholders ought to be informed about the policy's loss settlement provisions, and reliable construction cost estimators geared to the property's type of construction and location should be included with initial policy application and renewal materials.

Many policies have replacement cost guarantees, inflation-guard endorsements, or other features designed to help policy limits keep pace with local construction costs. Since such provisions could yield automatic annual coverage and premium increases, it is important that insurers and producers monitor individual renewals to ascertain that: (a) replacement cost is not exceeded due to application of such provisions; and (b) coverage is adequate relative to replacement cost.

Very truly yours,

[SIGNATURE]

SALVATORE R. CURIALE

SUPERINTENDENT OF INSURANCE