

THE RHA REVIEW

ROUTE TO:

Vol. 16, No. 2, First Quarter 2010

A publication of Robert Hughes Associates, Inc., an international litigation support, actuarial, risk management and insurance consulting company.

Ali Baba

by Joseph J. Launie, Ph.D., CPCU, FACFE

The most persistent image of the Jesusita fire in my mind is my 80-year-old widowed neighbor on her hands and knees sifting through the ashes of what had been her home. She was looking for a hinge or drawer pull from a valuable china cabinet that was destroyed in the fire. The insurance adjuster refused to believe she owned the piece without some bit of evidence.

Now I, and anyone with any property fire insurance experience, know that a fire hot enough to melt steel and destroy concrete is going to melt the brass fittings for that desk. The random cruelty of that adjuster's cynical act makes me ashamed of my years in the financial services industry. Unfortunately the problem is that, while Ali Baba had only 40 thieves, the financial services industry has legions of them.

The Jesusita fire started for me not with a bang, but with a splash. I was in the pool at my health club doing my workout when the news came over a poolside TV set. I ran dripping out to my car and tried to get back to my home to retrieve my two Manx cats, only to run into roadblocks. I called a friend who really knew the hills, and she gave me directions for a back way in. I approached my home coming down the mountain rather than up, where the police expected people. Thankful I had a four-wheel-drive

SUV, I used back roads and slipped past three roadblocks to get to our half-mile-long private road.

When I got to the house, my problems were not over. My wife usually handles the cats and, although the carriers were there, the cats were not interested in getting in them. I found a stranger wandering around who had just finished helping a neigh-



The Jesusita fire began on May 5, 2009, in the hills of Santa Barbara, California. It burned 8,733 acres and destroyed or damaged more than 160 structures.

bor. However, the cats are afraid of strangers. It took us almost an hour to catch them. We finally had to overturn the king-size bed they were under. My office looked as though a brawl had taken place there. The stranger kept saying, "This is dumb; we are going to die." I said, "Yes, but we are going to get the cats first." We did. The fire did not get to our area for another 24 hours, but we were gone in under 2 minutes once the cats were in the carriers. I did not even pick up my reading glasses. So much for being prepared.

The fire roared through, and the houses on both sides of us were destroyed, along with our detached garage, storage buildings and 90

percent of our landscaping, including our entire fruit orchard. The house itself sustained only a cracked upstairs window. Since it was only the outer pane of a dual pane window, the house survived. All windows and doors in the house were dual pane. Other reasons for its survival were fully concreted eaves and overhangs, minimal exterior wood and huge rainbird sprinklers on the flat rock roof. Risk management does work. The dual pane windows and doors were so tight that there was virtually no interior smoke damage.

Adjustment of the loss itself was instructive. Although I have been in the industry since 1957 and have both taught claims adjusting and been involved in major claims, this was my first time as a fire victim. I learned that it is different, and no amount of technical knowledge can fully prepare you for the experience.

We were evacuated for a week. At first we had a friend's pool house on a large estate. The cats thought this was neat. The morning of the third day, there was a police officer at the door. The fire was heading toward Montecito, and we were going to have to evacuate. In that neighborhood, instead of a phone call, you got a messenger. The message was the same — time to go again. We found another friend who could take us and the cats, and we settled in for the rest of the week.

When we returned home, the air conditioning system and the dual pane windows had kept down the smell of smoke inside, but outside it was like a war zone. There were smoke and

(Ali Baba, continued inside)

IN THIS ISSUE:

- **Ali Baba**
- **From Near and Far**

(Ali Baba, continued from cover)

ash everywhere. We went to look at the stump of a large eucalyptus tree that we had cut down before the fire. It was gone. In its place there was a hole in the ground with a series of empty tunnels running down into the ground as far as we could see. The stump and the roots had burned.

For two days there were four fire trucks with crews on our private road, guarding against flare-ups. The firemen could not have been more helpful. They even turned the king-size bed back over.

I realized that any wildlife that survived would have lost all their forage and would soon starve, so I put out bowls of dry dog food and water on the deck at night. Soon we had a raccoon family and a family of striped skunks who shared well once I separated the two food dishes. They shared the water dish peacefully. Emergencies force you to cope, and they did.

Our insurance coverage was in the California FAIR Plan of assigned risk fire with a State Farm DIC, a wrap-around homeowner's policy to provide extra coverage. The FAIR Plan policy was a DW 1, a basic dwelling policy, so my agent at the time of purchasing the property, a long-time CPCU friend, assured me that the State Farm DIC would provide all of the homeowner's coverage lacking in the basic policy. I would like to say that I sat down and analyzed the two policies to see how they fit together, but I did not. After all, I knew what a DIC was, and I was dealing with my CPCU buddy and the largest personal lines insurer in the world.

As it turned out, the claims department of the FAIR Plan and its independent adjuster performed well. The adjuster clearly was overloaded with too many files, which led to frequent delays. However, we never lacked for money. He sent us a \$22,000 advance the minute he opened the file. We arm-wrestled a little over this and

that but nothing that you would not expect. At the end of the day, we arrived at a reasonable settlement, based on the coverage available.

The underwriting department of the FAIR Plan was a different story. I had a small role in setting up the California FAIR Plan in 1965. The insurance industry in Southern California had just had two major shocks. First, there was the Watts riot, which made insurance coverage in the ghettos disappear. Second, a Lloyd's pool writing 600 high-valued brush risks in areas like Brentwood and Bel Air collapsed. Talks began on setting up an assigned-risk fire plan to handle those two types of risks, ghetto and brush. I delivered a paper, which was published in the *Journal of Risk and Insurance*,

“FAIR stands for Fair Access to Insurance Requirements. There is nothing in the insurance code or legislative intent about bare-bones minimum coverage.”

suggesting that, since the federal government was the insurer of last resort, HUD could write reinsurance for the private companies in this pool. With the risk gone, the private companies reluctantly stepped forward, and the FAIR Plan was born.

FAIR stands for Fair Access to Insurance Requirements. There is nothing in the insurance code or legislative intent about absolute bare-bones minimum coverage. The insurance requirements of the FAIR Plan policy holders are the same as those of the rest of the insured population, but the FAIR Plan underwriters unilaterally have decided to provide the barest minimum possible. A committee made up of industry underwriters, plus a public member and a department of insurance representative, runs the

FAIR Plan. The industry members have managed, by cutting coverage to the bone and charging high premiums, to turn this “public service” into a profit center. Meanwhile the California Department of Insurance slept at the switch. The Department of Insurance's handling of FAIR Plan coverage and pricing makes a strong argument for federal regulation of insurance. The California FAIR Plan in a recent year had a 45 percent loss ratio, much better than its regular business. Ali Baba would be green with envy.

How do you limit property coverage? The California FAIR Plan underwriters found a way. First, you refuse to sell replacement cost on contents. Next, you refuse to provide coverage for landscaping. This is particularly glaring when one considers that a major portion of the FAIR Plan coverage is in brush areas which include some of the most elaborately landscaped and expensive homes in the area. Next you refuse to provide more than \$10,000 in code upgrade coverage. Incidentally, none of these coverages can be bought back at any price. The FAIR Plan announced that you could buy \$30,000 of additional living-expense coverage only after the Jesusita fire, which did us no good. One of my friends whose home burned will have additional living expenses of \$6,000 a month for 24 months. That \$30,000 will not go too far in Santa Barbara. Homes destroyed in the Jesusita fire and the Tea fire before it, and insured in the FAIR Plan, had zero dollars of additional living expense coverage. How any underwriter can say, with a straight face, that such a bare-bones policy meets the insurance requirements of the insured is beyond comprehension.

The so-called “wrap-around” homeowner's policy sold by State Farm is deceptive in its marketing and wildly overpriced. The State Farm agent who sold me the policy told me that the State Farm policy would dovetail with the FAIR Plan policy and provide

(**Ali Baba**, continued from opposite)

proper coverage. I assumed that the State Farm policy would drop down, like a true wrap-around, to fill in the coverage gaps in the FAIR Plan policy, providing things like landscaping coverage, for example. After the fire I discovered that the policy excluded all property insurance coverages. Remember, what was delivered to me was a State Farm homeowner's policy with a neat endorsement removing all of the property coverages. Since I started in the insurance industry in 1957 and the homeowner's policy was instituted in 1950, I recall its early days. Back then we were well aware that the homeowner's policy was a package policy combining the former single lines coverages of property, liability and crime. The State Farm wrap-around homeowner's policy for FAIR Plan policyholders actually unwraps the package and removes the property part, leaving the liability and crime coverage. What is left is little more than a comprehensive personal liability policy plus residence theft. Those policies, sold alone, command a minimal premium. State Farm charges a full homeowner's policy price for this hollow shell it foists off on its FAIR Plan customers. One wonders if the California Insurance Department bothered to examine the loss ratio on these unwrapped wrap-arounds.

The only insurance proceeds we received from State Farm came from the auto company, which paid us for the third seat from my Lexus GX 470, which was located in one of the outbuildings totally destroyed by the fire. That loss adjustment was prompt and fair.

Perhaps the most difficult organization we had to deal with was GMAC, mortgage holder on the property. It was named on the checks from the FAIR Plan for the garage and other structures. GMAC was totally uncooperative and hard to deal with. It continually asked the adjuster and me

for data, information and reports which did not exist. GMAC had its own view of how this loss should be adjusted and which reports should be provided. This view had no foundation in any approach to fire-loss adjusting that either the adjuster or I had come in touch with. The adjuster and I wasted many hours trying to get the people at GMAC loss-adjusting center to understand what was going on. The only reason we were able to complete the construction of the garage and other structures on a timely basis was that we used the insurance proceeds provided for the contents loss, which did not have to go through the GMAC roadblock.

The endless request for non-existent documents had the effect of slowing the process, virtually to a halt. For example, construction on the garage and other structures was completed on December 15, 2009, and the GMAC inspector did not arrive until January 15, 2010. It took numerous phone calls by the adjuster and me to get GMAC to agree to order the inspection. After one particularly frustrating call, the adjuster, who had over 20 years' experience, commented that these were the stupidest people he had ever dealt with. I heartily agreed.

When the inspector did arrive, it was clear within five minutes that she had little experience with fire claims or construction. She gave me her form to fill out. Since it was a form with questions about frame construction, we both struggled with making it fit the reinforced concrete structure she was inspecting. Somehow we filled in all the blanks, which is what she needed.

It took another three-and-a-half weeks for the check to finally arrive. We were told it would take five to seven business days to evaluate the report and another five to seven business days to draw the check.

GMAC's poor performance has two possible explanations. Either it was truly incompetent when dealing with a fire property loss, which was so

different from the auto physical damage claims it usually dealt with, or it was just stalling to get extended use of our money.

GMAC is one of the companies that was saved from ruin by federal government intervention. Its performance in this simple matter causes me to question the wisdom of that intervention. Joseph Schumpeter, a Harvard economist, developed an innovation theory of the business cycle. Essentially he said, "First there are the innovators who boost the economy with the brilliance of their new concepts. As the business cycle takes off in its upward swoop, they are followed by the swarm of the incompetents." Schumpeter thought cycle downturns were good for the economy because they weeded out the swarm of incompetents.

Federal government intervention to prop up a mismanaged company filled with incompetents interferes with a business Darwinism that is beneficial to the economy as a whole. If a company such as GMAC cannot perform adequately on its own, perhaps it should fail.

It is now six months since the fire. The structures have been rebuilt and the property relandscaped. The experience has provided many lessons. Overall, our risk management efforts worked. We did learn that the videotapes we took of the house and its contents were useless in adjusting the loss of three storage buildings. We wonder how many people will include a contents inventory as part of the task when they clean out the garage. We also wonder how many people will be able to recognize the guise of the modern Ali Babas. **RHA**

Joseph Launie, Ph.D., CPCU, FAFCE, is an associate consultant with Robert Hughes Associates, Inc. He is currently professor emeritus of finance and insurance at California State University, Northridge.

ROBERT HUGHES ASSOCIATES INC.

508 TWILIGHT TRAIL, SUITE 200
RICHARDSON, TEXAS 75080
(972) 980-0088 FAX (972) 233-1548

PRSR STD
U.S. POSTAGE
PAID
RICHARDSON, TX
PERMIT NO. 1380

ADDRESS SERVICE REQUESTED

FROM NEAR AND FAR



Port Arthur, Texas — On January 23, the Eagle Otome, an oil tanker, collided with a barge in the Sabine-Neches Waterway, spilling 462,000 gallons of oil. The UK Protection & Indemnity Club provides insurance coverage for the tanker.



USA — According to Foxnews.com, tractor-trailer thefts are on the rise. In 2009 thieves stole 859 truckloads of goods valued at \$487 million. That is a 67 percent increase over 2008, according to FreightWatch International, an Austin, Texas-based security firm.



Fort Collins, Colorado — The Tropical Meteorology Project at Colorado State University has issued its first prediction for the 2010 hurricane season. It says, "We foresee an above-average Atlantic basin tropical cyclone season in 2010 and anticipate above-average probability of U.S. and Caribbean major hurricane landfall. We should expect to see approximately 11-16 named storms, 6-8 hurricanes and 3-5 major hurricanes occur during the 2010 hurricane season."



Dallas/Fort Worth, Texas — The record snowfall (more than 12 inches) that began on February 11 resulted in insured losses that add up to \$25 million, according to the Insurance Council of Texas. About 4,200 auto-damage, homeowners and commercial property claims were filed.



Oakland, California — According to Oakland-based EQECAT, the two major snowstorms that barreled across the United States in February may have caused more than \$2 billion in insured losses. It said that the majority of losses would be in a corridor stretching from Northern Virginia to New York. Snowfall was reported in 49 states during February, with Hawaii being the odd state out.

THE RHA REVIEW

Publisher Robert N. Hughes
Editor John R. Oakley
Assistant Editor Alice H. Oakley

The RHA Review is published quarterly by Robert Hughes Associates, Inc. — an independent international litigation support, actuarial, risk management and insurance consulting company based near Dallas, Texas, with offices in Houston, Texas, as well. The purpose of this publication is to offer insurance-related information and critical comment pertinent to the clients, friends and fellow professionals of Robert Hughes Associates, Inc. This publication is available free to interested parties. The information contained in this publication is intended to be general in nature; readers should obtain professional counsel before taking any action on the basis of this material.

The RHA Review is a refereed publication.
The peer review board consists of
Joseph Launie, Ph.D., CPCU,
Amy Puelz, Ph.D.,
Robert Puelz, Ph.D., ChFC, CLU, and
Tim Ryles, Ph.D.

Copyright © Robert Hughes Associates, Inc.,
2010. All rights reserved.