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Legal Update

A WRA Publication Exclusively for the Designated REALTOR®

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Addressing Transactional Property Insurance Issues in Wisconsin

Despite the fact that Wisconsin homeowner's insurance is generally cheaper and more available than in other parts of the country, more and more transactions are being threatened by the lack of insurance availability. Many issues surrounding insurance availability must be addressed at the national level, but there are potential remedies that can be implemented in individual transactions.

This *Legal Update* examines the role of homeowner's and dwelling insurance in real estate transactions. The various problems facing the insurance industry in today's economy and market are reviewed, along with the steps being taken by the insurance industry to combat these problems.

Many people do not realize that insurance companies use insurance scores based upon an individual's credit history, as well as the claims history of the individual and the property, when deciding whether to provide property insurance and at what rates. Insurers' use of credit scores and insurance scores when issuing new policies and making renewal decisions is discussed, followed by an explanation of the claims history database used by insurers. Legal Hotline questions and answers and an informal survey of REALTORS® and insurance agents in Wisconsin illustrate the impact of these insurance concerns upon Wisconsin real estate transactions. The *Update* concludes with consumer information that can be copied and distributed to customers and clients to help them intelligently purchase the property insurance required for a successful real estate transaction closing. Additional resources for more information about homeowner's insurance issues are also provided.

Insurance Crisis Nationwide

To understand the insurance problems facing the insurance industry, it is helpful to first have a basic understanding of the insurance underwriting process. The problems facing the insurance industry across the nation have caused insurers to implement various measures that address the dangers caused by a host of different events.

Wisconsin Insurance Underwriting Basics

The basic principles of insurance involve methods of assessing the kind of risk, determining insurability, determining the degree of risk and classifying risk. This process is called underwriting. The purpose of underwriting is to spread the risk among a pool of insureds in a manner that is equitable for the insured. Insurers perform this service for a fee (premium) and expect to make a profit from this activity.

In making a decision on an application, the insurer obtains as much information as possible about the risk and evaluates the risk for potential loss. Insurers use underwriting guidelines to establish criteria to use when evaluating the risk. Some of the factors insurers use to determine acceptance,

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modification, or rejection of an applicant include claims history, change in physical risk, and motor vehicle records.

The ratemaking process is related to the underwriting process, but it is somewhat different. A rate is a charge per unit of coverage which determines the total insurance premium when considered with the amount of coverage provided by an insurance policy. Many factors may be considered in rate making, but rates are basically dependent on two primary factors: (1) the frequency of claims (which generally parallels the frequency of occurrences such as auto accidents, fires and thefts) and (2) the severity, as measured by the cost, of each claim (which in turn is affected by the costs of goods and services for which insurance pays).

The Problems Besieging Insurers

High insurance premiums, insurance coverage restrictions, and the outright lack of availability of insurance coverage are becoming increasingly common across the United States. This is especially true for new homebuyers who may have no credit history and for current homeowners who may have filed one or two legitimate water-related claims.

According to the Insurance Information Institute, the average cost of homeowner's insurance increased eight percent last year and is expected to rise an additional nine percent in 2003. However, some individual homeowners have had premium increases in the 30-70 percent range.

Many factors have contributed to the rise in insurance costs. Increased claims and court judgments have resulted from natural disasters such as wildfires and floods, lead-based paint, mold and terrorism. Market share competition and slumping values in insurance investment portfolios have also contributed to rising costs. The Insurance Information Institute estimates that claims related to Sept. 11 will total $40.2 billion, while some estimate it may be as much as $70 billion. The property/casualty insurance industry posted a $7.9 billion net loss in 2001, its first-ever net loss.

Insurers' Reactions

Given this dismal state of affairs in the insurance industry, insurers have acted to limit their risk. Many insurers are limiting the number of new policies written, increasing premiums, instituting new policy exclusions for some hazard claims, and tightening their underwriting criteria for both borrowers and properties. Some are even refusing to renew existing policies, making property casualty insurance increasingly difficult and more expensive to obtain.

No New Policies

Some insurance companies have gone so far as to limit new policies. State Farm has decided not to write new policies in 30 states and not to insure condominium associations in Florida. Farmers Insurance had planned not to renew any homeowners' policies in Texas until the Texas insurance commissioner intervened.

More Underwriting Restrictions

Because of the relationship between water damage and mold problems, many insurers are refusing to insure a property that has a record of past water damage claims and are instituting exclusions for mold coverage from the basic homeowner's policy terms. When it comes to underwriting the physical structures themselves, insurers have slowly tightened their underwriting requirements for structures, including bans on wood shake roofs and requirements for circuit breakers rather than fuses.

Insurers are tightening their underwriting criteria for both potential policyholders and the homes themselves. A homeowner who files "too many" claims may be notified that the insurer will not renew his or her coverage for the coming year. Potential policyholders are now underwritten for risk through the use of insurance risk scores—a hybrid of the credit scoring methodology used by lenders to evaluate credit risk.

Insurance Risk Scores Based On Credit Scoring

Insurers also are increasingly using applicant credit scores and credit-based insurance risk scores to evaluate property insurance coverage and make decision about the policies they are willing to provide for consumers. Potential policyholders are now underwritten for risk through the use of insurance risk scores computed using consumers' credit report information. While the insurers have not shown a causal relationship between insurance claims and an insurance score based on credit history, they indicate that there is a correlation between the two. One common industry explanation is that individuals who are not careful about paying their bills on time and managing their credit are likely to be similarly careless when it comes to dealing with routine maintenance or how they use their property and, therefore, will generate excessive claims.

Credit Reports

Most consumers are familiar with credit reports and consumer reporting agencies. Consumers encounter credit reports when they apply for a charge account, a personal loan, a mortgage loan, or even a job. The consumer reporting agencies, more commonly known as credit bureaus, have credit history information on file about most individuals. These credit files contain information on where a person works and lives, a record of how promptly bills are paid, whether an individual has been sued or arrested, or whether an individual has filed for bankruptcy.

Credit providers provide the credit bureaus with factual information about how their credit customers pay their bills. The credit bureaus assemble this information, along with public record information from around the country, into a file on each consumer. The three major credit bureaus keep credit files on consumers and issue credit reports that may be used by businesses and landlords making decision about whether to extend credit or accept a tenant. Credit bureaus merely report the information they have compiled and do not approve or reject consumer credit applications.

Consumers are encouraged to review their credit reports, especially before making any major purchase like a car or a house. Consumers may request a copy of their credit reports by contacting one of the major national credit reporting agencies:

- Equifax: (800) 685-1111, www.equifax.com
- Experian (formerly TRW): (888) 397-3742, www.experian.com
- TransUnion: (800) 888-4213, www.transunion.com

Consumers who find errors in their credit reports should promptly report this to the credit-reporting agency, which must investigate and respond within 30 days.

Credit Scores

The concept of credit scores is less familiar to many consumers. Most adults have a credit score, but most do not know what their score is or how it is calculated.

A credit score is a number between 300 and 850 that represents a consumer's financial history. A higher score indicates that a consumer is financially responsible and poses a lesser credit risk. Most banks and other businesses use credit scores to determine how risky it is to extend credit to a consumer for a credit card or a loan, and sometimes it is used to determine what interest rate the consumer will pay. Somewhat surprisingly, insurance companies also use credit scores to determine whether to sell an insurance policy to an individual and what the premiums will be if they do. Many insurers say a credit score is a dependable predictor of whether a consumer will file a claim.

Although they come from credit bureaus, a credit score is not the same thing as a credit report. Credit scores are most often generated by the three major credit bureaus by feeding a consumer's credit report information into a computer program developed by Fair, Isaac & Company, Inc. (Fair Isaac), the California company that created the concept in the 1950s. Hence these credit scores are often called FICO® scores.

How credit scores are calculated is a mystery. Fair Isaac won't reveal its formula, but it has indicated the different types of consumer credit information and the relative weight of each component:

Payment History

Approximately 35 percent of a consumer's credit score is based upon payment history. Lenders and other businesses want to know if the consumer has paid past credit accounts on time.

Amounts Owed

Approximately 30 percent of a consumer's credit score is based upon the amounts the consumer owes. Having credit accounts and owing money on them does not mean that a consumer is a high-risk borrower with a low score, but owing a great deal of money on many accounts can indicate that a person is overextended.

Length of Credit History

Approximately 15 percent of a consumer's credit score is based upon the length of the consumer's credit history. In general, a longer credit history will increase a consumer's score.

New Credit

Approximately 10 percent of a consumer's credit score is based upon the consumer's new credit. People tend to have more credit today and shop for credit via the Internet and other channels. However, opening several credit accounts in a short period of time may represent greater risk, especially for people who do not have a long-established credit history.

Types of Credit in Use

Approximately 10 percent of a consumer's credit score is based upon a consumer's mix of credit cards, retail accounts, installment loans, finance company accounts and mortgage loans. It is not necessary to have one of each, and it is not a good idea to open credit accounts that will not be used.

When a lender or other business receives a consumer's FICO® credit score, up to four reasons why the score was not higher are also provided. If the lender rejects the consumer's request for credit, and the FICO® score was part of the reason, these score reasons can help the lender tell the consumer why the score wasn't higher.

Homebuyers should understand that mortgage lenders typically use these FICO® credit scores when they evaluate whether to provide a mortgage loan. Consumers can obtain their FICO® scores from http://www.myfico.com/ (Fair Isaac credit score $12.95+).

Insurance Scores

Insurance companies use insurance scores to help them issue new and renewal insurance policies. An insurance score is a credit-based statistical analysis of a consumer's likelihood of filing an insurance claim.

There is a difference between FICO® credit scores, and insurance scores. Credit scores use information contained in consumer credit files to predict the likelihood of satisfactory repayment of loans and credit obligations. Insurance scores, also developed by Fair Isaac, involve a set of from 15 to 30 credit characteristics, each with an assigned weight. Insurance scores range from 100 to 999. Some credit variables that are used in calculating an insurance score include: outstanding debt, length of credit history, late payments, new applications for credit, types of credit used, payment patterns, available credit, public records, and past due amounts. Insurance companies use a variety of insurance score formulas.

Insurance companies claim to use insurance scores as an objective and consistent tool that insurers can use along with other applicant information to better predict the likelihood of a consumer filing future claims. The reasons behind the predictive value of credit scores appear to be behavioral. The character trait that leads to careful money management seems to show up in other daily situations in which people have to make decisions about how to act, such as driving.

The insurers claim that this data can help underwriters better predict the risk associated with extending personal auto or homeowner's insurance to an individual. Scores also help streamline the decision process, so policies can be issued more efficiently. By predicting the likelihood of future claims, insurers say that they can control risk, and thus offer insurance coverage to more consumers at a fair cost.

Some companies use generic insurance scores that have been developed by Choice Point, a widely used reseller of credit information. Choice Point provides a system for an insurer's home office or insurance agent to access credit bureaus in order to receive an individual's credit report. Once Choice Point obtains the credit report information, it can calculate an insurance score for the insurance company, which will then assess the insurance risk and make the underwriting decision. The data returned to the insurance company or agent can include the full credit report, a subset of the credit report, an insurance score, reason codes, a customized message based on the credit data and the insurer's underwriting guidelines, or a combination of these information products. A growing number of insurance carriers use customized scores that have been developed to meet that company's specific underwriting criteria. There are different types of insurance scores used for auto insurance purposes and homeowner's insurance purposes.

A consumer may obtain his or her general insurance score for $12.95 by going to http://www.choicetrust.com/servlet/com.kx.cs.servlets.CsServlet?channel=welcome&subchannel=.

Fair Credit Reporting Act

The Fair Credit Reporting Act (FRCA) is a federal law designed to promote the accuracy, fairness, and permissible use of information contained in the files of consumer reporting agencies. The FCRA outlines specifically who can see a consumer's credit information. Businesses must have a legitimate business need and a permissible purpose, as stated in the federal law, to obtain a consumer's credit data. Choice Point and other consumer reporting agencies may furnish consumer report information for insurance related purposes. This includes furnishing information to insurance companies for underwriting purposes or for determining whether the consumer continues to meet the terms of the account. Insurance companies may obtain this information when a consumer asks for an insurance quote or applies for insurance, or when an insurance company is checking the status of a consumer who already has coverage.

A consumer must be told if information in a credit report has had an adverse impact on him or her. The FCRA requires that if an agent or company makes an adverse underwriting decision based on information received from a consumer report, the entity requesting or receiving the report is legally obligated to furnish the consumer notice of such adverse action including: (1) the name, address and telephone of the reporting agency, (2) written notice of the consumer's rights under the FCRA, (3) a statement that the credit reporting agency did not make the decision to take the adverse action and is unable to provide the consumer with specific reasons as to why the adverse action was taken, (4) a notice of the consumer's right under the FCRA to obtain a free copy of the consumer report from the credit reporting agency within 60 days after receipt of such notice by the customer, and (5) a notice of the consumer's rights to dispute with the credit reporting agency the accuracy or completeness of any information in a consumer report furnished by the CRA. If the adverse action is taken by the agent as part of the underwriting function, or if the agent has the responsibility for communicating the adverse action to the consumer, the agent shall comply with the FCRA notice requirement, unless the agent verifies that the company has done so.

Generally, adverse information that is more than seven years old may not be reported by a consumer-reporting agency, except in certain circumstances.

- Information about criminal convictions may be reported without any time limitation.
- Bankruptcy information may be reported for 10 years.
- Information reported in response to an application for a job with a salary of more than $75,000 has no time limit.
- Information reported in response to an application for more than $150,000 worth of credit or life insurance has no time limit.
- Information about a lawsuit or an unpaid judgment against you can be reported for seven years or until the statute of limitations runs out, whichever is longer.

Reaction to the Use of Insurance Scores

Different organization, state legislatures and state regulatory agencies have adopted measures to limit or restrict how insurance companies may use credit information and insurance scores.

The National Conference of Insurance Legislators (NCOIL) approved a model law on the use of credit scoring in underwriting and rating in December 2002. Among other things, the model legislation requires insurers to (1) disclose to consumers that a credit report may be used, and (2) to notify the policyholder, in compliance with the federal Fair Credit Reporting Act, when credit is the basis for an adverse action. It prohibits the use of credit information as the sole basis for refusal to insure, refusal to renew, or cancellation. It also bars the use of disputed information or information identified as medical collection accounts in the credit report and encourages insurers to take into account extraordinary life events, such as catastrophic illness or the death of a spouse.

Many states have considered legislative measures to address potential abuses in the use of insurance scores. For example, a law passed in the state of Washington in March 2002 prohibits cancellations and non-renewals based in whole or in part on credit history, beginning Jan. 1, 2003. In Maryland, which had previously allowed the use of information from credit histories, the Legislature passed a highly restrictive bill, effective October 2002, which bans the use of credit reports in homeowner's insurance altogether.

In Colorado, the insurance department rather than the Legislature has addressed the regulation of credit scoring. The department issued a regulation that excludes the use of credit information for people 65 and older with no recent credit history. These so-called "no hits" generally are people who have paid off a mortgage and do not use credit cards. The regulations also exclude the use of credit information that adversely affects insurance scores if the information is related to a divorce, debts of a former spouse, or medical debt collection accounts. The regulations also require insurers to review new information in credit reports at policy renewal time and adjust underwriting and rating accordingly.

State of Wisconsin Office of the Commissioner of Insurance Position Regarding Use of Credit Reports

Wisconsin insurers have begun using credit history information for selecting and sometimes refusing to renew homeowner's insurance consumers. Insurers may use credit information as one of the criteria they consider when underwriting personal lines insurance. However, it is the position of the Wisconsin office of the Commisioner of Insurance that insurers should not use credit information, whether they use credit reports or credit scoring mechanisms, as the sole reason to refuse an application, cancel a new insurance policy in its first 60 days of coverage, or refuse renewal of an existing policy.

The Commissioner of Insurance recommends that insurers in Wisconsin should:

1. Have written underwriting criteria stating how credit information affects underwriting decisions.

2. Disclose to the applicant or insured the items on the credit report that resulted in the underwriting decision if the insurer uses credit information.

3. Consider any information received from the applicant or insured about any inaccurate information contained on his or her credit report

4. Consider and establish guidelines relating to the timeliness and applicability of any credit information to the risk being insured.

5. Avoid all uses of credit information on an unfairly discriminatory basis.

6. Disclose on its insurance application when it will gather credit information and/or order a credit report.

When a policy first becomes effective, the insurer may cancel that policy any time within the first 60 days without providing you with a reason for the cancellation. The cancellation is not effective until at least 10 days after the insurance company mails or delivers to a written notice of cancellation per Wis. Stat. § 631.36(2)(c). In June 1996, the Commissioner of Insurance also issued a bulletin stating that the position of that office is that insurers should not use credit information whether they use credit reports or credit scoring mechanisms, as the sole reason to cancel a new insurance policy in its first 60 days of coverage.

Comprehensive Loss Underwriting Exchange (CLUE) Property Database

Insurers are increasingly using the Comprehensive Loss Underwriting Exchange (CLUE) loss history database to deny property insurance coverage and decline renewal coverage for homeowners who file "too many" claims. The CLUE database is a ten-year-old service of Choice Point, part of the Equifax credit-reporting agency, and contains a record of 90 percent of all insurance claims made in the United States. The database contains individuals' names, addresses, telephone numbers, credit reports, any claims filed on individuals or their property in the past five years, and a record of insurance company inquiries from the past two years. More than 600 companies represent over 90 percent of the homeowner's insurance market contribute loss data and over 40 million claims are loaded in the system. These reports help insurers make decisions faster, more accurately, and with less expense.

Only businesses or individuals with a permissible purpose under the Federal Credit Reporting Act (FCRA) can access a consumer's claim history report from this service. However, the FCRA authorizes a consumer-reporting agency like Choice Point to furnish a consumer report to a company that intends to use the information in connection with issuing insurance quotes, verifying insurance applications or underwriting insurance involving the consumer.

Insurers use information from CLUE and other providers of loss history data to underwrite homeowners insurance. Insurers have always relied upon historical data to help them underwrite and price policies. A greater risk that the insurer will have to pay a severe claim, or smaller claims more frequently, pushes up the price.

Insurance companies say they want information to determine a fair and accurate price for homeowners insurance based upon the risk characteristics of the property and the homeowner. Insurers want the claim history of the person applying for insurance as well as information concerning the condition and maintenance of the home. Consumers do not remember the details of claims very well, so insurance companies began using a loss history database to access important underwriting information.

For a homeowner's policy, loss history includes a particular property's claims history and the individual's claims history. Claims history would include the number and type of claims reported, as well as the amount of the payment. CLUE information includes the dates of initial reports of possible claims and a brief description of the claim's status as it is investigated, adjusted and settled. CLUE reports contain up to five years of property loss information, including the type of loss and the amount paid. The average homeowner files an insurance claim only once every 10 years, so 70 percent of all CLUE reports have no reported claims or paid losses. If there is no loss history, as in a new construction, insurers rely on information such as the type of construction, the material, the geographic location, the amount of coverage, and the proximity to a fire station and a police department.

Insurers use CLUE reports to underwrite and rate new policies. A home with two water damage claims in the past five years may receive standard pricing, but it is more likely to be rated at a higher price level or be refused coverage. Insurers do not usually use CLUE reports for renewals because insurers will have those claims in their databases.

Critics might say CLUE is an unnecessary obstacle. They contend that CLUE may contain too much data, such as information from situations where there may have been damage but the loss was below the deductible amount or not covered, so the insurance company did not pay. According to the insurance companies, the fact remains that damage has occurred and prospective buyers should be told about this event, especially water damage such as flooding, that can affect a whole neighborhood. Some say it should only report claims that result in a claim payment.

An inquiry is a call by a consumer to discuss the terms of coverage where no actual loss has taken place. Most companies do not report these types of calls to CLUE.

If a consumer sees a mistake (CLUE reports are said to be 99.9 percent accurate) like an invalid claim report or incorrect loss payment, they can contact Choice Point, which will contact the insurance company in question and ask for clarification. Consumers can add notes to their individual CLUE reports. For example, a consumer could note that he or she got rid of a dog that bit someone.

CLUE reports play an increasingly important role in real estate transactions. Subscribing insurance companies access reports and consumers can get the reports on themselves and their properties. Buyers may want to require sellers to provide CLUE reports on houses being sold.

A consumer can request a copy of his or her claims history report at anytime through www.choicetrust.com or by mail to Choice Point's Consumer Disclosure, P.O. Box 105108, Atlanta, GA 30348-5108. Choice Point requests that mail requests be submitted on a form that may be downloaded from the Web site at http://www.choicetrust.com/pdfs/curious_consumer_form.pdf.

REALTOR® Practice Tips: Consumers should be aware that contacting their company or agent to discuss the applicable coverage and deductibles for an actual loss will be reported by the insurance company to the CLUE database as a claim, even if the insurance company never pays out. This is because damage has occurred that may be covered by the terms of the policy.

Impact on Wisconsin Real Estate Transactions

The availability and affordability of property casualty insurance is critical for homeownership efforts and the real estate industry. Insurance is a necessary component in securing a mortgage, and continuing insurance coverage is necessary for meeting the terms of most mortgages. Premium increases can prevent the marginal homebuyer from being able to afford a home and can severely strain the ability of existing homeowners on fixed incomes to keep their homes.

As the following Legal Hotline and Member Response sections indicate, transactions in Wisconsin are sometimes delayed and small numbers are falling through. Perhaps the most troubling reports are those that indicate that new homeowners are being informed after the closing that the insurer will not offer the coverage indicated in the binder.

Legal Hotline Questions and Answers - Insurance Problems

A broker had a sale on a five-acre farmette with a partial barn and an old grainery for an outbuilding. Prior to purchase, the insurance company looked at the property and insured the buyer. The insurer then cancelled the policy after the purchase. Can the insurance company legally do that? What state agency can the buyer go to for insurance coverage?

An insurance company will evaluate an application to determine if it qualifies under its guidelines for new business. When a policy first becomes effective, the insurance company may cancel that policy any time within the first 60 days without providing a reason for the cancellation. The cancellation is not effective until at least 10 days after the insurance company mails or delivers written notice of cancellation.

Buyers may contact the office of the Wisconsin Insurance Plan (WIP). The WIP is Wisconsin's residual property insurer. It was created to provide basic property insurance for homes, rental dwellings, and certain types of business properties that cannot be insured by other insurance companies. Insurance from WIP is expensive and provides only basic coverage for certain types of damage.

WIP may be contacted online at http://www.wisinsplan.com, by mail to 700 West Michigan Street, Suite 320, Milwaukee, Wisconsin 53233-2415, by telephone (414-291-5353), by fax (414-291-5365) or by e-mail (thewip@execpc.com).

An agent just wrote an offer on a property that does not have updated electrical - it still has fuses. The agent became concerned when another agent told her that it might be impossible to get homeowner's insurance because of this. Is this a concern?

There have been numerous reported cases of the inability of buyers to obtain insurance for properties with less than 100 amp service or fuses. Brokers may wish to refer buyers to their insurers in a timely manner to assure offers are drafted with appropriate contingencies. Contingencies may require verification of insurability with regard to the electrical system. If the system must be upgraded the offer would indicate which parties would be responsible for the expense.

An agent just heard that a law has been passed that Wisconsin insurance companies can no longer insure homes with 60 amp service. Is that true?

Although there is no statutory prohibition for insurance companies to insure homes with 60-amp service, most insurance companies are electing not to insure such homes. As insurance companies struggle with a variety of economic challenges, they are faced with hard decisions regarding whether they will write insurance policies on real estate and what risks those policies will cover.

It may be an important service to send a buyer to an insurance agent at the same time they are pre-qualifying for a mortgage. In the best case, buyers will have information regarding risks commonly excluded from coverage and those property conditions that may need to be addressed in the offer to assure coverage.

Last month a seller's family dog bit a neighbor, and the seller turned the claim over to his insurance company. Now the seller has received a notice from his insurance company stating that they are not going to renew his

homeowner's insurance. Can they do this?

Under most circumstances companies are free to refuse to renew insurance policies. If someone has had multiple claims or has the potential for additional claims, the insurance company will often refuse to renew a policy. If an insurance company pays an insurance claim as a result of the actions of an animal kept on the premises, the insurer may require that the animal be removed before it will continue to provide insurance.

Member Reports of Transaction Problems With Insurance

The WRA Legal Department attorneys asked for member input about problems that they have experienced with property insurance creating obstacles or delaying closings. The following summarizes some of the situations that were reported.

Electric Service

The most frequent comment related to electrical service was that either insurers are not covering homes with less than 100 amps or with a fuse system rather than a circuit breaker system. For example, one member reported:

> "Insurance companies will not insure on less than 100-amp service, and will insist that it be changed prior to closing. This can sometimes be an undue hardship on the seller. The member found only two companies that will insure on the 60-amp service, and they will use their high-risk companies, which means that the premium will be higher."

Another member found that some insurance companies would insure houses with under 100-amp service provided that the electrical service were upgraded within one to six months. If this were not done, the insurance premium would increase substantially. The electrical work would potentially cost between $800 and $2,500.

Another member reported that the same thing happened when there was knob and tube wiring. After much searching, an insurer was found to provide insurance as long as the wiring was replaced within six weeks. It was difficult to renegotiate the accepted offer with the sellers. Another member was not so fortunate in a similar case where the seller could not afford to upgrade the 60-amp electrical service and the transaction had to be cancelled.

> **REALTOR® Practice Tips**: 100-amp service is apparently the minimum for most insurers. Brokers should refer buyers to their insurers early on. It may be necessary to include contingencies in offers to purchase requiring verification that the electrical system meets insurability standards and assigning responsibility for costs if the system must be upgraded.

Dwelling Policy

When looking for dwelling insurance for a duplex with a fuse box, one member was forced to buy insurance from the WIP for an annual premium of $729. His insurance agent informed him that there was no liability coverage with this, so he installed circuit breakers. One of his customary insurers then insured the building.

Note: A dwelling policy provides more limited property coverage than a homeowner's policy, covering against loss to a dwelling or personal belongings. A homeowner's policy, on the other hand, offers a combination of property and liability coverage. To qualify for a dwelling insurance policy, a building does not have to be occupied by the owner, and it may even be under construction. Dwelling policies are commonly used to insure rental properties and seasonal homes, which are unoccupied for portions of the year.

Fire

One member reported that a customer lost his house to a fire on Christmas Day 2001. His insurance company promptly and appropriately settled the claim. When he found another home, and his original insurance company and two other insurers denied his homeowner's insurance application.

He ended up petitioning to the Wisconsin commissioner of insurance, who assigned his application to yet another company. His new premium was exorbitant, but at least he was able to secure some sort of coverage.

Note: This customer apparently applied to the WIP—see http://www.wisinsplan .com.

Location

A prospective homeowner had a difficult time securing insurance because of the distance of the house from a fire hydrant. This individual had to shop extensively to find insurance at a reasonable rate in order to close.

Note: A building's location affects the cost of coverage because some communities have better fire protection than others. Insurance companies divide the state into rating territories. Each city and locality in Wisconsin has a fire protection classification ranging from 1 to 10, depending on the amount of fire protection in the area. These rating classes depend on such factors as water pressure, access to the local fire department, and the training and skills of firefighters. Most of the larger cities in Wisconsin are in classes 1—4. Small towns and rural areas have higher fire protection classes and generally higher prices.

Physical Property Characteristics

Just a couple of weeks prior to closing, the insurance company demanded a copy of the home inspection report. It submitted a long list of minor repair items, like a drippy faucet, and stated that it wouldn't issue a policy unless every item was attended to and proof of repair submitted. Fortunately, the buyer talked the insurer into insuring the property and giving them a month to have things fixed.

In a similar case, an investor bought a two-unit building. The insurance company inspected the property and gave him a list of things that needed to be done or it would not insure the property. Another company would only insure it at a premium of $1,500 for one year. This investor had excellent credit and no prior claims. The property electrical system had been updated three years before, the roof was near the end of roof life, and the furnaces were fairly new, but it needed windows and down the line needed handrails. The insurer wanted the investor to repaint inside and any wood trim outside.

Note: An insurance company may refuse to issue or renew a policy because of a property's condition. This can include something like a worn-out roof. Unless the wear is due to a covered loss, the owner would be responsible for paying to repair or replace it.

Replacement Cost

A four-unit rental property that had been insured for about $182,000 could later only be insured at a replacement cost of around $350,000. That put the annual premium at about $1,200. The property is only worth about $300,000 on the open market for the land and buildings. The reporting member was concerned that these high-priced and restrictive requirements by the insurance companies will soon negatively impact on the ability of buyers to afford income properties, and thus will lower the market value.

Note: Replacement cost is the amount it would take to replace or rebuild a property or repair damages with materials of similar kind and quality, without deducting for depreciation. Depreciation is the decrease in home or property value since the time it was built or purchased because of age or wear and tear. In order to qualify for replacement cost coverage, the dwelling is required to be insured to at least 80 percent of the replacement cost. On the other hand, actual cash value is the value of your property when it is damaged or destroyed. This is usually computed by taking the replacement cost and subtracting the depreciation.

Insurance Agents' Comments on the State of Property Insurance in Wisconsin

A few insurance professionals also made some informal observations regarding property insurance in Wisconsin.

Insurance Company

One insurance company indicates that underwriting requirements in Wisconsin are tighter, and that all companies are using CLUE and credit scores, in varying ways, to identify the clients who are more likely to have losses and then make a premium charge for it. Almost all insurance companies find 60-amp electric service to be a problem, and an exterior finish insulation system (EFIS) can also be a problem, but to a lesser degree. Wisconsin insurance companies also are very concerned about the aggressive plaintiffs bar and the mold issue. Some companies might exclude mold while others might modify policies to limit coverage for mold to specific limits.

Premiums for homeowners insurance may go up 10 percent to 15 percent, depending on the company and their experience, for the next few years. Homeowners who do not purchase car insurance in conjunction with their homeowner's insurance will find a very restrictive market to chose from. Bear in mind, however, that Wisconsin ranked 50th out of the 50 states for the lowest average homeowner's premium in 2001.

Insurance Agent

An agent stated that the insurance company he works for does credit checks but will not reject a prospective insured based upon credit alone. He stated that every insurer does check for losses using CLUE. Insurers may refuse coverage for a poperty with multiple claims or provide coverage with large deductibles. The agent observed that most people call just a couple of days before closing and then have to rush to get coverage. Homebuyers need to shop early so that if there is a problem they have time to search different companies.

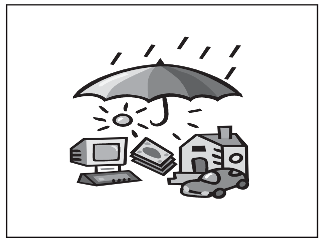
Independent Insurance Agent

An idependent agent noted that some markets have increased rates from 20 percent to well over 120 percent on clients' homeowner's insurance renewals, and have imposed mandatory $1,000 wind and hail deductibles in response to the mild to severe wind storms in Wisconsin from 1999-2001 and the ice damming to many roofs in December 2001.

The agent also observed that some insurance companies have became more restrictive and have not renewed policies where there are one or two claims. Some have installed surcharges for prior claims, some use CLUE and credit/insurance scoring systems, while others are expected to put moratoriums on new applications. Insurers look at the condition of the home: roofs can have no curled or broken tabs or signs of wear; trees with overhanging branches must be trimmed; and wiring, furnace and plumbing must be updated in older homes.

With so many homeowners looking for replacement insurance, many insurers may propose higher deductibles and closely evaluate a property's location and the relative difference between market value and the cost to rebuild. If it costs more to build than buy a neighborhood replacement, companies will only

Insurance Tips for Homebuyers



Consumers making a real estate purchase should not take property insurance for granted and must not wait until the last minute to apply for insurance. Consumers should be aware that insurance companies evaluate the buyer's credit information, the buyer's insurance claims history, and the claims history of the property when they consider homeowner's insurance applications. Insurance rejections may be based upon the condition of the property (such as having fuses rather than circuit breakers) or prior claims related to the property. Some insurance rejections are also based upon buyer characteristics such as the buyer's pets or the buyer's prior claims records.

Both lenders and insurance companies will consider the credit history of the buyers. Many consumers are familiar with their credit reports, but many lenders and insurance companies instead use credit scores. The most widely used credit scores are FICO® scores, prepared by Fair, Isaac & Company, Inc. FICO® scores are computed using information from credit reports. These and other credit scores are a snapshot of your credit risk at a particular point in time and are intended to predict the likelihood that you will make all of your payments on time.

Some insurance companies use insurance scores instead of credit scores. An insurance score is a credit-based statistical analysis of your likelihood to file an insurance claim within a given period of time. Insurance scores are computed using information from your credit report, but the formulas used are different than the formulas used to compute credit scores.

Insurance companies also look at the buyer's claims history and the property's claims history, which are compiled into Comprehensive Loss Underwriting Exchange (CLUE) reports. Insurance company studies have shown a correlation between a consumer's prior claims history and his/her future insurance loss potential. A CLUE claims history report contains a record of all insurance claims made with respect to a property over the past five years. Consumers should be aware that contacting their company or agent to discuss an actual loss is generally considered to be reporting a claim, even if the insurance company never pays out.

Before Looking for a House

1. Get a copy of your credit report and correct any errors or problems at least six months before you start looking for a house. Remember that your credit report information is used to compute your credit score and your insurance score.
2. Ask your insurance agent for homeowner's insurance information and application procedures. Also ask about any property conditions or lifestyle issues that routinely result in refusals to insure.
3. Get your FICO credit score (starting at $12.95) from Fair, Isaac & Company, Inc. at http://www.myfico.com/, or get your homeowners insurance score ($12.95) from Choice Trust at http://www.choicetrust.com/servlet/com.kx.cs.servlets.CsServlet?channel=welcome&subchannel=.
4. Obtain your claims history (CLUE) ($12.95) from Choice Trust at http://www.choicetrust.com/servlet/com.kx.cs.servlets.CsServlet?channel=welcome&subchannel=.

Once You Are Interested in a Property

1. Ask the seller for the CLUE claims history report on the property before you write an Offer to Purchase.
2. If the seller won't voluntarily provide the property CLUE report, put a contingency in the offer to purchase requiring the seller to furnish this information.
3. If the house has 60-amp electrical service or fuses instead of circuit breakers and your insurance company won't provide coverage, put a contingency in the offer to purchase for an electrical service upgrade.
4. If your REALTOR® or the seller's CLUE report points to a property condition problem that may make it difficult to obtain reasonably priced homeowners' insurance, discuss with your REALTOR® whether a contingency might be included in the offer to address this issue.

Hints for Successfully Obtaining Homeowner's Insurance

- Use your own insurance company, or use the insurance company that the seller uses to insure the home you are buying.
- Insure your car and your home with the same insurance company—your insurance will likely be less expensive.

offer market value coverage.

The insurance agent emphasized that it is critical that homebuyers plan properly for their insurance needs, well in advance of closing.

Consumer Handout

The Insurance Tips for Homebuyers consumer handout on page 10 of this *Update* has been designed by the WRA for REALTORS® to use in their residential transactions. The handout gives a brief explanation of the various factors considered by insurance companies when considering homeowner's insurance applications. The handout contains a list of tips to follow so that the potential homebuyer can be prepared to successfully obtain the insurance necessary for a successful closing.

WRA Insurance Contingencies for Offers

The WRA is developing offer contingencies that may be used to address insurance related issues such as the provision of the owner's CLUE report or upgrading 60-amp electrical service. Look for sample insurance contingencies on the Homeowner's Insurance Resource Page to be created on the WRA Web site.

Resource Materials for Homeowner's Insurance Availability

For additional information about the insurance issues impacting real estate transactions, see:

- NAR Field Guide to Insurance Availability: http://www.realtor.org/libweb.nsf/pages/fg718
- State of Wisconsin, Office of the Commissioner of Insurance: http://oci.wi.gov/oci_home.htm
- NAR Property Insurance Fact Sheet: www.realtor.org/publicaffairsweb.nsf/pages/InsFactSheet?OpenDocument
- NAR Property Casualty Insurance Report: www.realtor.org/GAPublic.nsf/ages/propcasinsurance
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