The Protection Gap in Property Insurance: Does property insurance deliver—especially after natural disasters—and what improvements are needed?

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Session topic:
Successful economic recovery, especially after disasters, depends on the flow of insurance dollars, but underinsurance and coverage limitations leave a Protection Gap. This session will use the Essential Protections for Policyholders project to examine whether and how regulation of buying insurance, coverage, and the claims process can fill the gap.

In the past few years the insurance industry and academics who study it have paid increasing attention to the “protection gap”—the gap between losses incurred and losses insured, or the gap between the amount of insurance actually purchased and the amount that would be economically beneficial to insureds.¹ Because insurance plays an important economic and social role in many ways, the gap is significant to individuals, firms, the communities in which they reside or operate, and the economy as a whole.

The most visible and most discussed examples of the protection gap are the lack of insurance products of many kinds in developing countries and the failure in both developing and developed nations for individuals and businesses to purchase adequate coverage against natural catastrophes. And the concept has been explored in practically every other insurance arena—cyber risk, health, retirement, terrorism, and general property risk.

The property insurance market in the United States varies along a spectrum, of course. Residential property insurance and the people who buy

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¹ The Geneva Association, the insurance industry’s global think tank, has done the pioneering work on the protection gap. See Geneva Ass’n, Understanding and Addressing Global Insurance Protection Gaps (2018); Lloyd’s, A World at Risk: Closing the Insurance Gap (n.d.); Bermuda:Re/insurance+ILS, The Protection Gap (2017).
and sell it differ, on the whole, from commercial property insurance and its participants. There is wide variation within each category: High net-worth individuals are likely to be more sophisticated purchasers than middle-income consumers, and small businesses buying insurance more resemble ordinary homeowners than sophisticated commercial insureds. The channels of distribution differ, too; most residential property is bought and sold largely as a commodity, and large commercial policies are likely to be tailored with the aid of intermediaries. This session focuses on ordinary residential property insurance, as does the Essential Protections for Policyholders project, although the discussion can be extrapolated to other elements of the market.

This session focuses on the protection gap in property insurance in the United States, especially residential property insurance, and particularly after natural disasters. It describes the protection gap and suggests possible cures, especially as presented in Essential Protections for Policyholders.²

The Protection Gap in Property Insurance also will be the subject of a conference sponsored by the Rutgers Center for Risk and Responsibility on March 29, 2019. The conference will engage lawyers, industry professionals, academics, and others in the existence, causes, and cures of the protection gap. More information is available at https://crr.rutgers.edu/event/protection-gap/

EXAMPLES OF THE PROTECTION GAP

The protection gap takes several forms.

Entirely uninsured

At its extreme, an entity is entirely uninsured, either because coverage is not available or because the entity cannot or does not access insurance (for example, for economic reasons). This is relatively rare in property insurance in the US, with the notable and high-profile exception of Puerto Rico. Only about one-half of the residential properties in Puerto Rico

² As a project of the Rutgers Center for Risk and Responsibility at Rutgers Law School in cooperation with United Policyholders, Essential Protections for Policyholders draws on academic research, an extensive survey of state law, and practical experience. All project documents are available at https://epp.law.rutgers.edu/. More information on the project is at notes 15-17 infra.
have homeowners insurance, a problem that the devastation of Hurricane Maria brought to light.³

**Insured, but certain perils are not covered**

The best-known and perhaps the largest category of the protection gap in property insurance occurs because a policyholder is insured but significant perils are excluded from coverage. This is particularly true of residential property and disaster coverage. Homeowners insurance policies, for example, exclude coverage for losses caused by natural disasters such as flood or earthquake, and the exclusions are written broadly to exclude, respectively, many types of water damage and earth movement.

The effects of exclusion of perils can be dramatic. For example:

- About 70% of the total residential flood costs as a result of Hurricane Harvey in 2017 were uninsured.⁴
- California insurers have been pulling back from writing new business and, in many cases, renewals in areas most at risk from wildfires, forcing insurance consumers into the state’s residual market FAIR plan.⁵

**Under-insured**

A significant protection gap arises when the amount of insurance is insufficient to cover a loss. This results from incorrect assessment of the amount of insurance required at the time of purchase or renewal, or by a failure properly to specify the interest to be insured.

- Three of every five homes in America are underinsured by an average of 20 percent less than full value, according to analytics firm CoreLogic.⁶
- A year after the North Bay wildfires in California, 66% of survey respondents who knew if they had enough insurance to cover the cost of repairing, replacing or rebuilding their home, reported being underinsured, according to a United Policyholders survey.

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Insured peril, restrictive policy terms

In many cases a peril will be covered but the extent of coverage will be limited.

- Many homeowners insurance policies contain hurricane deductibles or windstorm or wind/hail deductibles, typically in the form of percentage deductibles varying from 1 percent of a home’s insured value to 5 percent or higher. These special deductibles are subject to regulation in a number of states.7

Other exclusions or restrictions on coverage

In many instances the protection gap arises because of narrower exclusions or limitations.

- Some of these focus on the nature of the loss. Both ISO and AAIS have filed “cosmetic damage endorsements” to exclude or limit coverage from damage that arguably affects the appearance but not the function of the property or a specific portion of it.8
- Others arise from restrictive loss settlement provisions. The ISO HO-3 policy is ambiguous about matching a repair to an undamaged portion of property. Some policies clarify and limit coverage, providing that the insurer “will not pay to repair or replace undamaged property due to mismatch between undamaged and new material.”9

CAUSES OF THE PROTECTION GAP

The protection gap arises when insureds or potential insureds are not offered or do not purchase insurance that is appropriate to their circumstances. The Geneva Association focuses on the protection gap that arises in the process of acquiring insurance, on the demand side and the supply side.10 The protection gap also can arise when coverage is in place

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7 III, Background on: Hurricane and windstorm deductibles, available at https://www.iii.org/article/background-on-hurricane-and-windstorm-deductibles
10 Understanding and Addressing Global Insurance Protection Gaps, supra.
but is not given effect because of factors that occur after a loss.

Demand side
One set of causes is on the demand side—factors that are important in determining whether potential purchasers buy insurance that is adequate to their needs. These factors are:

- Affordability. Potential buyers have to be able to afford available insurance, so the wealth of individuals and the economy as a whole matters, as does the distribution of wealth. Many kinds of insurance are also very price-elastic.
- Awareness. Potential purchasers need to be aware of the risks to which they are subject and aware of the availability of insurance products to protect those risks.
- Appeal and quality of product and service. Perceptions of quality, convenience, and ease of purchase are important.
- Trust. Insurance requires a purchaser to protect faith in the insurer into the future, so trust in individual firms and the industry as a whole are essential.
- Cultural and social factors. Societal views about risk, gambling, and the morality of insurance vehicles.
- Individual factors, including decision-making ability and behavioral biases. Traditionally this category focused on information asymmetries between purchaser and insurer and on the ability and willingness to invest in search costs. More recent scholarship has focused on behavioral factors that affect purchase, such as loss aversion, mental accounting, discounting or salience of risk, and status quo inertia.

In the homeowners insurance market several of these factors are particularly important. Affordability is an important part of the issue, but for many insureds it is not so much that prices are high as that price is extremely important to purchasers, resulting in buying decisions that are driven by price as much or more than by coverage and quality. Awareness is bifurcated; homeowners know that they need insurance, or are required by their mortgage lenders to buy insurance, but the content of the coverage is poorly understood. Part of this is due to the complexity of insurance and the limited means or desire for homeowners to educate themselves about it. Part of it also due to behavioral biases and cognitive errors. Homeowners tend to over-estimate small risks, so the purchase of low deductibles is widespread, while they tend to under-estimate large risks, so earthquake or
flood insurance is too seldom purchased by those who need it.

In short, much of the residential property insurance market is a price-sensitive market with low consumer literacy. Under-valuation is also a problem, in two senses: Proper setting of policy limits and purchase of proper coverage (for example, Extended Replacement Cost rather than ordinary Replacement Cost.) Policyholders are unfamiliar with the need or the tools for proper valuation and insurers and producers have limited ability and incentive to inform them.

Supply-side

The second set of causes are on the supply side—factors that determine the availability and distribution of insurance, with particular but not exclusive emphasis on market imperfections. These include:

- Limits to availability. Not every risk is insurable. As a general matter, insurance fails to work where risks are non-random or are correlated and are hard to quantify as to severity and frequency. The resulting calculation also has to produce premium rates that are economically viable.
- Transaction costs. Search and acquisition costs raise the price of insurance, affecting demand.
- Information asymmetries. Adverse selection and moral hazard can increase costs of insurers and therefore of lower-risk insureds, reducing demand.
- Institutional obstacles and shortcomings. Here there are two traditional categories.
  - Insurer obstacles and shortcomings. This relates to affordability and appeal on the demand side. Of particular discussion at the moment is the cost and lack of appeal of outdated systems and technology in the risk assessment and marketing of insurance.
  - Legal and regulatory frameworks. Regulation is essential to the creation and operation of insurance markets, and regulation that is too lax or too rigorous retards the market. Government and other non-industry entities affect the market by providing alternatives or programs that increase or reduce the need for insurance.

In homeowners insurance these factors play out in interesting and complex ways. In particular, adverse selection may be less of a problem than in other areas; homeowners insurance is required by lenders and otherwise
broadly purchased, and lower risk insureds may be the ones more likely to purchase more and better coverage because they are more aware and more risk-averse. The rise of insurtech in underwriting and distribution aims to address the shortcoming of legacy systems. The price-sensitivity of the market leads to fragmenting of coverage—requiring separate policies or endorsements for many important risks—and to the hollowing out of coverage, reducing coverage by exclusions or interpretations. Finally, the regulatory framework is variable; states regulate policy forms and market conduct, but the robustness of the regulation has been questioned.

**Claim-side**

Demand- and supply-side factors are important, but there is a third set of factors that the traditional account of the protection gap fails to consider. Under any of the definitions of the protection gap, the assumption is that the amount of insured losses is relatively fixed, and that the presence of insurance equates to coverage and payment. But even where coverage nominally is or might be available, there are factors in the claim process that can result in the failure to pay and therefore a gap in protection. These factors also fall into two categories.

On the policyholder side, the factors are captured in the well-known concept of the dispute pyramid.\(^1\) Of all covered losses (the base of the pyramid), only some are actually paid, due to filters that cause the pyramid to narrow as losses proceed through the process to eventual payment at the top of the pyramid. Policyholders first must recognize they have a covered claim. If they contact their insurer and the insurer responds that the claim is not covered, or if the insurer offers an amount in settlement, they may defer to the insurer’s expertise. Policyholders may not seek professional help, find the transaction costs of doing so are unjustified in small claims, or may be willing to resolve claims for less than full value because of the financial and emotional toll of delay.\(^2\)

On the company side, failure to pay claims at less than full value may be due to bureaucracy, lack of knowledge of personnel, or worse. The “worse” is the potential mismatch of incentives in an organization; customer service that aids reputation and retention are important, but so are the need


to limit claim costs. If claims is perceived as a profit center, claims can be underpaid in ways large and small, incidental and institutional.  

CURES FOR THE PROTECTION GAP

In general

The protection gap literature offers a structure of remedies to help fill the gap, with emphasis on the steps that can be taken by three sets of institutions.

- Insurers can reduce the gap by reducing production costs, therefore increasing affordability, increasing awareness of their products, improving customer experience, innovating new products, and addressing particular need.
- Collateral actors can help fill the gap by various measures. Most importantly in the residential market, mortgage lenders require homeowners insurance with particular features.
- Government can and does play a key role, and government’s role is the focus of this session.

The Geneva Association suggests that in developed countries there is “limited need for heavy government involvement,” and that involvement largely involves the need to “design and provide legal and regulatory framework for the private insurance sector.”  

Within that framework, licensing of insurance companies, rate regulation, solvency regulation, and guaranty funds are essential to the operation of the market and avoid a protection gap that would occur from insolvent insurers. Government also encourages or requires risk mitigation through building codes and other devices. In residential property insurance generally and in the catastrophe area in particular, government often is the insurer of last resort where the market fails, through residual market mechanisms such as FAIR plans, the National Flood Insurance Program, the Texas Windstorm Insurance Association, and the California Earthquake Authority.

Key areas of regulation that affect the protection gap include the approval of policy forms and the catch-all category of market conduct regulation which includes the marketing and underwriting of policies and claim practices. It’s useful to think of four areas in which state regulation

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14 Understanding and Addressing Global Insurance Protection Gaps, supra, at 8.
can cure the protection gap:

- Making the market for insurance more effective
- Prescribing policy terms to ensure adequate coverage
- Regulating claim practices
- Providing special protections for disaster victims.

The Essential Protections for Policyholders project focuses on these four areas. In each area, the project identifies a series of general principles that motivate the particular analysis and recommendations. Then the principles are given more detail in recommendations about the direction state regulation should take. In most cases, recommended statutory language is included. The recommendations are based on a discussion of the issue and a survey of current law. A unique feature of the project is that it rests on an extensive national database of state law regulating homeowners insurance. The database of law in the fifty-one jurisdictions also provides a basis for comparing and evaluating individual states’ current systems of regulation. Part of the project is to prepare scorecards comparing states’ homeowners protections on a variety of issues.

**The market for insurance**

A starting point is the market for homeowners insurance. For the market to achieve optimal results, when consumers shop for and purchase insurance they must have access to good information about the extent of coverage provided by different policies, the price of that coverage, and the quality of insurance companies offering the coverage. Better information also affects policyholders’ decisions about risk after they have purchased

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15 On protecting disaster victims against losing their insurance due to insured losses in a catastrophe, for example, the general recommendation states, “Disaster victims should be protected against sudden dislocations in the insurance market.”

16 “Insurance companies may not decline, cancel, nonrenew, surcharge, or increase premiums because of disasters.”

17 One of several recommended statutory provisions states,

The declination, cancellation, or nonrenewal of a homeowners insurance policy or the addition of a surcharge or an increase in the premium of such policy is prohibited if the declination, cancellation, nonrenewal, addition of a surcharge, or increase in premium is based solely on any loss incurred as a result of one or more catastrophic events for which a state of emergency has been declared by the President of the United States or the Governor or for which a local emergency has been declared by the executive officer or governing body of local government or which has been declared by a nationally recognized catastrophe loss index provider.
policies and it empowers them in the event of a claim. Currently consumers have adequate information only about price, which causes them to make buying decisions that result in a protection gap. Issues of coverage particularly need to be addressed.\textsuperscript{18}

Comparing terms of coverage is more difficult. The traditional lore of insurance has been that policy forms are standardized, so homeowners insurance policies use the statutorily prescribed standard fire policy or ISO forms HO-3 or HO-5. If that was once true, it is no longer the case; there is wide variation in the terms of policies.\textsuperscript{19} And terms of coverage are not easily available to consumers. Insurers and intermediaries usually provide summaries of some policy terms to shoppers but refuse to provide the actual policy language until after the policy has been purchased.

For a policyholder to evaluate a policy being considered for purchase, to determine whether to file a claim, or to resolve a dispute with an insurance company, the policy must be clearly organized and written in plain, non-technical language. An Essential Protection is to require insurance policies to conform to minimum standards of organization, presentation, and readability.\textsuperscript{20}

Even the clearest insurance policy will not aid consumers in their buying decisions unless its terms are readily available prior to purchase. Insurance is an unusual product in that consumers don’t know what they are buying before they buy it. Essential Protections recommends that

\textsuperscript{18} The quality of an insurance policy reflects two things: the ability of the insurer to pay claims and its practices in doing so. The former is adequately addressed by the non-market solution of state solvency regulation, the area in which regulators have been most successful. The quality of claim practices, by contrast, is the area in which there is little information available to consumers. When choosing among insurers, consumers have few effective means of evaluating and comparing which insurer is more likely to pay promptly, fully, or at all for which type of claims. See Jay M. Feinman, The Regulation of Insurance Claim Practices, 5 UC Irvine L. Rev. 1319, 1321-23 (2015).


\textsuperscript{20} Many jurisdictions have Plain Language laws governing insurance policies. The NAIC’s Property and Casualty Insurance Policy Simplification Act (MDL-730) sets a general standard requiring that policies be “simplified, taking into consideration [various] factors.” The implementing Model Regulation (MDL-731) adds requirements such as a table of contents, self-contained sections, legibility, and a minimum score on the Flesch Reading Ease Test of 40.
insurance departments should post online both the homeowners insurance policies of all insurance companies doing business in the state (or at least those companies that have a significant market share) and a policy comparison tool that enables consumers easily to compare key terms of insurance policies.\textsuperscript{21}

Even policies that are freely available, well-organized, and written in non-technical language are forbidding to most homeowners. Therefore, an Essential Protections is that applicants and policyholders be provided accessible summaries of the terms that are likely to be most important to them.\textsuperscript{22} At the time of renewal, policyholders especially need to be informed about changes in terms.

\textit{Coverage}

The market for homeowners insurance, like other consumer markets, cannot be perfected by providing more information to consumers. Consumers possess limited ability and inclination to process the information because of its complexity and because of their own cognitive limitations and biases.\textsuperscript{23} Therefore, coverage needs to be structured in ways that more closely align with a well-functioning market and with the legitimate expectations of ordinary policyholders.

Not every coverage shortfall is a protection gap. Homeowners differ in what kind of insurance they need, want, or are willing to pay for. But for homeowners insurance to serve its purpose of providing basic financial

\textsuperscript{21} The National Association of Insurance Commissioners (NAIC) has had in place a Transparency and Readability of Consumer Information Working Group. The charge of the Working Group is to “Study and evaluate actions that will improve the capacity of consumers to comparison shop on the basis of differences in coverage provided by different insurance carriers.” [http://www.naic.org/committees_c_trans_read_wg.htm](http://www.naic.org/committees_c_trans_read_wg.htm); [http://www.naic.org/cipr_topics/topic_transparency_readability.htm](http://www.naic.org/cipr_topics/topic_transparency_readability.htm). However, the progress of the Working Group has been limited; it has produced generic shopping tools but has not acted to recommend the publication of policy forms.

\textsuperscript{22} An example in the health insurance context is the Summary of Benefits and Coverage mandated by the Affordable Care Act and developed by state insurance regulators; the Summary answers in a clear format questions such as “What is the overall deductible?” and “Do I need a referral to see a specialist?” [https://www.healthcare.gov/health-care-law-protections/summary-of-benefits-and-coverage/](https://www.healthcare.gov/health-care-law-protections/summary-of-benefits-and-coverage/)

security, all homeowners need certain basic coverage and should have the opportunity to purchase other coverage that is best suited to them. Examples of basic coverage that states should mandate include provisions that effectuate the purpose of Replacement Cost coverage and adequate coverage for Additional Living Expense.

Replacement Cost, as its name suggests, covers the cost to repair or replace without a deduction for depreciation—often referred to as “new for old.” To fulfill policyholders’ expectations about Replacement Cost coverage, several Essential Protections are needed. First, replacement cost coverage typically is capped at a dollar amount stated in the policy limit. Extended Replacement Cost coverage provides an additional percentage that may be recovered. This protection is necessary if the estimate of the cost to repair that is the basis for the policy limit—an estimate that often is provided by the insurance company—is too low, and is especially important after catastrophes, when the cost of labor and materials typically rises. To make sure that policyholders know what they are buying, Extended Replacement Cost should be offered at the time of purchase of Replacement Cost coverage. Second, if a homeowner chooses to rebuild or relocate at another location, the benefits of the policy still should be available, limited to the cost of replacement at the original location.24 Third, repair or rebuilding of damaged property often requires that the property be improved from its prior condition because building codes have changed since the original construction. A damaged property must be repaired or rebuilt to conform to the current building code which may require additional expense. Policyholders with Replacement Cost coverage reasonably expect that this additional cost—“Law and Ordinance Upgrade”—will be part of their policy.25

Claims

The most basic promise in a policy concerns the insurer’s conduct in the event of a claim. The core requirement for insurance companies when handling claims is that they must act reasonably. An Essential Protection is

24 The ability to replace property at a different location is specified by statute in California, Cal. Ins. Code § 2051.5(c), and by judicial interpretation of the insurance policy in other states. E.g., Huggins v. Hanover Ins. Co., 423 So. 2d 147 (1982); Blanchette v. York Mutual Ins. Co., 455 A.2d 426 (Me. 1983).

to incorporate that requirement into law and to provide remedies for its violation. Reasonableness does not demand perfection; everyone makes mistakes, including insurance companies. Reasonableness does demand that insurance companies adhere not only to the express terms of policies but also to widely accepted industry standards of performance and requirements of law.  

Policyholders typically are at a disadvantage in the claim process. They lack information and expertise about coverage under their policies and about the claim process and they may be financially and emotionally vulnerable after a major loss. To correct this imbalance and to make sure that insurance companies honor their promises, an Essential Protection requires insurance companies to provide adequate information to policyholders about the claims process and establish and implement reasonable standards for processing, investigating, evaluating, and paying claims.

A first step in redressing the information imbalance in the claim process is to require insurance companies to provide policyholders with information in a timely manner about policy terms, time limits, and other requirements for pursuing their claims, and information the companies have received or developed about the claims. Policyholders also should have full access to information relevant to their claims, including information the companies have received or developed about the claims, commonly referred to as “the claim file.”


Most states have adopted the NAIC’s Model Unfair Claims Settlement Practices Act which, with the accompanying Unfair Property/Casualty Claims Settlement Model Regulation, define minimum standards of reasonableness. Some states have adopted statutes other than the UCSPA that define claims practices standards. Courts in most jurisdictions also recognize that an obligation of good faith and fair dealing is embodied in every insurance policy; the good faith obligation has been a major source of the law of claim practices, requiring the insurer to act fairly and reasonably in processing, investigating, evaluating, and paying a claim. See Feinman, The Law of Insurance Claim Practices, supra.


28 Many of these obligations are defined in detail in state adoptions of the NAIC’s Unfair Claims Settlement Practices Act (UCSPA), e.g., UCSPA § 4.M., and Model Regulation and in other state law. E.g., Cal. Ins. Code § 10103. Other state laws impose similar duties. E.g., Cal. Ins. Code § 10103.

29 The duty to provide a copy of the claim file on request is specifically mandated in California Insurance Code § 2071. A similar requirement is contained in La. Rev.
Often the most controversial issue in homeowners insurance claims is determining the value of the loss. An Essential Protection is to require companies to observe reasonable standards for determining and paying the Actual Cash Value or the Replacement Cost of the claim, as applicable under the policy. For example, under a Replacement Cost policy, in cases of partial loss homeowners expect that their policies enable them to repair or replace the damaged property without additional cost. Repair or replacement often requires matching the damaged part of the property to the undamaged part to restore the property to the condition prior to loss; for example, replacing only damaged shingles on a roof fails to restore the uniform appearance.

After a loss, policyholders need time to collect information, retain contractors and other experts, make repairs, and restore their standard of living, all while they are suffering the financial and emotional hardships caused by a loss. Insurance companies also need time to assist policyholders and to investigate and evaluate claims. Therefore, insurance companies must provide policyholders adequate time to make sure repairs are made, claims are fully documented, and the conditions for payment in insurance policies are fully complied with. If disputes arise, policyholders may require more time to retain legal representation and to initiate litigation. An Essential Protection is to provide a reasonable statute of limitations, such as two years, and to prevent an insurer from attempting to shorten the period in which a suit may be brought that is specified in the statute of limitations. Policyholders may be unaware of time deadlines and their effect, so insurance companies should be required to give them timely and adequate


notice so that they can comply with the deadlines.

When a loss occurs, homeowners need to receive the benefits of their insurance policies quickly and fully in order to repair their property and rebuilding their lives. In order to facilitate rebuilding and to remove pressure on a policyholder to prematurely conclude a claim, an Essential Protection requires companies to pay what they acknowledge they owe, even if other portions of claims are disputed, and not use the threat of litigation to coerce policyholders.34

When disputes arise, policyholders need efficient, effective, and expeditious means of resolving the disputes. Litigation ultimately may be necessary but it is a last resort for policyholders because it takes time, delaying the process of recovery, and it is financially and emotionally draining. Two alternatives to litigation that can be effective for homeowners are mediation and appraisal.35

The protections that policyholders have are only as good as the means available to enforce them. When insurance claims are improperly delayed or denied, policyholders may suffer other financial losses and emotional harm. For example, homeowners who do not receive prompt payment may have additional expenses due to being out of their homes and may suffer extreme aggravation and distress. If policyholders have to pay attorneys and incur other litigation expenses to get what they are entitled to, they are never fully compensated for their losses.

Therefore, Essential Protections require insurance companies to act reasonably in processing, investigating, evaluating, and resolving claims and give policyholders the right to sue for appropriate damages if the companies do not do so.36 Appropriate damages include the unpaid amount


Companies sometimes attempt to prevent policyholders from having their day in court through forced arbitration clauses in insurance policies. An Essential Protection is to bar the use of pre-dispute mandatory arbitration clauses in insurance policies. More than a dozen states prohibit enforcement of arbitration clauses in insurance policies by statute or regulation, e.g., Ark. Code Ann. § 16-108-201; Haw. Rev. Stat. § 431:10-221. and another ten states restrict the use of arbitration. E.g., Utah Admin. Code R590-122; Wyo. Rules Ins. Gen. ch. 23, sec. 9.

36 In a majority of states, insurance companies are liable only if they act
of the clam, other actual damages, attorneys fees and costs, and extra-compensatory damages such as interest at a higher than statutory rate, or treble damages.

**Disaster victims**

Often disaster victims need more extensive protections because of the distinctive conditions created following disasters. After a disaster policyholders may be unable to meet the ordinary conditions and time limits specified in insurance policies through no fault of their own. Entire communities may be inaccessible for periods of time, preventing policyholders from returning to their homes. Insurance companies are inundated with inquiries and claims, delaying communication with policyholders. Contractors are overwhelmed with work, delaying repairs and rebuilding. In those circumstances, policyholders should be granted additional time for processing their claims. Some types of problems can be anticipated and specified in advance, such as the need to extend time limits for filing additional living expense and full replacement cost claims. Other types of problems depend on the situation and require action by insurance

unreasonably and if they know they have done so or acted in “reckless disregard” of the lack of a reasonable basis for their action. Other states only require unreasonable behavior for the cause of action. See Feinman, The Law of Insurance Claim Practices, supra, at 701-04.


departments to make sure that insurance companies recognize the need to be flexible. The Essential Protections for Disaster Victims mandate flexibility in the claim process, standards that prevent unexpected gaps in insurance due to unfair exclusions, and prevention of dislocation in the insurance market.

The California wildfires in 2017 and 2018 have revealed a protection gap among insured homeowners due to undervaluation of their property. For example, twelve months after the 2017 North Bay Fires, two-thirds of respondents to a broad-based survey by United Policyholders who know if they have enough insurance to cover the cost of repairing, replacing or rebuilding their home, reported being underinsured. Insurers attempt to arrive at reasonable estimates of property value under Replacement Cost policies, but errors can be made and valuations can become out of date. An Essential Protection is to require insurers to provide an estimate of rebuilding cost every other year upon renewal, or otherwise update the valuation. Where the valuation has proven to be inadequate, a homeowner should be able to use the amount of coverage designated for other structures to rebuild the primary dwelling if necessary.

States should adopt statutes that extend the time for additional living expense and for filing claims after a disaster and that authorize insurance departments to extend other time limits. For example, every homeowners insurance policy should provide for twenty-four months of Additional Living Expense, and the period for ALE should be extend for up to an additional twelve months or more of the insured cannot reasonably rebuild within that time.

After disasters, some property owners may choose not to rebuilding a high-risk area or an area where an entire community has been devastated. In those situations, policy proceeds should be available to replace or rebuild the insured property at another location, though in an amount not exceeding the replacement cost of the insured property.

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1 The California Insurance Code permits extension of time or coverage following disasters. Cal. Ins. Code § 2051.5. Other states took similar action in response to particular events such as Hurricane Katrina, Superstorm Sandy, and the Louisiana flooding of 2016. Responses to particular disasters are helpful, but the enactment of statutes to deal with all disasters provides certainty for policyholders and insurance companies and avoids the need for hasty action.
Following a wildfire, hurricane, or other disaster that causes a large number of losses to a community or region, insurance companies sometimes react—over-react—by cancelling, failing to renew or imposing a surcharge on existing policies, and declining to offer new policies in the affected areas. Over time the companies may moderate their positions as the extent of losses and likely future risks become clearer, but in the meantime insurance may be unavailable or unaffordable. An Essential Protection is to ensure that catastrophes or other significant events do not cause a sudden and often unjustified dislocation in the insurance market. States should limit the ability of insurance companies to cause temporary dislocations in the market by failing to write or renew policies or imposing higher costs after a major disaster.  

A particularly controversial issue that arises on a large scale after a disaster but also occurs in other cases concerns losses that arise from covered and excluded causes. Homeowners insurance policies cover losses caused by some risks and exclude coverage caused by other risks. For example, policies typically cover hurricane damage caused by high winds but exclude losses caused by flooding during a hurricane. In many cases, however, a loss will occur due to a covered cause and an excluded cause, acting either in sequence, together, or in a manner that cannot be determined after the fact. Many homeowners policies have language that attempts to deny coverage in these cases, even if it is clear that part of the damage was due to a covered cause of loss. Commonly used language bars coverage due to an excluded cause “regardless of any other cause or event contributing concurrently or in any sequence to the loss”—even if the “other cause” is covered under the

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43 Many states have statutes that prohibit adverse actions after disasters or due to weather-related losses. A large number of states prohibit cancellation or nonrenewal due to weather-related events other than catastrophes, such as prohibiting cancellation or nonrenewal because of a claim resulting from an “act of God.” E.g. S.C. Code 1976 § 38-75-790. By their terms, these statutes would include adverse action due to catastrophes. Statutes in other states refer specifically to disasters. E.g., Ct. Gen. Stat. Ann. § 38a-316d; N. M. Stat. Ann. § 59A-16-20.1. A few states authorize the insurance department to declare a cooling-off period following a disaster during which cancellations and nonrenewal are suspended, e.g., N.Y. Ins. Law § 3425; Fla. Stat. Ann. § 627.4133. or to take other action. E.g., Ala. Dep’t of Ins. Bulletin 2010-10, citing the Unfair Trade Practices Law, Ala. Code § 27-12-1 et seq.; RI Ins. Reg. 110.  

policy. Terms such as this—known as “anti-concurrent causation clauses”—disappoint the reasonable expectations of policyholders that they will be compensated for losses due to covered causes and can be particularly problematic after catastrophic events. An Essential Protections ensures that losses due to covered causes are covered by limiting the scope of anti-concurrent causation clauses.

**CONCLUSION**

Not all losses can or should be insured. The concept of a protection gap helps frames discussion about what insurance should be available and how it should be regulated. Essential Protections for Policyholders provides one contribution to that discussion, in service of the goal shared by insurers and policyholder advocates alike: To recognize the importance of insurance in protecting the financial well-being of families and businesses and to make it more effective in providing that protection.

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46 The majority of states observe the rule of “efficient proximate cause” in cases involving covered and excluded causes of loss. 5-44 Appleman on Insurance § 44.03. Efficient proximate cause is often described as “the predominating cause of the loss” that “looks to the quality of the links in the chain of causation.” Murray v. State Farm Fire & Cas. Ins. Co., 509 S.E.2d 1, 12 (W. Va. 1998). Although a few statutes define causation under insurance policies, e.g., Cal. Ins. Code § 530; Fla. Stat. § 627.702(1)(b); N.D. Cent. Code § 26.1-32-01, it largely has been left to the courts (sometimes applying relevant statutes) to decide whether an anti-concurrent causation clause in an insurance policy can narrow the rule of causation that otherwise would be dictated by state law. The states are divided on this issue. Leading cases include Safeco Ins. Co. of America v. Hirschmann, 773 P.2d 413 (Wash. 1989), (clause unenforceable); State Farm Fire & Cas. Ins. Co. v. Bongani, 925 P.2d 1042 (Alaska 1996) (clause enforceable). See Annot., Validity, Construction, and Application of Anticoncurrent Causation (ACC) Clauses in Insurance Policies, 37 A.L.R.6th 657.