DON'T LET AN EARTHQUAKE SHAKE YOUR AGENCY

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There is a 100% chance of an earthquake occurring somewhere in the world today. Most earthquakes are so slight that they are not felt by humans. But hundreds are sufficiently strong to cause property damage and injury.[i] In North America quakes along the Pacific seaboard are frequent and often significant. In fact, the USGS says that within the next 30 years the probability of an earthquake measuring 6.7 on the Richter scale in the San Francisco Bay area or Southern California is 62% and 60%, respectively.[ii]

Some of the strongest quakes in United States history occurred along the New Madrid fault in 1811. Contrary to popular belief, the New Madrid earthquake was not a single quake but a series of three major quakes over a period of three months. Occurring in Arkansas, Missouri and Tennessee, all three quakes measured in excess of 7.4 on the Richter scale. During the quakes, waves on the Mississippi River capsized boats and resulted in a number of deaths. River banks caved in and collapsed into the river. Entire islands in the river disappeared. The area affected was sparsely populated at the time.[iii] But today a severe earthquake like those of 1811-1812 would constitute a major disaster. The USGS says there is a 40% likelihood of a severe quake in the same area within the next 50 years.[iv] The New Madrid Fault Zone is now densely populated, with Memphis, Little Rock, Birmingham, Nashville, Louisville, and St. Louis all less than 250 miles from the most seismically active part of the area.

The East Coast is not normally considered a seismic area. Yet in August 2011, a 5.8 quake hit Virginia and Washington, D.C., resulting in the closure of the Washington Monument for many months. Another strong earthquake on the East Coast occurred in Charleston, SC, in the late 1800's, when over 50 people died and most buildings in the city were damaged or destroyed.[v]

Earthquake damage and destruction is typically excluded from homeowner and commercial property policies. However, earthquake coverage can be obtained from a number of insurance companies for an additional premium.

Still, only 12% of homeowners in California carry earthquake coverage.[vi] In Oregon, only 20% of homeowners have earthquake insurance.[vii] In Missouri counties located near the New Madrid fault, the number of residences with earthquake insurance has decreased to less than 50% in recent years.[viii]

This lack of insurance raises the question: What is the insurance agent's duty to advise customers regarding the need for earthquake coverage?

Duty to Advise:

There is no set standard regarding an agent's duty to advise an insured that they need to obtain earthquake coverage. The extent of advice an agent must provide to clients varies from state to state.

Some states will find that, absent a special relationship, an agent has no duty to advise the client of optimum limits, insurance available, or to tell the client when coverage is too low. This view was set forth in *Blevins v. State Farm Fire & Cas. Co.*,961 S.W.2d 946 (Mo.Ct. App.1998):

> Missouri does not recognize a duty on the part of an insurance agent to advise customers as to their particular insurance needs or as to the availability of optional coverage. *Farmers Ins. Co., Inc. v. McCarthy*, 871 S.W.2d 82, 85 (Mo.App.1994). In McCarthy, the plaintiff argued that her insurance agent had an affirmative duty to advise her concerning underinsured motorist coverage. Rejecting this argument, the court refused to hold the agent liable because doing so: (1) would remove the responsibility from the insured to look after his own financial needs; (2) would change insurance companies into financial counselors or guardians of the insured; (3) would open companies to liability for failing to advise of every conceivable option, even those offered by competitors; and (4) would allow insureds to circumvent risk by allowing the opportunity for coverage after a loss by an allegation that the insureds would have sought additional coverage if it were offered. Id. at 85-86. The court noted that the insureds know more about their personal assets and ability to pay than does their insurance agent. Id. at 85. It follows, therefore, that it is the responsibility of those seeking insurance to advise an agent as to what they want. Id.

Other states require a special relationship between the agent and the insured if the court imposes an affirmative duty to advise customers of available coverage. The establishment of a special relationship is usually based on one or more of the following factors: extra compensation beyond premium, long-term relationship where the agent is aware the customer is relying upon and dependent upon the agent's advice or the agent's self-promotion as an expert.

In *Durham v. McFarland, Gay & Clay, Inc.*, 527 So.2d 403 (La. Ct. App. 1988), the Court of Appeals of Louisiana found that an agent breached his duty to advise the insured of the need for residential flood protection. The agent had handled the insured's insurance needs for 10 to 15 years and knew the insured had no flood insurance on the residence. Also see *Free v. Republic Ins. Co.*, 11 Cal.Rptr.2d 296, 297 (Cal.Ct.App.1992), where the court found that a long-term relationship or special agreement with an insurance agent might create a "special duty to use reasonable care."

A few states find the agent responsible to advise clients about available insurance coverage, even absent a special relationship. New Jersey courts have stated that the agent has a duty to: (1) have the degree of skill and knowledge requisite to his or her employment responsibilities; (2) exercise good faith and reasonable skill, care and diligence in the execution of his or her employment responsibilities; (3) possess reasonable knowledge of available polices and terms of coverage in the area in which the insured seeks protection; and (4) either procure the coverage necessary for the client's exposures or advise the client of his or her inability to do so. *Rider v. Lynch*, 42 N.J. 465 (1964) at 476477.

With regard to earthquake coverage for individuals, California has avoided the whole issue of whether agents have the responsibility to advise their clients on the need or the availability of earthquake coverage, by passing legislation referred to as the "Earthquake Insurance Act."[ix] This law requires the carrier to advise their insured of the availability of the coverage.

Documentation

The agent should reduce all recommendations and advice to writing, and take clear notes of client instructions. Confirm discussions through letters sent to the client. If earthquake coverage is discussed with a client, make sure file documentation exists to demonstrate advice was rendered as to the availability of earthquake coverage – even if rejected as too expensive. If coverage is rejected, the agent should send a letter confirming the coverage was offered. Ask clients to sign and return a form acknowledging that they were offered coverage and chose to reject it. Retain a copy of the letter in the policy file indicating how the letter was sent - with proof of delivery where possible.

Documentation is extremely important when disputes arise. Memories may fade, but proper documentation lives on.

Explanation of Coverage Provisions:

An agent is more likely to be drawn into litigation when a client is disappointed with the amount of payment for a claim or when a client has misunderstandings regarding provisions found in the policy. Because earthquake insurance is somewhat unique in its terms and provisions, the agent should explain those less understood provisions, such as deductible provisions, exclusions, and sublimits.

Earthquake insurance is structured as catastrophic coverage, requiring the insured to have greater participation in the payment of loss than a typical property policy. Typically, the deductible for earthquake insurance is structured as a percentage of insurance limits carried rather than a set amount per occurrence. For example, a 5% deductible on a $200,000 dwelling would mean a deductible of $10,000 whether the loss were $50,000 or $200,000. Additionally, the deductible percentage applies to each separate coverage. For example, if the insured's dwelling limits were $200,000 and the insured's personal property limits were $100,000 and the insured carried 5% deductible, the party would be responsible for a deductible of $10,000 for the dwelling (5% of $200,000) and another $5,000 for the personal property (5% of $100,000).

Every policy has certain exclusions and this is also true with earthquake policies. For instance, the earthquake policy may exclude or have a limitation on the amount payable for damage to swimming pools, fences, or china and glassware. Unreinforced masonry siding or chimneys and brick walls may also be excluded or limited, and this is not an exhaustive list.

Additionally, there may be underwriting restrictions such as waiting periods during which agents are unable to secure earthquake coverage for clients. When there has been recent seismic activity, individuals become eager to add earthquake coverage. Yet further aftershocks may damage property. Thus, insurers will place a moratorium on writing new earthquake coverage when there has been a recent earthquake in their area. Typically, the moratorium will range from 30 to 60 days. The agent should clearly communicate to clients that no earthquake coverage can be bound until the moratorium has elapsed. If the agent has an answering machine, it is always advisable to leave a message emphasizing that coverage cannot be bound or altered.

Conclusion:

Despite recent quakes and an increasing awareness of the devastation that earthquakes can cause, few consumers are choosing to purchase insurance protection against this inevitable event. A lack of insurance and a poor understanding of the coverage options available will increase the potential for errors and omissions claims to be brought against insurance agents. Understanding your duty to advise your clients, documenting your files and carefully educating your customers about the terms of earthquake coverage will keep you on steady ground even when the earth quivers.

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[i] "100% Chance of an Earthquake." *100% Chance of an Earthquake*. Web. 17 June 2012. http://earthquake.usgs.gov/learn/topics/100_chance.php.

[ii] "FAQs - Probabilities, Seismic Hazard & Earthquake Engineering." *FAQs - Probabilities, Seismic Hazard & Earthquake Engineering*. Web. 15 June 2012. <http://earthquake.usgs.gov/learn/faq/?categoryID=9.

[iii] "Historic Earthquakes." *Historic Earthquakes*. Web. 15 June 2012. http://earthquake.usgs.gov/earthquakes/states/events/1811-1812.php.

[iv] Memphis Earthquake Hazard Mapping Project." *Memphis Earthquake Hazard Mapping Project*. Web. 17 June 2012. http://earthquake.usgs.gov/regional/ceus/urban_map/memphis/.

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[vi] Kovacs, Paul. *Reducing the Risk of Earthquake Damage in Canada: Lessons from Haiti and Chile*. Publication. Institute for Catastrophic Loss Reduction. Print. Nov. 2010.

[vii] "Few Oregonians Have Earthquake Insurance." - *Portland Business Journal*. 18 Jan. 2010. Web. 15 June 2012. http://www.bizjournals.com/portland/stories/2010/01/18/daily8.html.

[viii] "Missouri Department of Insurance." *News*. Web. 17 June 2012. http://insurance.mo.gov/news/2011/Department_of_Insurance_Missouri_consumers_not_being_protected_with_earthquake_insurance.

[ix] "Earthquake Insurance." *Earthquake Insurance*. Web. 17 June 2012. http://www.insurance.ca.gov/0100-consumers/0060-information-guides/0040-residential/earthquake-insurance.cfm.