

**FINAL DRAFT**

**Do Not Use Until DFS Approves Course**



**NATIONAL ASSOCIATION OF INSURANCE AND FINANCIAL ADVISORS – FLORIDA**

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This self-study course is approved by the Florida Department of Financial Services for continuing education credit. Provider is the National Association of Insurance and Financial Advisors – Florida (#654). Course is [redacted] for one (1) hour of credit, intermediate level, for course authority 2-20. Course ID # is [redacted].

**HERE'S HOW IT WORKS:** Read the following article and when you're ready to take the exam, simply contact Paul S. Brawner at [brawner@faifa.org](mailto:brawner@faifa.org) and request the exam. You'll receive the exam and an affidavit attesting you did not receive help on the exam. Return the exam and signed affidavit via fax, e-mail or regular mail (see contact information at top of page). Upon successful completion of the exam (70% or higher), NAIFA–FL will send you a Certificate of Completion within 20 business days.

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## **ORDINANCE AND LAW COVERAGE ISSUES:**

### **IMPACT ON THE INSURED**

#### **1 Hour of Self-Study CE**

#### **Course Reading Assignment**

#### **I. INTRODUCTION**

The goal of this course is to help insurance agents understand the many issues and concerns related to Law and Ordinance coverages, so that they can then properly advise and assist their

clients in obtaining and maintaining the best possible coverage conditions for their property and business exposures. This course will explain the issues, risks, and procedures surrounding law and ordinance coverage, review the actions taken by the Florida Legislature to make this coverage available to residential property policyholders, and describe the insurance policy forms and rating factors relating to law and ordinance coverage used in Florida.

## II. HISTORY

Do you know what coverage is in your property insurance policy (contract)? Do you know what the “conditions” are? Have you stopped to consider the impact of the many perils, such as fire, hurricanes, falling objects, etc. on peoples’ lives and properties? What are their expectations of their insurance coverage? With this back drop we will explore an area of insurance coverage that is often unknown or misunderstood.

Catastrophic losses by their very term and description are very destructive and often occur within wide geographical areas. Given this level of destruction, communities take a long time to recover and rebuild. One needs only to recall the recent 24-hour news coverage of the two year anniversary of Hurricane Katrina, which demonstrated the difficulty that the Gulf Coast communities, which were affected, have encountered in their recovery rebuilding efforts. Certainly this extensive loss and delay in restoration is not limited to Katrina. There is significant evidence of this problem looking back only as far as 1992 with Hurricane Andrew. The likelihood of large CAT events occurring in the future is as certain as the expected clamor following future disasters from officials, in both the public and private sector, berating the lack of strict and up-to-date building codes and espousing the need for reconstruction to be completed in a manner that is meant to prevent or mitigate future CAT events.

Building codes became widespread in the United States during the last century. Although the earliest known building regulation appeared in the Code of Hammurabi over 4000 years ago. That early code stated, if an architect built a house negligently or improperly, and the house fell down and killed the owner’s son, then the architect’s son was to be put to death.

The first statewide building code legislation was mandated by the Florida Legislature in the early 1970s. It required all cities and counties to adopt and enforce one of the four State recognized “model codes”. In the late 1990s, the Florida Building Commission was created. It developed a single, statewide building code. One reason for the development of the new Florida Building Code was to strengthen and make more uniform building code requirements for windstorm-related exposures. In general, the new building code has stronger windstorm-related requirements for buildings closer to the coast.

Building codes typically set forth minimum requirements for the quality and durability of building construction materials and construction techniques to be adequate for protecting life, safety, and welfare of the public. The codes cover most aspects of building construction. Most are developed to define fire and structural safety and electrical, plumbing and mechanical systems. Because building codes change from time to time and tend to reflect higher standards and improved technology, an important feature of building codes is that they apply only to new construction and are not applied retroactively to existing buildings. That is until the older building incurs a loss that requires reconstruction, at which time the current construction code is used. Prior to Hurricane Andrew in 1992, most homeowner's insurance policyholders were unaware of law and ordinance coverage. Those familiar with this coverage knew their homeowner's insurance policy contained an exclusion for expenses associated with compliance upgrades due to a change in local building code laws and ordinances, in the event of damage to their residence. That changed when large numbers of older and not-so-old homes were severely damaged or destroyed by Hurricane Andrew. Many policyholders found out that the cost of reconstructing their homes exceeded the coverage limits in their homeowner's policies because they had to repair and rebuild their homes to comply with the current building code rather than the building code that was in effect when their homes were originally built.

In 1993, the Florida legislature created the Study Commission on Property Insurance and Reinsurance to consider a number of important property insurance issues. The Study Commission made a number of recommendations, including the following:

‘Law and Ordinance Coverage—There should be a mandatory offer of law and ordinance coverage by insurers, with limits of 25 percent of the dwelling limits. This offer should be required to be made upon issuance of the policy and first renewal, and once every 3 years thereafter. A declination of such offer by a policyholder should be obtained in writing. ‘

The initial legislation required that insurance carriers offer an additional amount of Coverage A equal to 25% of the insured dwelling value to apply to the increased cost of more stringent building codes. Subsequent CAT events in our state caused the legislature to revisit this and now for the homeowners' lines you can purchase up to 50% of Coverage A for law and ordinance coverage.

Additionally, Reinsurance companies have taken a new underwriting perspective to potential losses incurred due to ordinance and law changes in the building codes. The indirect loss perils were often contemplated, and could be included in their premium rating. But they did not contemplate the expenses related to demolition of undamaged property and debris removal that caused so much additional claims expense in recent years.

### REVIEW EXERCISE 1

Building codes became widespread in the United States during what timeframe?

(Ref: Section I, Pg 2)

- a. In the early 1990's
- b. Over 4000 years ago
- c. **Within the last century**
- d. Following the 1993 legislation session

### REVIEW EXERCISE 2

Ordinance and Law Coverage requires a mandatory offer of coverage by insurers, with limits of what amount of the dwelling?

(Ref: Section I, Pg 3)

- a. **25%**
- b. 35%
- c. 50%
- d. 100%

## III. COMPONENTS AND EFFECTS OF ORDINANCE AND LAW COVERAGE

A building, regardless of its age, can be affected by changes in the building ordinance or laws in effect in a given community. This is without regard to the year of original construction or the renovations. As an example, the date that a building permit is issued is often time the same date of building code to which the construction must comply. Even upon completion some time later, a newer building code may have become law. The subsequent new codes can have a dramatic impact on the reconstruction process. Some key issues to consider that affect the loss would be the anticipated re-construction costs, time element needed to re-build to the current building code, demolition of both damaged and undamaged property and debris removal.

It is not the responsibility of the insurance agent to know all of the Ordinances and Laws, or their changes that can impact an insured property. This begs the question, "how many building owners know the Ordinances and Laws that affect their building and how they will be impacted at the time

of a loss”? Historically, uniform building codes are adopted and later amended to reflect the needs of the community. Further, state building codes may regulate specific industries. In this regard an agent may want to think of gas stations or their former locations, or other industries that may cause newly noted environmental concerns. Or consider the necessary expansion of public facilities such as hospitals, schools or public buildings. Federal building codes are imposed on federally sponsored housing and governmental buildings. “Eminent domain” may cause other changes to the location altogether, such as significant expansion of a roadway and its drainage.

Older construction is often “grandfathered” for a period of time, or until a property loss requires a step-up to the current building code with the resulting reconstruction following the loss. Also, a lawsuit brought against the building owner may cause immediate changes to internal portions of a building. Agents should keep in mind the “Americans with Disabilities Act” as a major factor in many reconstruction changes. This law has been in force since July 26, 1992. This is not an Ordinance and Law exposure by policy definition, **until** a direct loss peril causes a claim. Just because the building is not compliant, will not be a reason for an “insured claim”. Remember the “direct” or “indirect” loss cause needed to create a claim situation.

Some types of building ordinances that will affect a claim settlement are noted below. Note that in each area there may be multiple situations that cause mandated changes.

- Roofing at the structure may involve the specific physical materials to be installed; the application process of installation; or construction rules.
- Changes in roof “geometry” or elevation issues, to part of a building, may cause a total “face-lift” for the entire structure.
- There may be additional layers of construction materials now mandated by the current code for safety and stability of the building, even to undamaged parts of the roof.
- Electrical code changes requiring updated materials, or specifically excluded materials to be replaced (aluminum wiring, fuses systems or specific brands of breaker boxes). The process of routing the electrical wiring within the building may change.
- Plumbing purposes also change with sewage or septic tanks vs. potable water lines. The removal of piping materials no longer deemed to be stable in preventing leaks. Updates required to the routing of water lines. Underground exposure changes for pipe lines, septic tanks and the necessary digging or back-filling requirements. There may also be a need to move the “principal connection to the water main. Note that all of these changes may not fall under the perils insured within an unscheduled policy.
- Set back requirements may change with any planned road expansion, new side walk installation or reconstruction of corners with handicap access.

- Parking allocation may have been updated based on tenant-occupied space, as the space count may have been increased based on occupied space. New changes to parking spaces for handicap accessibility will require more space and different markings. Exit or entry driveway requirements may have been modified, as sightlines are no longer deemed to be safe in multiple lane traffic flow. The height of curbing or parking bumpers may have changed.
- Signage rules often change relating to the location or positioning of the sign as it relates to the overall property or entry or exit areas. The artistic shape or design, lighting options, attachment rules may necessitate a new sign altogether.

These are only some of the areas that might be affected. Additional other exterior considerations might include: grading of the area; sloping for drainage and landscaping. Internally the flooring, insulation, structural supports and safety signage will need to be brought up to current code.

### REVIEW EXERCISE 3

Americans with Disabilities Act law is not an Ordinance and Law exposure by policy definition, until what action occurs?

(Ref: Section III, Pg 4)

- a. A lawsuit is filed
- b. State rule is put into effect
- c. A direct loss peril causes a claim**
- d. An indirect loss causes a claim

### REVIEW EXERCISE 4

All of the following are examples of ordinances that will affect a claim settlement **EXCEPT**:

(Ref: Section III, Pg 4-5)

- a. Roofing at the structure involving the specific physical materials to be installed
- b. Property boundary changes as a result of new surveys requested by the homeowner**
- c. Set back requirements may change with any planned road expansion, new side walk installation or reconstruction of corners with handicap access
- d. Changes in roof “geometry” or elevation issues, to part of a building

## IV. WHO NEEDS ORDINANCE and LAW COVERAGE?

Obviously a building owner, who must bring his structure up to current code following a direct loss has a very real need. Standard perils of coverage do not offer extra money to pay the expense of re-building costs in excess of the policy limits even for the specific perils insured against.

Additionally, will the loss of rents coverage within the policy extend to time lost or rents lost if tenants are unable to operate in the building due to a loss that closes off access to part or all of the occupied building? Is there a “dominant property” or “dependent property” that might incur a loss even though it is unaffected by the direct loss? There are other coverage questions to be considered by the building owner. Is there an elevator that is non-compliant with code? This could be a factor in closing the entire building even without direct loss to other floors or areas of the building. Will the “debris removal” coverage be adequate for the entire loss and additional expenses to comply with Ordinance and Law changes?

Often the building owner can ask the carrier about the option of providing coverage for the loss of rental income or extra debris removal expense that would result from a directive of “Ordinance or Law”. Even if the coverage is provided for a “direct loss”, it may not extend to the delay in time to repair or reopen the building exclusively because the repairs extend beyond the perils covered within the standard policy language. Often the larger the risk the more options that are open to “Ordinance and Law” coverage.

Tenants, who have paid for build out of improvements or betterments in their leased space, may have the coverage for direct loss perils, but not for the expenses related to “Ordinance and Law” changes mandated. The tenant is often contractually, by lease, responsible to replace and upgrade tenant improvements or betterments. Is there a tenant, who does not incur a direct loss, who incurs an extended loss of business income, due to the building owner being required to bring the building up to current code? Is there a dominant tenant who incurred a loss that results in the other areas of the building being inaccessible?

#### **REVIEW EXERCISE 5**

Which of the following parties has coverage for expenses related to any mandated “Ordinance and Law” changes?

(Ref: Section IV, Pg 6)

- a. **A building owner**
- b. A tenant
- c. A mortgagor of the property
- d. A property management company

#### **V. Ordinance and Law Policy Form Information**

## **CAUSES OF LOSS – SPECIAL FORM CP 10 30 06 95**

A specific “Exclusion” is listed as item “B” in an ISO business policy. The insurer will not pay for loss or damage caused directly or indirectly by any of the following. Such loss or damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss.

- a. ORDINANCE or LAW. The enforcement of any ordinance or law.
  - (1) Regulating the construction, use or repair of any property: or
  - (2) Requiring the tearing down of any property, including the cost of removing its debris.

This exclusion, Ordinance or Law, applies whether the loss results from:

- (1) an ordinance or law that is enforced even if the property has not been damaged; or
- (2) the increased costs incurred to comply with an ordinance or law in the course of construction, repair, renovation, remodeling or demolition of property, or removal of its debris, following a physical loss to that property.

This exclusion applies to any property, not just “Building”.

### **“Ordinance and Law” coverage CP 04 05**

Coverage A- is coverage for loss to the undamaged portion of the building.

Coverage B- is the demolition cost coverage. If the covered cost of loss occurs to covered building property and demolition cost limit of insurance is shown, the policy will pay up to the illustrated limit.

Coverage C- is the increased cost of construction coverage. If a covered cause of loss occurs to the covered building property and an increased cost of construction limit of insurance is shown in the schedule above we will pay for the increased cost to repair, rebuild or construct caused by enforcement of buildings, zoning or land use “Ordinance or Law, if the property is repaired or rebuilt. It must be rebuilt with intended use for similar occupancy as the current property, unless otherwise required by zoning or land use “Ordinance or Law”.

However, we will not pay for the increased cost of construction if the building is not repaired or replaced.

Nor, will the endorsement pay for the costs associated with the enforcement of any “Ordinance or Law” which requires any insured or others to test for, monitor, clean up, remove, contain,

treat, detoxify or neutralize, or in any way respond to , or assess the effect of “pollutants”.

### **BUILDING ORDINANCE and LAW COVERAGE OPTIONS**

The standard “Ordinance and Law” endorsement provides direct physical loss coverage for “Building only”. There is no coverage applicable for increased “Ordinance and Law” requirements for machinery or equipment. The building owner needs to ask the carrier for coverage for the mechanical equipment that may need to be replaced due a required update to “Ordinance and Law”. Just because the equipment is attached to the building, does not mean it is considered “building” coverage.

### **RATE MODIFICATION for BUILDING ORDINANCE or LAW COVERAGE**

Coverage A- rate modification for causes other than earthquake or flood for the undamaged portion of the building, are usually developed by multiplying the 80% coinsurance Building rates by 1.15.

Coverage B- demolition cost coverage will use the standard 80% co-insurance building rate without any further modification.

Coverage C- increase cost of construction coverage will also use the standard 80% co-insurance building rate without further modification.

For the building owner who wants coverage for mechanical equipment, it is preferred to have the rate developed using the “building rate” rather than a “business personal property rate”. Again using any of the coverage listed above for a cause of loss that could generate additional expenses to comply with “Ordinance and Law” requirements.

### **BUILDING ORDINANCE and LAW EXCLUSION and BUSINESS INCOME**

Remember that these are two different endorsements that should be applied to the coverages (A/B/C) that are exposure areas on the policy.

The cause of loss form is attached to the Business Income Coverage Form. Accordingly the exclusion for “Ordinance and Law” applies to the Business Income coverage form that applied to the Building and Business Personal Property Coverage Form. A loss incurred on the Business Income is due to the potential additional “time” it might take to bring a building up to current code. Additional time lost equals additional income lost. This situation applies more often in a partial loss than a total loss.

**ORDINANCE and LAW – INCREASE PERIOD OF RESTORATION CP 15 31**

- A. If a covered cause of loss occurs to property at the premises described in the Declarations page, coverage is extended to include the amount of actual and necessary loss you sustain during the increased period of suspension of “operations” caused by or resulting from the enforcement of any Ordinance or Law that:
1. Regulates the construction or repair of any property;
  2. Requires the tearing down of parts of the property not damaged by the covered cause of loss; and
  3. Is in force at the time of the loss.
  4. However, coverage is not extended under this endorsement to include loss caused by or resulting from the enforcement of any Ordinance or Law which requires any insured or others to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of “pollutants”.
- B. The “period of restoration” definition is replaced by the following:
1. Ends on the earlier of: the date when the property at the described premises should be repaired, rebuilt or replaced with reasonable speed and similar quality; or the date when business is resumed at the new permanent location.
  2. Immediately after the time of direct physical loss or damage for “extra expense” coverage; caused by or resulting from any covered cause of loss at the describe premises; and
  3. Period of restoration” means the period of time that begins: 72 hours after the time of direct physical loss or damage, for business income coverage.
  4. “Period or restoration” includes any increased period required to repair or reconstruct the property to comply with the minimum standards of any Ordinance or Law, in force at the time of the loss. This regulates the construction or repair, or requires the tearing down of any property. The expiration of the policy will not cut short the period of “restoration”.
- C. Ordinance and Law – description of coverage for “business income” coverage form may be extended to cover additional loss of time necessary to replace or repair the damage building to conform with the current building Ordinance or Law.
- D. Rate Modification: causes of loss other than earthquake, would multiply the “time element rate” by 1.2. For earthquake the multiplier is 2.0.

## REVIEW EXERCISE 6

Which of the following policy coverage sections applies to the demolition cost?

(Ref: Section V, Pg 8)

- a. Coverage A
- b. Coverage B**
- c. Coverage C
- d. Demolition cost is not a covered expense

## VI. ADDITIONAL MISUNDERSTOOD ISSUES REGARDING PROPERTY ISSUES and ORDINANCE and LAW

“Zoning Laws” are often misinterpreted as an Ordinance that must be considered in compliance and part of the coverage endorsement. “Zoning Laws” regulate everything about the “what” is built, where. So the specific considerations might be building height, parking allowances, occupancy prior to and after a loss, environmental impact studies or building dimensions versus land size.

“Manuscript ACV Cap Language” will impact any building(s) or structure(s) affected by “Zoning laws”, so that the building’s usage, size (height or total square footage, dimensions) are limited by law. The policy will provide for “replacement cost” for that portion of the building the insured can, by law, replace, and then pay actual cash value (ACV) for the differential in value that the insured cannot pay.

Although for the most part this article was written regarding the commercial property coverage, in its general context the coverage areas are very similar to those within the homeowner policy. When the insured has an option to select or reject this valuable coverage, Ordinance and Law, it is important that the agent clearly explains the exposures that are created by any choice to reject or minimize this coverage. As many Floridians have seen following severe weather experiences, or even personal home losses, there are areas that could be called into question in the adjustment of their claim. Even the best effort to make sure the building coverage limits are adequate to replace the structure, at the time of catastrophic losses, the best estimates may not be adequate. The issue of predator repair contractors, price-gouging and uncompleted repair work often create a problem in claims settlement.

## REVIEW EXERCISE 7

Zoning Laws regulate everything about what is built and where. All of the following factors apply to zoning laws **EXCEPT**:

(Ref: Section VI, Pg 11)

- a. building height
- b. parking allowances
- c. interior furniture placements**
- d. environmental impact studies

## **VII. Unauthorized Entities**

Unauthorized entities engaging in insurance are a serious and growing problem in Florida for consumers and agents. Consumers are substantially harmed with these entities failing to pay claims and defrauding through deception. Agents are unwittingly (sometimes knowingly) representing these entities and placing clients and themselves at risk. Florida law is violated under the guise of these unauthorized entities claiming to be ERISA exempt or some type of association plan that claims to not be insurance or to be exempt from Florida regulation. All of this is simply not true! This is a problem in the state of Florida and other states.

The problem of unauthorized entities selling unauthorized products originated in the health insurance arena, although the problem now seems to be spreading into property-casualty arena as well. These unauthorized entities promised low health insurance premiums, a promise fueled by skyrocketing health insurance premiums with legitimate health insurance carriers. In the current market, low health insurance rates just do not exist. The public and certain agents, apparently, were ripe for the picking by these scam artists. Remember, these are scams and the intent is to collect as much premium as possible without having to pay claims, or very few claims.

Unsuspecting licensed insurance agents are also vulnerable to this type of scam because representatives of the unauthorized entity will contact the licensed agents and send them (or give them in person) printed marketing materials touting the unauthorized entity and their bogus products which, again, gives the impression of legitimacy and credibility.

Maybe the agent is asking too many questions of the representative – is just a little too inquisitive – about who they are, where they're located, how long they've been in business, etc. The agent may even question the legitimacy of the product. Some scam artists tell agents their products do not have to be authorized by the Department because it is an ERISA plan, or that the plan is part of a MEWA (multiple employer welfare arrangement) or it's to be sold to labor unions – all the while stating that under any of these previously-mention circumstances, the products do not have to be approved or authorized by the Department.

The representative of the unauthorized entity might say, “It doesn’t require approval, because this is an ERISA plan.” Or, “It doesn’t require approval because this is plan is part of a MEWA plan.” Or “This plan doesn’t require approval because it’s for labor unions.” None of this is correct! Any product which contains an insurance component is required, by law, to receive authorization of that component by the Department before it can be sold in Florida. Any legitimate company representative who approaches you about selling and representing their products should not mind the scrutiny you put them under by verifying their status with the Department.

### **626.902 Penalty for representing unauthorized insurer**

(1) In addition to any other penalties provided in the insurance code:

(a) Any agent licensed in this state who in this state represents or aids an unauthorized insurer in violation of s. 626.901 commits a felony of the third degree, punishable as provided in s. 775.082 or s. 775.083.

(b) Any person other than an insurance agent licensed in this state who in this state represents or aids an unauthorized insurer in violation of s. 626.901 commits a felony of the third degree, punishable as provided in s. 775.082, s. 775.083, or s. 775.084.(2) In addition to the penalties provided for in subsection (1), such violator shall be liable, personally, jointly and severally with any other person or persons liable therefore, for payment of taxes payable on account of such insurance under s. 626.938.

Agents or any other persons are prohibited from representing or aiding an unauthorized insurer. If an agent or any other person represents an unauthorized insurer, they are subject to severe penalties, including possible civil and criminal action. Agents are subject to suspension or revocation of their licenses and/or monetary penalties for violation of the unauthorized insurer law. Agents can be held liable for claims and losses not paid by unauthorized insurers. Agents who represent or aid an unauthorized insurer commit a felony of the third degree.

Don’t be fooled by phony products that sound too good to be true! Investigate before you sell or buy these plans. Check to see if an entity or plan is an authorized insurer by calling the Department of Financial Services at 877-693-5236 or 850-413-3089.

### **Review Exercise 8**

Any agent licensed in this state who in this state represents or aids an unauthorized insurer in violation of s. 626.901 commits what level of violation?

(Ref: Section VI, Pg 11)

- a. **Felony of the 3<sup>rd</sup> degree**
- b. Felony of the 1<sup>st</sup> degree
- c. Misdemeanor of the 2<sup>nd</sup> degree
- d. Misdemeanor of the 3<sup>rd</sup> degree

**Review Exercise Answer Key**

- 1. C
- 2. A
- 3. C
- 4. B
- 5. A
- 6. B
- 7. C
- 8. A