

Replacement Cost of a Home

Homeowners' Insurance Task Force

2026 CAS Spring Meeting

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Presenters

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Consumer Misunderstanding

Market Value vs Replacement Cost

Homeowners often confuse market value with replacement cost, causing underinsurance and claim issues.

Misconceptions on Risk Coverage

Many consumers wrongly believe flood and earthquake risks are covered by standard insurance policies.

Impact on Consumer Behavior

Misunderstandings influence consumer choices and reduce uptake of necessary insurance coverage.

Role of Education

Educating consumers and incorporating behavioral factors helps improve insurance ratios and risk models.



Insurance-to-Value & Ratemaking

Importance of Accurate Replacement Costs

Accurate replacement cost estimates ensure fair premiums and prevent financial shortfalls in homeowners' insurance.

Risks of Underinsurance

Underinsured homes can result in premiums insufficient to cover claims, causing financial strain on insurers.

Actuarial Model Integrity

Reliable data on replacement costs prevents distortion of actuarial models and supports accurate pricing strategies.

Ensuring Financial Sustainability

Up-to-date replacement cost data supports sustainable and fair insurance products for policyholders.



Insurance-To-Value & Ratemaking Example

Risks of Underinsurance to Insurers

Underinsured homes can result in premiums insufficient to cover claims, causing financial strain on insurers.

Risks of Underinsurance to Consumers

Consumers may not be made whole for a large loss, when they are most vulnerable and may be unable to afford costs associated with rebuilding or repairing.

Assumptions in Ratemaking Example

- Losses are uniformly distributed
- Frequency is 1%
- The true replacement cost of the insured home is \$250,000
- The "underinsured" example insures the home for \$200,000
- Expenses are not considered in the simplified example

Size of Loss (000s)	Assumed Loss Distribution	Fully Insured Average Payment (000s)	Underinsured Average Payment (000s)
0 <X≤ 25	10%	12.5	12.5
25 <X≤ 50	10%	37.5	37.5
50 <X≤ 75	10%	62.5	62.5
75 <X≤ 100	10%	87.5	87.5
100 <X≤ 125	10%	112.5	112.5
125 <X≤ 150	10%	137.5	137.5
150 <X≤ 175	10%	162.5	162.5
175 <X≤ 200	10%	187.5	187.5
200 <X≤ 225	10%	212.5	200.0
225 <X≤ 250	10%	237.5	200.0
		125	120

Assumed Frequency	1%	1%
Pure Premium	1.25	1.20
Amount of Insurance (000s)	250	200
Rate Per \$1,000	5.00	6.00





Valuation Tools & Underestimation

Systematic Underestimation Risk

Valuation software may underestimate replacement costs, creating challenges for accurate insurance pricing.

Causes of Inaccuracy

Outdated data, consumer misreporting, and lack of independent validation can contribute to possible valuation errors.

Impact on Insurance

Underestimation results in underinsurance, affecting insurer liability and actuarial pricing models.

Actuarial Evaluation

Critically assessing valuation tools helps identify errors and ensures greater accuracy in premium setting.

Coverage Types & Implications

Replacement Cost Coverage

Replacement Cost pays to rebuild a home with similar materials, covering the basic rebuilding expenses.

Extended Replacement Cost

Extended Replacement Cost provides 125%-200% of replacement cost buffers against sudden cost increases during rebuilding.

Guaranteed Replacement Cost

Guaranteed Replacement Cost covers full rebuild expenses regardless of policy limits, increasing insurer risk exposure.

Actuarial Impact and Pricing

Actuaries typically factor coverage variations into risk models and premium pricing, especially for catastrophic risk areas.



Coverage Types & Implications— ASOP No. 23



Data Selection: The Actuary's Role

Determining the appropriate data is crucial for accurate analysis. Actuaries should take into account the scope and intended use of the analysis.

Key Considerations for Data Selection

- Desired Data Elements/Alternative Data
- Data Appropriateness
- Data Reasonableness (internal and external)
- Data Sufficiency
- Limitations of the Data
- Sampling Methods



Post-Catastrophe Cost Surge

Demand Surge Impact

Catastrophic events cause labor and material demand surges, driving rebuilding costs beyond normal limits.

Coverage Limitations

Standard replacement cost coverage often fails to cover increased costs, creating gaps for homeowners.

Mitigation Strategies

Extended and Guaranteed Replacement Cost coverages help reduce risk but rely on accurate property valuation.

Actuarial Modeling

Actuaries include cost surge risks in models to ensure premiums reflect true risk and insurer solvency.



Roof Coverage & Matching Laws

Limited Roof Coverage

Roof coverage is often limited to actual cash value or defined payment schedules, especially for older roofs.

Variation in Matching Laws

Matching laws differ by state, with some mandating material matching and others relying on case law or policy language.

Actuarial Impact

Legal and coverage variations are factored into actuarial models to maintain the accuracy of ratemaking and pricing integrity



Special Hazards

Special Hazards Are Not Covered by Default

Deductibles for these policies can be high, and represent an additional financial burden on insureds both through policy costs and through potentially high deductibles in the event of a loss

Flood

Most people (51%) believe they are covered under a standard Homeowners insurance policy

Earthquake

California has 90% of earthquakes, but other areas like the New Madrid Seismic Zone are also affected

Agent, Insurer & Consumer Roles

Agents Provide Consumer Education

Agents can inform and assist consumers by providing education through the quote or renewal process

Insurers Improve Valuation Accuracy

Insurers can leverage aerial imagery and alternative data to improve replacement cost estimates and policy coverage.

Consumers Research Their Risk

Consumers should use publicly available sources and their own understanding of risks to their property to research, understand, and select coverage limits and options.



Q&A

- Emma Casehart—Vice Chairperson of Homeowners' Insurance Task Force
- David Reyes—Member of Homeowners' Insurance Task Force

Thank You

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