COMMERCIAL PROPERTY INSURANCE: Overview (557-1)

EO 1. **RISK MANAGEMENT** is the process of identifying, analyzing, and treating loss exposures. **Insurance** lets an entity transfer the financial consequences of loss to an insurer in exchange for payment of a premium.
Commercial insurance covers the loss exposures of for-profit businesses and of nonprofit organizations.
*[**Personal insurance** covers the nonbusiness loss exposures of individuals and families.]*

A loss exposure is a condition or situation that presents a chance or possibility of loss.
Commercial insurance responds to three types of loss exposures:

1. **A property loss exposure** is a chance an entity will suffer a financial loss due to damage, destruction, taking, or loss of use of property in which it has a financial interest.
   ***Example*:** The chance of earthquake damage to a building in California.
2. **A liability loss exposure** is a chance an entity will suffer a financial loss due to a claim seeking monetary damages or other legal remedy.
   ***Example*:** The chance a store will be sued by a customer who slipped and fell due to a spill on its floor.
3. **A personal loss exposure** is a chance a person will suffer a financial loss due to injury, illness, or death.
   Example: The chance a person will be injured in a car accident.

[The three elements of a loss exposure:

1. ***The item subject to loss**--what can be lost.*
2. ***The peril or cause of loss**--how the subject can be lost.*
3. ***The financial impact of loss**--how much value can be lost.]*

THE SIX-STEP RISK MANAGEMENT PROCESS:

1. Identify loss exposures.
2. Analyze loss exposures.
3. Evaluate risk treatment options.
4. Select the best risk treatment technique(s).
5. Implement the chosen technique(s).
6. Monitor the results to be sure goals are achieved and updated to changing circumstances.

FIVE RISK MANAGEMENT TREATMENT TECHNIQUES:

1. **Avoidance**--totally avoids or eliminates a loss exposure by foregoing the activities that create the loss exposure.
   ***Example*:** Refraining from manufacturing a do-it-yourself brain transplant kit avoids the potential liability for injuries it might cause by its unforeseen improper use.
2. **Loss control--reduces loss frequency and/or loss severity, ie, takes steps to**
   a. prevent losses from occurring (storing hazardous materials in appropriate containers) and/or
   b. reduce the size of those losses that do occur (installing sprinklers).
3. **Retention**--requires an entity to pay all or part of its losses through self-insurance or large *[or small]* deductibles.
4. **Insurance**--is a contract under which the insurer pays for specified losses in exchange for premium payments from the insured.
5. **Noninsurance transfer**--occurs when one entity (such as a building owner) receives a promise from a second entity (such as a contractor) to pay for specified losses for which the first entity is liable arising out of the second entity's actions.
   Noninsurance transfers are often included in leases, construction contracts, and purchase agreements.

EO 2. **<u>FIVE FORMS OF BUSINESS OWNERSHIP</u>:**

1. **<u>Corporation</u>**--is a ***separate*** legal entity owned by stockholders who bear ***no*** personal liability for corporate acts beyond the potential loss of their investments.
   A corporation can be either for-profit or not-for-profit.
2. **<u>Partnership</u>--**is a for-profit business entity jointly owned by two or more persons who share ownership, profits, ***and*** losses.
   Each partner bears ***unlimited*** personal liability for partnership obligations.
   Partnerships avoid the double taxation of corporations because business income 'passes-through' to individual members to be taxed at their individual tax rates.
3. **<u>Joint venture</u>--**is a temporary business association of two or more entities formed to carry out a particular business operation or project.
   Joint ventures are easy to form and are dissolved once the project is completed.
   Participants form joint ventures to pool their resources and to share the risks of a new project.
4. **<u>Limited liability company (LLC)</u>--**offers its owners (aka members) the limited liability of a corporation and the 'pass-through' tax advantages of a partnership.
5. **<u>Unincorporated association</u>**--is a voluntary association of individuals acting under a common name for a lawful purpose. It can be either for-profit or not-for-profit.
   Associations are easy to form and its members avoid corporate taxation, ***but*** it is not a legal entity ***and*** its members can be held ***individually*** liable for association obligations.

<u>The form of ownership</u> affects the insurability of a business ***and*** determines ***both*** who has legal responsibility for business decisions ***and*** how the named insured is identified in the policy.

EO 3. **A <u>LINE OF BUSINESS</u> is a specific type of insurance.**

1. **<u>Commercial property insurance</u>--**covers commercial buildings and their contents against direct loss. *[Assignments 2 + 3]* ***[Note:*** *In a very broad sense, commercial property insurance can refer to any type of commercial insurance that covers property loss exposures.]*
2. **<u>Business income insurance</u>**--covers businesses against **<u>indirect loss</u>** (decreased revenues and/or increased expenses) following direct damage to property. *[Assignment 4]*
3. **<u>Crime insurance</u>--**covers money and securities against a variety of natural and human perils and other property against human perils. *[Assignment 5]*
4. **<u>Boiler and machinery insurance</u>--aka <u>equipment breakdown insurance</u>**--covers physical damage and business income resulting from breakdown or tearing asunder of a covered boiler or other machinery. *[Assignment 5]*
5. **<u>Inland marine and ocean marine insurance</u>**--covers vessels and their cargoes **(<u>ocean marine</u>)** ***or*** goods in transit, bailees' customers' goods, moveable equipment, unusual property, property of certain dealers, and instrumentalities of transportation and communication **(<u>inland marine</u>).** *[Assignment 6]*
6. **<u>Commercial general liability insurance</u>**--covers the nonprofessional, nonauto liability loss exposures of businesses to nonemployees. *[Assignments 7 + 8]*
7. **<u>Commercial auto insurance</u>--**covers physical damage to automobiles and liability arising from their use. *[Assignment 9]*
8. **<u>Businessowners insurance</u>--**covers property and liability (but ***not*** auto or workers' compensation) loss exposures of small and medium-sized businesses. *[Assignment 10]*
9. **<u>Farm insurance</u>**--covers the farmer's home, household property, property used in farming operations, farm structures, ***and*** liability arising from personal and farming activities. *[Assignment 10]*
10. **<u>Workers' compensation and employer's liability insurance</u>--**covers employers' statutory liability exposures arising from coverage required under workers' compensation laws and employee claims not covered by workers' compensation laws. *[Assignment 11]*

11. **Excess and umbrella liability insurance--provides**
    a. higher limits over primary policies **(excess coverage)** ***and***
    b. higher limits plus primary coverage for some claims ***not*** covered by primary policies **(umbrella coverage).** *[Assignment 12]*
12. **Professional liability insurance**--covers doctors, lawyers, engineers, and other professionals against liability associated with the rendering of their professional services.
    Professional liability also includes
    a. directors' and officers' liability insurance,
    b. fiduciary liability insurance, ***and***
    c. employment practices liability insurance.
    [Assignment 12]
13. **Management liability insurance**--covers directors' and officers' liability, employment practices liability, ***and*** fiduciary liability. *[Assignment 12]*
14. **Aircraft insurance--**covers liability, physical damage, and other aircraft loss exposures. *[Assignment 12]*
15. **Environmental insurance**--covers injury, damage, and cleanup costs caused by the release of pollutants.
16. **Surety bond**--is an agreement by one person **(the surety)** to guarantee the performance of another person **(the principal)** to a third person **(the obligee).** *[Assignment 12]*
    Example: A contract surety bond guarantees that a contractor will complete a building project on time, pay his bills for materials and labor, ***and*** deliver the work free from defects.

EO 4. **A PACKAGE POLICY** insures at least two coverage parts (property and general liability). **A monoline policy** insures only one type of coverage or one coverage part (property, inland marine, crime, boiler, general liability, auto, farm, workers' compensation, umbrella, or surety).

THE INSURANCE SERVICES OFFICE (ISO) COMMERCIAL PACKAGE POLICY (CPP) *MUST* BE STRUCTURED TO INCLUDE a common declarations page, common policy conditions, and two or more coverage parts before it qualifies for a package discount.
Coverage parts that may be used in an ISO CPP include commercial property, commercial crime, equipment breakdown, commercial inland marine, commercial general liability, ***and*** commercial auto.

INFORMATION SHOWN IN THE COMMON POLICY DECLARATIONS: policy number; names of the insurer, producer, and named insureds; first named insured's address and business description; policy effective and expiration dates; the premium for each coverage part; the total premium; and **the 'in consideration' clause** (the insurer agrees to provide the described coverage in return for the premium).

SIX PROVISIONS OF THE COMMON POLICY CONDITIONS:
1. **The cancellation clause** lets the insured cancel at ***any*** time and lets the insurer cancel for nonpayment with 10 days' notice or for any other legal reason with 30 days' notice.
2. **The changes condition** states that the written policy is the ***entire*** contract and may ***only*** be changed by written endorsement. Only the first named insured may request policy changes.
3. **The examination of books and records condition** allows the insurer to check the insured's books as they relate to the policy for up to three years after expiration, so the insurer may accurately determine premium when a variable premium base, such as payroll or sales, is used.
4. **The premiums clause** states that the first named insured must pay the premium and will receive any premium refund.
5. **The transfer of rights and duties under the policy clause** prohibits the insured from assigning its future policy rights without the insurer's permission ***but*** it automatically transfers those rights to his legal representatives ***if*** he dies.

6. **<u>The inspections and surveys condition</u>** allows, but does ***not*** require, the insurer to inspect the insured's premises and operations (to determine insurability and proper rating).
The insurer ***may*** tell the insured the survey results, but is ***not*** obligated to make safety inspections.
A disclaimer clause states that the insurer does *not* claim to make safety inspections, guarantee conditions are safe, ***or*** guarantee the insured is complying with legal regulations.
The disclaimer protects the insurer against lawsuits by people who were allegedly injured by the insurer's failure to identify a hazardous condition ***and*** claims by the insured that the insurer failed to detect legal violations, with resulting fines.

A <u>COVERAGE PART</u> consists of

1. declarations specific to that part;
2. one or more coverage forms, containing insuring agreements, exclusions, and policy provisions;
3. any applicable endorsements; ***and***
4. a conditions form that applies to the coverage part.

EO 5. **<u>COMMERCIAL INSURANCE PREMIUMS</u>** are calculated by applying a **<u>rate</u>** (price per exposure unit for insurance coverage) to a particular **<u>exposure basis</u>** (measure of susceptibility to loss).
In simple form, the **<u>premium</u> equals** the amount of insurance times the rate divided by the unit amount.
Example: If the rate is $0.60 per $100 of insurance (the unit amount) and the amount of insurance is $1,000,000, then the premium equals $0.60 X $1,000,000 / $100 = $6,000.
In reality, premium calculation is more complicated because it often includes additional computations to reflect territorial differences and adjustments for deductible changes and coverage options.
<u>The Commercial Lines Manual (CLM)</u> contains the rating procedures and the **<u>loss costs</u>** (the portion of the rate that covers projected loss payments and loss adjustment expenses) for rating ISO coverages.
To convert CLM loss costs to complete rates, an insurer calculates a loss cost multiplier that covers other expenses (such as underwriting, marketing, and taxes).
The insurer might also add an adjustment for possible errors and an allowance for profit.

<u>PACKAGE MODIFICATION FACTORS</u> are credits that apply to regular policy premiums when the commercial package policy includes ***both*** property ***and*** liability coverages.
The insured receives a package discount that is determined by applying the appropriate package modification factors to the premiums for the eligible coverage parts.
Example: A package modification factor of 0.85 means that the premium for that coverage will be 85% of the premium that would have applied if the coverage part were issued as a monoline policy.
Package modification factors reflect the type of risk, the coverage part, ***and*** underwriting acceptability.

[Bonus information *from a previously deleted reading:* ***<u>Advantages of package policies for the</u>***

1. *<u>insurer</u>--*
   a. ***reduced administrative expenses--****inspection, underwriting, policy issuance;*
   b. ***increased premium volume; and***
   c. ***lowered adverse selection--****more diverse exposures, hence lower loss dispersion.*
2. *<u>insured</u>--*
   a. ***reduced administrative expenses--****fewer policies to buy and maintain;*
   b. ***reduced chance of delay in loss settlement--****due to disputes among insurers about which policy covers the loss;* ***and***
   c. ***lower premiums--****as reduced insurer expenses are passed along.*
3. *<u>producer</u>--*
   a. ***increased account selling--****resulting in fewer errors and omissions claims, less shopping by insureds, and lower client turnover* ***and, sometimes,***
   b. ***easier rating and more coverages sold****.]*