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1 Basics of Property & Casualty Insurance

1.1 Purpose of Insurance

The purpose of insurance is to spread risk amongst others and is intended to provide a practical solution to economic uncertainties and unexpected losses.

1.2 Types of Risks (uncertainty of loss)

1. Speculative Risk: This risk implies that an individual could not only have the potential of improving his/her financial position but also has the potential to being placed in a worse financial position by losing something. The best example for speculative risk is **GAMBLING**. Therefore, insurance policies will **NOT** protect speculative risks.

2. Pure Risk: On the other hand, this risk is what insurance is all about. It covers losses only and does not imply that the insured can "make money" after a covered loss. The goal of insurance is to place the insured back to his/her financial position just prior to the loss. Obviously, life insurance can't replace the deceased, but instead, will help provide financial stability to the family or loved ones of the deceased.

1.3 What Produces Risks?

1. Hazards: These are things that might cause a peril, which creates the risk, which leads to a loss. As an example, an individual has heart disease (hazard) which causes a heart attack and the person dies.

2. Perils: A peril is the immediate, specific cause of a loss. Using the above example, the hazard (heart disease) gave rise to the potential cause of death, which is the heart attack, (known as a peril) that eventually causes the actual loss (death), and therefore creates a claim on the life insurance policy.

- **Policy Perils**
    - ♦ Property and casualty insurance policies are written in one of two ways concerning the perils covered. The first are ***named perils*** and the second type known as ***all risk or open perils***.

◊ Named perils lists the specific perils that it will cover. Obviously, in order for the insured to collect, the specific loss must be covered or the insured will not recover.

◊ On the other hand, an all risk or open perils policy covers all risk of loss or all perils except those that are specifically excluded.

1.4 Loss

Loss is an unintended or unforeseen reduction or destruction of financial or economic value. If an insured's building burned to the ground, this event would be considered a total loss because the value of the ashes would be drastically different than the value of the home before the loss.

- **Direct Loss** is a loss, which occurs directly through an "unbroken chain of events" as a result of an insured peril. This is done without any intervening cause.

- **Indirect or consequential loss** is a loss or damage, which results from a hazard or peril, but the loss was not actually caused by that hazard or peril. These are losses, which result from the actual physical loss itself.

  - ♦ Example: a fire burns a clothing store to the ground. The direct loss from the fire peril would be the total destruction to the building and its contents. The indirect loss from the fire peril would be the inability of the clothing storeowner to conduct business following the fire loss.

1.5 Examples of Hazards

- Employee hates his employer and "wants to get him." **(Morale Hazard) This is an attitude problem!**

- An individual decides to burn down someone's home. **(Moral Hazard)**

- **Physical Hazard -** These are physical, tangible items that can create a peril. Examples can include piles of oily rags, bad brakes, no brakes, slippery falls due to wax, skate board on the stairs etc.

1.6 Accident vs. Occurrence

Property and casualty contracts are usually written in two ways:

1. Accident-basis

An accident is a sudden unexpected, unforeseen event resulting in financial loss.

Example: Man falls on a cracked sidewalk. A truck hits a car. Lightening strikes a house causing a fire.

2. An Occurrence

An occurrence is a sudden, unexpected unforeseen event resulting in financial loss including repeated and continuous exposure to conditions.

Example: Industrial waste ***gradually*** pollutes a river. An insured worker ***gradually*** becomes ill due to repeatedly handling asbestos on the job.

1.7 Deductibles

In order to avoid minor claims, companies usually write deductibles into their property contracts. This means that the insured must pay some portion of the loss. Just like in health insurance, the insured will pay the deductible first and then the insurance company will pay the remainder of the claim within covered limitations.

1.8 Managing Risks

The following are ways that risks can be "managed".

1. Avoidance: If you avoid doing something, like not driving an automobile, you will avoid the possibility of a loss involving an automobile.

2. Assumption: Instead of purchasing insurance you decide to assume the risk by self-insuring. An example of this would be declining fire insurance for your home. If the house burns down, you will not be reimbursed for the loss as you assumed it.

3. Transfer: This choice is what insurance is all about and is the most common way to manage risks. Transfer the risk to the insurance company and have the insurance company pay for any losses.
4. Sharing: While you transfer most of the risk to an insurance company you may have to share part of the losses. Examples of this would exist in health, auto and casualty insurance through the use of deductibles and co-insurance requirements.

5. Reduction: Examples of risk reduction is the installation of smoke detectors, sprinkler systems, burglar and fire alarm systems and the use of air bags in autos. Some insurance companies offer special rate reductions when you have some of these.

1.9 Rules:

1. Law of Large Numbers: Actuaries look at similar type losses using large numbers of incidents. The word **Homogeneous** defines this process. With a large enough pool of risks, an insurer can predict with reasonable accuracy the number of claims it will have during any given time.

2. The loss must be accidental in nature and not done with the intent of creating a situation just to “collect the insurance proceeds”.

3. The loss must be significant when compared to the initial cost of the policy. As an example: Your death benefit is $1,000,000 and the annual premium cost is $1,000. The loss, represented as the death benefit, is significant when compared to the cost ($1,000 a year). This is also known as an **aleatory contract.** Another way to say this is, the premium is less than the company agrees to pay in the event of a loss.

4. The loss must be measurable and due to chance, outside the control of the insured.

5. The loss must be caused by a non-catastrophic cause, which means the following situations would usually be eliminated from policy coverage; Insured persons in the National Guard while in a “War Zone or in a Foreign Country Police Action”.

1.10 Insurable Interest

In order for the insurance company to pay a claim the insured will have to establish that an insurable interest existed between the insured and the subject of the insurance. As an example, if the insured had placed a claim for the loss of a stolen vehicle, the insured will have to establish that he/she owned or leased the vehicle, prior to the insurance company paying on the claim. The following represents the rules surrounding an insurable interest with property and casualty insurance.

1. An insurable interest must exist at the time of loss.

2. An insurable interest will exist if a loss of property will result in a financial loss to that individual.

3. Examples of someone having an insurable interest is;

    - person owning property
    - person having a lien on the property
    - person living on the property
    - person owed money by the owner
    - banker (mortgage holder)
    - family

1.11 Indemnity Insurance Contracts

All property and casualty insurance contracts are contracts of indemnity and their purpose is to make the insured “whole again” or pay he/her back. The purpose is to put the insured back in the same financial positions as he/she was prior to the insured loss.

1.12 Types of Insurers

Stock Company Insurers: Owned by shareholders just like shareholders of AT & T and General Electric. Shareholders share the profits of the company when and if a dividend is declared. This type of dividend represents profits, not a return of invested capital.

Mutual Company Insurers: The owners of this company are the policy owners, not shareholders. Policy owners may receive dividends, but unlike a stock company dividend, the dividends represent a return of premium, which is based on factors, which will be discussed later.

Non-Profit Service Organizations: Examples include Fraternal Organizations such as the "Royal Elk of Palatine", HMOs, PPOs and Blue Cross and Blue Shield.

Reinsurers: These companies insure insurers by accepting the transfer of a portion of or all of the risks, which the original company has insured.

1.13 Legal Parts of a Contract

1. The Offer: The insurance company, through its agents, will attempt to solicit invitations for offers (THEY DO NOT MAKE THE OFFER) through advertisements, telephone calls and conversations. **The prospect makes the offer by filling out the application and submitting it to the insurance company.**

2. Acceptance: After the insured submits the application and the initial premium is paid, it is up to the insurance company to accept the offer by issuing the policy.

3. Consideration: All parties in all contracts must provide some form of consideration (something of value) to make the contract valid. The insured pays the premium while the insurance company makes a promise to pay a covered claim in the future. A contract in which one party, the insured pays something, and the other party, the insurance company, promises to do something in the future, is known as a **Unilateral Contract**.

4. Contract must be for a legal purpose. As an example, you can't buy a policy with the intent to kill the insured to collect the proceeds.

5. Parties must be competent and understand all the terms: If your prospect only understands a foreign language, you must provide a means to interpret the terms of the contract or there won't be a valid contract.

1.14 Parts of The Insurance Contract (D - I - C - E)

Part I - Declarations

- Name and address of insured/owner
- Subject of insurance (i.e. Individual life insurance)
- Policy period dates
- Premiums and rates
- List of coverage

Part II - Insuring Clause

- Describes the obligations of the insurance company.
- Package policies provide individual insuring agreements for each covered form
- Described are the perils covered and risks assumed

Part III - Conditions

- Describes what both the insured and insurer must do in regard to their rights and duties.

Part IV - Exclusions

- If the insurance company is going to exclude any type of coverage it must be **specifically** listed in the exclusion part of the insurance policy contract or it cannot be excluded.

1.15 Legal Terms & Definitions

1. **Warranty:** Provision in the insurance policy that pledges that a certain condition does or does not exist. (i.e. "No heart disease problem")

2. **Concealment:** Failure to disclose a **MATERIAL FACT** that the underwriter, if had known, would not have issued the policy.

3. **Binder:** A temporary contract of insurance, oral or written, offered by an insurer pending issuance of the policy. It is usually written for a period of 30 or 60 days and remains in force for that period unless canceled or a permanent policy is issued or refused by the insurer.

   Example: You purchase a new car, call your insurance agent and the agent tells you that your are covered. This is an example of a binder.

4. **Misrepresentation**: A false statement made by the insured such as indicating that he/she doesn't smoke when in fact the prospect smokes three packs a day. Remember, all answers to all questions asked on the insurance application are considered representations. If an answer is not true it would be a misrepresentation.

5. **Policy Riders**: Riders can only be added to an existing policy and they modify coverage by adding to, or taking away policy coverage.

6. **Aleatory Contract**: A contract in which values are exchanged for unequal values.

7. **Unilateral Contract**: All insurance contracts are unilateral as one party, the insured, pays the premium and the other party, the insurance company, makes a promise to pay in the future if the insured/owner submits a valid claim or wants to surrender the policy. (Act for a promise)

8. **Adhesion Contract**: All insurance contracts are contracts of adhesion because they are written and printed by the insurance company and the courts, if an ambiguity exits, will decide in favor of the insured if any changes to the policy were handwritten or typewritten. These will prevail over the original printed terms. If asked, handwritten changes will prevail over typewritten changes.

9. **Executory.** One of the parties to the contract has duties, which are unfulfilled but still needs to be done.

10. **Waiver:** Giving up of a known right.

11. **Estoppel**: The legal term used when an insurance company is denied it's right to challenge in court a claim because, by its actions waived a previous rule.

12. **Errors & Omission Insurance**: Professional liability insurance in which the insurer will defend lawsuits covered by the policy for insurance producers.

13. **Certificate of Insurance**: This is a document that evidences the existence of insurance coverage.

    - In **property insurance** a certificate of insurance may be used to demonstrate the existence of a master policy which provides protection for more than one person.

      Example: A condominium association may have a master property insurance policy insuring the buildings in a condominium complex. Certificates may be issued to each member as proof of their insurable interest.

    - In **casualty insurance** a certificate of insurance is generally issued to demonstrate proof of liability coverage for a specific location or project.

      Example: A contractor may be required by the property owner to provide proof of general liability insurance for his/her work.

14. **Proximate Cause**: An act through an unbroken series of events that can be determined to be the immediate or actual cause of the loss.

    Example: Everyone eating catfish in a restaurant gets ill. Even though these patrons did something else after leaving the restaurant, the fact is that they were served food, which was the proximate cause of the injury (sickness).

15. **Endorsement:** A form added to an insurance contract, which modifies the underlying coverage.

1.16 Agency Law

Licensed insurance producers will be representing an insurance company and as such are mandated to follow certain rules of agency law. These rules are as follows;

1. **Express Authority**: The agent is told exactly what to do. An example of this is giving the agent specific authority to collect premiums from the insured.

2. **Implied Authority**: While the agent isn't told specifically what to do it would be okay if the actions of the agent would

be acceptable as a reasonable business practice. A good example of this is when the insurance company supplies a receipt book for the agent but doesn't specifically tell the agent he/she has authority to collect premiums. It would be obvious to a reasonable person that the insurance agent had the authority to collect the premium.

3. **Apparent Authority**: This is the toughest to identify. It may appear that the agent has authority because of certain actions by the agent, and then an innocent third party relies on these actions.

   i.e. After an insurance producer is terminated by an insurance company for lack of production, the agent continues to sell policies. By the way, the insurance company failed to collect any of the forms, business cards and applications, which the agent had. The agent collects a premium and properly follows the conditional receipt rules (to be discussed later) and the proposed insured dies. Will the company have to pay the claim after normal underwriting? Maybe! We'll leave this up to the courts but this is a good example of the use of Apparent Authority because the proposed insured had no idea that the agent was terminated because the agent had all the "right" materials.

1.17 Insurance Company Functional Departments

- **Sales:** Markets insurance products
- **Actuarial**: Responsible for keeping the company financially sound by scientifically arriving at death benefit tables, payout options etc.
- **Underwriting**: Responsible for appropriate risk selections, reviewing all applications, sending for needed additional information such as property inspections etc.
- **Claims**: Collects and pays claims
- **Administrative**: Issues policies, billing, policy changes, reinstatement of policies etc.
- **Others**: Legal, advertising, data processing, public relations etc.

1.18 Types of Agents

Agents always act in a **Fiduciary Capacity**, which means they must always use utmost care in handling clients and client transactions.

- **Independent Agents**: Contracts with several insurance companies.
- **Captive Agents**: Can only represent one company (i.e. Allstate)
- **General Agent (GA):** Gets a geographical area and receives overrides for agents writing a particular insurance company policy in that area.
- **Direct Writing Companies**: Insurance company owns the business and have their own employees contact customers directly.

1.19 Tort Law - The Law of Legal Wrongs

1. Intentional Act: Insurance company will not cover this type of claim. An example may be when a beneficiary intentionally murders the insured.

2. Negligence: Failure to do what a reasonable person would do under similar circumstances. Was there a legal duty to act or not to act? Was there a breach of that duty? Was there injury or damage to another person? Was the act the proximate cause of the damages? If all the questions can be answered with a yes then a case for negligence can be made and typically insurance will pay for the covered losses.

- **Strict or Absolute Liability**: It doesn't matter what or who caused the wrong. The party doing the act is strictly responsible for the results. (i.e. contractors who dynamite buildings - people who have tigers as pets and the tigers attack curious children)

- **No-Fault Insurance**: This is a modification of no-fault insurance as it exists in some states such as New York. It preserves the right to sue another party under certain circumstances unlike true no-fault insurance, which doesn't allow any lawsuits.

1.20 Insured

The insured is defined in every property and casualty policy. A party not specifically named as an insured has no legal right to recover directly under a policy even if that party has an insurable interest in the insured property at the time of loss. Keep in mind, however, that it is possible for a person not specifically named in the contract to still have recovery rights in the event of loss such as a guest staying at your house. This guest is covered for specific types of loss under dwelling and homeowners forms.

Duties of the insured

- give notice of claim immediately (written or by telephone)
- prevent further loss as reasonably possible
- separate damaged from undamaged property to determine loss
- inventory the loss
- prepare a proof of loss which is required by the insurer within a reasonable time period, usually 60 days
- make all books and records pertaining to the loss available to the insurer

Duties of the insurer

- respond to the insured's claim in a timely fashion
- evaluate the claim
- treat the insured fairly
- provide repair or replacement cost

1.21 Mortgage Rights

The mortgagee (bank/lender) has an insurable interest in mortgaged property. The mortgagee must be given an opportunity to file a proof of loss etc. under the policy if the insured fails to do so.

Additionally, the mortgagee is given 10 days written notice of cancellation or nonrenewable if the insurer decides to cancel or not renew the policy.

If the insured fails to provide proof of loss, a mortgagee has 60 days from receiving notice of the failure to file such a proof of loss to file the loss themselves.

1.22 Underwriting

Underwriting is the process by which prospective insureds are reviewed or examined for their acceptance or rejection. The purpose of underwriting is to pool similar pure risks, not dissimilar ones so that losses can be predicted with a degree of accuracy***. (Avoid adverse selection)*** Premiums can be determined accordingly.

1.23 Loss Ratios

A loss ratio is the numerical description of the relationship of:

1. ***An incurred loss*** is a loss which has occurred during a specific period of time such as a calendar year; and

2. ***Earned premium*** is premium which has been allocated to an insurer's loss experience, general expense and profit.

The loss ratio formula can be written as follows:

$$\textbf{Loss Ratio} = \frac{\textbf{incurred losses}}{\textbf{earned premiums}}$$

If an insurer's incurred losses are greater than the amount of earned premium, the insurer is losing money. In short, loss ratios are numerical indicators of the quality of an insurer's underwriting.

1.24 Field Underwriting

Insurance producers have the initial responsibility for evaluating or field underwriting specific business. Insurance producers are the first representatives of an insurer to come in contact with a prospective insured. If a producer feels that a prospect does not fit within an insurance company's underwriting guidelines he/she must inform the company of same and detail the reasons and possible solutions.

1.25 Corporate Underwriting

The proposed insured's application will be reviewed by the insurance company underwriters to determine whether there is an insurable risk, whether there is an insurable interest and whether the property is insurable.

Factors looked at by underwriters

- inspection reports
- motor vehicle reports
- credit reports

1.26 Fair Credit Reporting Act

This federal act helps insure that applicants for insurance are treated in a fair, accurate and confidential manner. It is the producer's responsibility to explain the terms of this Act. The signed forms will give the underwriters authority to investigate the proposed insured further if they deem it necessary.

The Act also provides consumers with an opportunity to find out information that an investigative agency has used about them and to whom such reports have been made.

1.27 Deposit Premium/Audit

A ***deposit premium (initial premium)*** is a tentative charge made at the beginning of certain policies and reinsurance agreements, to be adjusted when the actual earned charge has been later determined.
An ***audit*** is the verification of books or accounts to determine their accuracy.
A premium computation method of deposit premium and audit is used in a variety of commercial property and liability contracts.

Audit premiums are due and payable on notice. If the sum of the advance and audit premiums paid for the policy term is greater than the earned premium, the insurer will return the excess to the first named insured.

The important concept to remember is that a ***deposit premium*** is required for many commercial insureds which is based on an estimate of their risk exposure (payroll or receipts). Thereafter, the insurer will compute the earned or final premium for the audit period in question.

1.28 Policy Delivery and Service

Delivering the policy not only means that the policy is physically delivered to policy but that the issued policy is the same as the one that was applied for. It is always best, just like in life and health insurance, to personally deliver the policy. Personal delivery allows you to review the policy terms with the insured to avoid any misunderstandings and confusion. It can also allow you to ask for referrals.

Service of the policy for you client should include the following;

- Maintaining of accurate records
- Advising your clients of anything that should mandate the updating of their policies
- Help clients file claims
- Review existing coverages

2. Business Risks and Insurance

2.1 Background Issues

Dating back hundreds of years, basic risks such as fire, burglary, robbery and more have continued and business owners need a way to transfer risks from them to an insurance company. While names have changed, the results have not.

However, in todays world and while going into the 21st. century, business owners need to be even more cognizant of different types of potential risks. Some additional concerns should include the following;

- Sexual harassment
- Computer theft
- Product liability
- Carpal tunnel syndrome due to increased use of computer terminals
- Employee law suits
- Etc

Part of risk management is the recognition of these and other types of risk as well as their impact upon the business owners business. Many businesses have hired risk management personnel to start asking “what if” questions and the probable solutions. Part of risk management is the identification of exposures to financial loss and selection of methods to manage those exposures.

Consider all of these situations and the potential negative results from ignoring them.

2.2 Working With Risk Management

Using Your Financial Statement

Taking a look at a business financial statement one will find a balance sheet which represents a snapshot in time of everything a business owns and it’s liabilities of what it owes.

One of the major items found on a balance sheet is the inventory on hand as well as acquired property. The assets of most importance will be;

- Buildings
- Equipment
- Plant
- Notes Receivable
- Accounts Receivable

The liabilities of major interest will be;

- Short term debt
- Accounts Payable
- Leases
- Long term debt

I must point out at this point that one must use caution when using a balance sheet as this record is not updated on a daily basis. Also, inventories, receivables and Payables may fluctuate on a seasonal basis so accurate record keeping is a must.

The other type of important financial report is the income statement, also known as a profit and loss statement. This report tracks the flow of income and payments in and out of the business. This type of report is even more important when the business has experienced any type of business interruption problems.

As with other types of potential insured losses, the losses must be fully documented so accurate financial records are imperative. Without good documentation the insurance company may not pay the entire claim.

Inspections

Seeing the exposures for yourself will have more impact then looking at a pile of reports. On-site inspections will certainly provide any current potential exposures and will help in the risk management evaluation.

Many insurance companies will actually provide on-site inspections with recommendations for risk improvement at no additional cost to the business owners. This service is often provided as a “no cost” service when purchasing an insurance policy. When purchasing Boiler and Machinery coverage insurance companies evaluate and inspect the equipment prior to writing the policy.

These inspections actually benefit both the insured and the insurer for all the reasons stated above.

Risk Retention

Risk retention by the business owner is important when dealing with small dollars and low risk issues. In order for an insurance company to insure a risk there must be an opportunity for the insurance company to make a profit. Therefore, small and or predictable losses do not warrant insurance coverage. Businesses should retain small losses and predictable losses and instead include them as a cost of doing business.

Managing Risks

As pointed out and discussed in Chapter One, Section 1.8, the following are ways that risks can be managed;

1. Avoidance
2. Assumption
3. Transfer/Insurance
4. Sharing
5. Reduction

Very often these methods are either ignored or not thought of by business owners. These methods can end up as an economical way to manage the cost of risk.

Starting a Risk Management Program

Once sources of potential losses have been identified and the business owner has decided that action is necessary a program needs to be implemented. Any one or a combination of the above ways to manage risks should be chosen.

In addition, the frequency and severity of the risks identified must be tracked and understood. Types of risks are related to certain types of businesses. A risk identified in one industry may not be a problem in a business participating in a different industry.

High Tech Risk Areas

As I alluded to before, it is important for todays business owner to understand and grasp some of todays high-risk computer areas. Some of these high-risk areas include, but are not limited to, loss of computer data, theft of computer data, software bugs, software viruses and more.

In this modern age, insurers can actually provide insurance coverage, which will reimburse the business owner for expenses, associated with recreating lost data files if the loss was caused by a covered event.

Concerns With Risk Management

A business owner must fully evaluate the benefits and costs of any risk management decision. The successful risk management program is one that balances the need for expensive loss control equipment and insurance coverage with the limited resources available for risk management activities.

2.3 The Application Process

Once the business owner concludes that insurance needs to be purchased in order to transfer some of the identified risks he/she must fill out an insurance application.

I know you remember our conversation in Chapter One about who makes the offer to purchase insurance. That’s correct, the applicant is the one who makes the offer to the insurance company. Logically, the insurance company is under no obligation to accept the offer from the applicant, but if they do then they accept by issuing the policy.

As all insurance contracts are aleatory in nature, parties will be exchanging unequal values. The applicant pays a premium to the insurance company while the insurance company will promise to pay for any covered claims. Of course, there may be a chance that the insurance company will never have to pay any claims but the insured will still have to pay the premium.

Once the insurance company receives the application it will be forwarded to their underwriting department to determine if there is an insurable risk and acceptable exposure. Guidelines differ from company to company. Keep in mind that the underwriting process is the last defense against insuring unreasonably high-risk applicants.

The underwriters will apply the law of large numbers under which the insurer knows from experience approximately how many policies will suffer a loss and how severe the losses will be.

One way to accept some risk and to transfer risk to other insurance carriers is by reinsurance. This practice is generally not made known to the insured as its up to the policy insurer to pay any claims and to recover amounts that are due the primary carrier. The practice of using reinsurers is quite common when involved with higher risk and or higher requested benefits by the applicant.

2.4 Insurance Policy Issues

As discussed in Chapter One, an insurance policy is a contract between the owner of the policy and the insurance company. With business insurance it is typical to use ISO Forms. ISO (Insurance Services Office) is an industry organization that evaluates the needs of most policyholders and drafts policy forms to accommodate their needs.

As insurance was never intended to wish away all risks, but rather a means for businesses and individuals to transfer away the uncertainty of events such as fire. Insurers now offer coverage for nearly any random event either through common policies such as Commercial General Property and Commercial General Liability policies or through additional coverages called endorsements that can be added to standard policies.

In the next chapter we will take a look at some definitions and terms used in property insurance so as to be able to understand the specific insurance coverage, rules and applications available for the business owner.

3. Property Insurance Definitions & Terms

3.1 Introduction To Property Insurance

Property insurance is purchased to cover real property (land) and or personal property (property other than land) against loss or damage from covered perils.

This first section will help introduce you to terms and definitions dealing with property insurance. Some of these terms were already reviewed in chapter one, but, as they are important we will review them again.

3.2 Indemnity

All property and casualty insurance contracts are contracts of indemnity and their purpose is to make the insured "whole again", not to profit. The purpose is to put the insured back in the same financial positions as he/she was prior to the insured loss.

3.3 Replacement and Actual Costs

Replacement Cost (RC)

This is the exact amount of money needed to replace damaged or destroyed property at the point the loss occurred with one of like kind and quality. As depreciation is not a factor, this represents a departure from indemnity rules.

Actual Cost Value (ACV)

Actual cost represents replacement cost less depreciation.

> ***Example:*** If a chair were destroyed in a covered loss and settlement were to be made on an ACV basis, the cost of the chair in today's market place would have to be determined first and then a deduction would be made that represents depreciation.
>
> However, if the same chair were destroyed and the policy provided for RC then no deduction would be made for deprecation.

Reality provides us with the fact that buildings insured under property contracts usually are insured on a replacement cost basis as they usually increase in value over time while contents of the building are usually covered under a ACV basis because of depreciation.

3.4 Limit of Liability

This is the maximum amount the insurance company is obligated to pay for any loss as specified in the insurance contract. This limit will govern settlement decisions. In most cases, the insurance company will never pay more than the face amount of the contract, which is the coverage as listed in the declarations part of the insurance contract.

Types of limits

1. **Split limits:** This provision provides separate payments for losses sustained from limits for bodily injury, property damage and per individual while offering a greater payment for “all individuals’ in an occurrence.

2. **Aggregate limits:** Maximum overall limit for the entire policy period.

3. **Combined single limit:** Offers maximum coverage and is less restrictive to an individual loss then split limits. This will apply on a per occurrence basis.

3.5 Coinsurance

Coinsurance is found in many property policies in order to require policyholders to carry adequate insurance on their property. A coinsurance clause is an agreement between the insurer and insured in which;

- the insurer agrees to provide a reduced premium rate for coverage;

- the insured agrees to carry a specified percentage of the replacement cost of the building

A typical coinsurance clause of a property policy will state that an insured has to satisfy an 80% level. This means that the insured must carry insurance equal to at least 80% of the value of the insured property.

If the coinsurance clause is satisfied, partial losses will be paid in full. If the coinsurance clause is not satisfied, partial losses will be subject to a penalty payment.

3.6 Settlement Formula

Formula:

$$\frac{\textbf{Amount of Insurance Carried (I)}}{\textbf{Amount of Insurance Required (R)}} \times \textbf{Loss (L)} = \textbf{Settlement (S)}$$

Example #1:

Market value of an insured building is $200,000
Coinsurance % = 80%
Loss = $40,000
Amount of Insurance = $ 160,000

Let's work out the numbers!

$$\frac{\$160{,}000}{\$160{,}000} \times \$40{,}000 = \text{Settlement } (\$40{,}000)$$

As the amount of insurance carried is the same as the amount required, the $40,000 loss will be paid in full.

Example #2:

Same facts as in example #1 except the amount of insurance carried is $120,000 instead of $160,000.

$$\frac{\$120{,}000}{\$160{,}000} \times \$40{,}000 = \text{Settlement } (\$30{,}000)$$

Example #3:

Same facts as in example #1 except the building burns down and is totally destroyed. Would the insured receive the full value of the building of $200,000?

Of course not! The insured will never receive more than the applicable limit of liability, in this example $160,000.

Settlement Rules

- The amount paid cannot exceed the limits of the insurance policy
- The amount paid cannot exceed the actual amount of the loss
- The amount paid cannot exceed the dollar amount determined by the coinsurance formula

3.7 Extensions of Coverage

If an insured satisfies the coinsurance clause he/she may elect to provide a certain amount of his/her coverage to property not normally covered by the policy as ***extensions of coverage***.

Examples:

- Personal property of others
- Outdoor property
- Newly acquired property
- Constructed property
- Papers and records
- Off premises property

3.8 Additional Coverages

Additional coverages provided under a property policy that are in addition to the main coverages. Some examples of additional coverages include the following;

- Reasonable repairs
- Removed property
- Removal of debris
- Loss by forgery
- Trees shrubs and plants

3.9 Pair and Set Clause

This clause in a policy will explain how a claim should be handled when one item of a pair or set is damaged. Loss to one item of a pair or set does not constitute loss to the entire pair or set.

The following options may be used;

1. Pay the difference between the actual cash value of the property before and after the loss or;

2. Repair or replace any part to restore the pair or set to its value before the loss

3.10 Cancellation

Either the insured or insurer may cancel provided coverage. Each property and casualty policy details the reasons for which the insurer can cancel the policy. Of course these reasons must be in compliance with individual state laws.
While the insurance company must give some specified written notice required by the state, the insured, on the other hand, can request immediate cancellation, without any notice.

If the ***insurance company cancels the policy*** any unearned premium will be returned on a pro rata basis. There is no allowance for deductions such as service fees. This allows the insured to get back all of the money which has not been used or applied to premium cost.

If the ***insured cancels the policy*** any unearned premium will be returned on a short rate basis (with deductions made for servicing the policy, etc.) With the short rate basis the insurance company can recoup some of the costs of underwriting and policy processing.

3.11 Appraisal

When and if both the insured and the insurer cannot agree on a settlement amount each is required to obtain an independent appraisal and share in the cost of an umpire to settle the dispute. The decision of the umpire is final and binding. The issue here is the amount of settlement not whether coverage exists or not.

3.12 Assignment

This is the transferring of some or all of the rights from one party to another. Assignment of rights and coverages is not permissible under property contracts without the written consent of the insurance company. As an example, owners of a home cannot transfer his/her homeowner's insurance policy when selling the home.

3.13 Subrogation

This is the process which allows the insurance company, after paying its insured for a loss, to step into the shoes of the insured as stipulated in the insurance contract in order to recover from third parties any recoverable loss which was reimbursed by the insurance company to the insured.

Subrogation reminds us that the idea of collecting twice for the same loss is not allowed under the doctrine of indemnity.

> ***Example:*** An insured sustained $2,000 property damage to her auto as a result of a rear end hit. The insured could decide to collect for this damage under her collision coverage and collect the amount of the loss less any deductible. Then the insurer assumes the insured's right of recovery against the responsible third party for the full $2,000. If the insurance company was not allowed to go against the third party then the insured would collect an additional $2,000 amounting to making a profit on the incident.

3.14 Pro Rata Liability (Other Insurance)

When more than one insurance company is used to insure a piece of property, pro rata liability rules will apply. This is done in keeping with the doctrine of indemnity. The formula to establish settlement contributions is as follows;

$$\frac{\textbf{Company Coverage Amount}}{\textbf{Total Amount of Insurance}} \times \textbf{Loss} = \textbf{Amount Company Will Pay}$$

> ***Example:*** Paco, a hard working author, purchases a retreat home in upstate Wisconsin. As a writer, Paco needed plenty of seclusion. Unfortunately, with seclusion comes a number of problems such as a lack of fire hydrants on every corner. Paco attempted to purchase a full coverage insurance policy for his $300,000 home from Lake in the Hills Insurance Company. Unfortunately, the Lake in the Hills insurance company would only provide insurance for $150,000 (Policy A). Paco then went to the Elgin Insurance Company and picked up a policy (Policy B) for the remaining $150,000.
>
> What would happen if there is a $50,000 loss? Will both companies pay the $50,000? Well, we know for sure that both companies won't pay the $50,000 because of the doctrine of indemnity. Let's take a look at what the companies will pay under pro rata liability;

$$\textbf{Policy A} = \frac{\$150{,}000}{\$300{,}000} \times \$50{,}000 = \$25{,}000$$

$$\text{Policy B} = \frac{\$150{,}000}{\$300{,}000} \times \$50{,}000 = \$25{,}000$$

Total Settlement = $50,000

3.15 Arbitration

This is a process in which insurance companies usually settle their differences when one company subrogates against another. During this process all parties agree to be bound.

3.16 Nonrenewal

This is the act of terminating an insurance policy after the specified policy period. Nonrenewal is a notice given by the insurance company to the insured indicating the intention not to renew the policy upon the normal termination date.

3.17 Vacancy/Unoccupancy

Vacancy refers to a building, which is unfurnished, and not being used as a dwelling or for a business.

Unoccupancy refers to a building, which is furnished, but not being used as a dwelling or for business.

Insurance policies treat these differently so make sure you understand the differences and analyze the questions carefully.

3.18 Right of Salvage

When an insurance company settles a claim it owns a right of salvage. The insurance company can reduce its losses in the matter by selling the salvage to a salvage dealer. It may determine whether or not property will be repaired, replaced or cash will be provided. In situations where an insured property is not completely destroyed, the insurance company may take possession of it and receive its salvage value when it has replaced or has made a cash settlement to the insured party.

3.19 Abandonment

An insured cannot be allowed to abandon the insured property and then demand from the insurance company to be paid in full. The insurance company, by contract, has the right to settle the loss by payment or repair or outright replacement of the property involved.

4 Property Insurance - Commercial Lines

4.1 Overview

Commercial lines property forms are designed to address the various property related insurance needs of businesses. In this chapter we will review commercial property coverages with the Commercial Building and Personal form, insurance for businesses through the use of the Causes of Loss forms, Business Income and Extra Expense forms to provide coverage against indirect or consequential business losses, Commercial Package Policy (CPP) permitting commercial insureds to package their own coverages and finally a commercial package designed for small businesses, the Business owners Policy, policy for manufacturing and other commercial risks, the Boiler and Machinery Policy.

4.2 Introduction

Protection extends to businesses that own and occupy their own premises or to businesses that rent or lease space. Businesses who lease tend to make expensive alterations or improvements in order to occupy a premises for a particular purpose. This investment needs to be protected through insurance.

Businesses have an insurable interest in buildings and equipment including fixtures, machinery, furniture and inventory. Important considerations also include consequential or indirect losses due to interrupting a business's ability to earn money because of a direct loss.

4.3 Commercial Property Covered

Building: All buildings, additions and extensions to the buildings as well as permanent fixtures

More than one building or structure may be described in the commercial property declarations. Notice that coverage applies to more than just the building itself-building additions, permanently installed fixtures and equipment, and property used to service the building or premises such as fire extinguishing equipment and ventilating systems are covered as part of building coverage.

Business Personal Property: Personal property of the insured used in business to include the following; (other than real property)

- furniture
- fixtures
- machinery
- equipment
- inventory
- all other property used in the business
- labor, materials or services on personal property of others including property in the insured's care and custody and property located in or on the building described in the declarations ***or within 100 feet of the premises***
- leased personal property may also be covered but only if you have a contractual obligation to insure it and it is not otherwise insured under the coverage for personal property of others.

4.4 Property Not Covered

As the Commercial Building and Personal Property coverage form contains relatively broad definitions of the types of property covered, it is necessary to review what it will not cover:

- valuables
- animals
- automobiles held for sale
- bridges and roadways
- contraband
- cost of excavations and grading
- foundations of buildings
- land
- pilings and docks
- property covered under other coverage
- growing crops
- personal property while airborne or waterborne

4.5 Additional Coverage Form

- debris removal
- expenses as a result of preservation of the property
- fire department service charge ($1,000 maximum)

- pollutant clean up and removal ($10,000 per policy period)

Coverage Extensions

80% coinsurance would apply under which the insured may have the following extensions of coverage;

- ***newly acquired or constructed property***

This property is covered up to ***25% or a maximum of $250,000*** per building. This applies to new buildings being constructed on the insured premises and buildings acquired at a location other than the insured's premises to be used for the same purpose as the insured's building or warehouse.

There is a ***10% or $100,000*** maximum of personal property applied up to 30 days to cover business personal property at a newly acquired location.

- ***Personal Effects***

A maximum of ***$2,500*** will be paid for loss of personal effects of the insured's officers, partners and employees. This coverage applies to all personal property, which could include a calculator, coat, briefcase etc.

- ***Valuable Papers***

Up to $1,000 at each described premises can be applied to the cost of researching, replacing or restoring lost information. This can include the existence of magnetic media.

- ***Property Off-Premises***

Insured property other than stock damaged or destroyed by a covered peril but will not apply to property in a vehicle, in the care or control of the insured's salesperson or at any fair or exhibition. Maximum coverage is $5,000.

- ***Outdoor Property***

A $1,000 maximum can be applied for outdoor property extensions such as outdoor fences, antennas, signs, trees, shrubs and plants destroyed by fire, lightning, explosion, riot or aircraft. There is maximum of $250 per plant or shrub.

4.6 Causes of Loss Forms

Basic Form provides coverage against the following perils;

- fire
- lightning
- extended coverage (EC)
- vandalism and malicious mischief (VMM)
- sprinkler leakage (automatic sprinkler system)
- sinkhole collapse (collapse into underground empty spaces)

Broad Form perils

- the Basic perils above
- breakage of glass
- falling objects
- weight of snow, ice or sleet
- water damage (accidental discharge or leakage from a system or appliance)
- building collapse

Special Form perils

- all risk or open perils except as excluded

Common Exclusions

- ordinance or law
- earth movement
- governmental action
- nuclear hazard
- off-premises services (power failure)
- war
- water (including flood)

Special Form Exclusions

Do not try to memorize the following exclusions. Just try and understand why they are exclusions. Remember, all property will have some wear and tear and as it is foreseeable, it is not insurable.

- artificially generated electric current

- delay or loss of use of market
- smoke or gas from industrial or agricultural smudging
- such cause of loss from;
  - ◊ wear and tear
  - ◊ rust and corrosion
  - ◊ smog
  - ◊ settling, cracking etc.
  - ◊ insects, birds and rodents
  - ◊ mechanical breakdown
- explosion of steam boilers
- continuous leakage of water over 14 days or more
- water leaks from plumbing, heating, air conditioning caused by freezing unless the insured attempted to maintain heat in the building or the insured drains the equipment and shuts off the water supply if the heat is not maintained.
- dishonest or criminal act by the insured, any partners, employees etc.

4.7 Earthquake Form

Coverage

Coverage is provided against earthquake, volcanic eruption and explosion. This coverage includes damage caused by shocks within 168 hours after policy expiration if shocks began during the policy term. Volcanic activity is also covered and will include lava flow, ash and airborne shock waves. Earthquake only coverage is not available

This is a named peril form used to add optional coverage for two additional causes of loss-earthquake and volcanic eruption. Since the scope of the coverage being provided is narrowly defined, this form has fewer exclusions than the other forms.

The earthquake form is divided into four major sections:

A. Covered causes of loss
B. Exclusions
C. Limitations
D. Deductibles

Additional Exclusions

It should be noted that there are two exclusions, which are unique to the earthquake form. Losses due to fire, explosion, tidal wave, flood and other causes will not be covered even if resulting from an earthquake or volcanic eruption.

Deductibles

For all coverage forms except business income and extra expense coverages, the earthquake deductible will be a percentage of the insured property's value. The applicable percentage must be stated in the declarations, and will be applied separately to (1) each building or structure, (2) the contents of each building or structure, and (3) personal property in the open.

4.8 Builders Risk (New Construction)

This policy is written for a period of one year usually on a completed value basis. A condition called "Need for Adequate Insurance" underscores the importance of accurately estimating the final value of the building by placing a virtual 100% co-insurance requirement on the contract. If the actual completion value is higher than the insurance completion amount, then any paid losses are lowered by the resultant difference in value versus actual coverage amount (i.e. the building ends up with a value of $200,000 but was only insured for $100,000. Any loss, which is less than total is paid at only a 50% rate by the insurance company)

Coverage begins when construction starts and it stops;

- when the purchaser accepts the property
- 90 days after construction completion
- upon occupancy or intended use of the building
- when the interest of the insured in the property stops
- if the builder abandons construction with no intention of completion

Coverages include the building being constructed, foundation, fixtures, equipment used to service the building, materials and supplies intended to be placed into the building which are within 100 feet of the premises.

4.9 Indirect Loss Coverages

Because the loss caused by the interruption of business may far surpass the actual physical loss to property, this exposure has been addressed through the development of several consequential or indirect loss coverages.

Business Income Coverage

This is also known as time element coverage, which pays for the loss of income over a period of time which, results from a direct physical loss. The Business Income Coverage Form covers this loss of income due to the interruption of business by an insured peril during the period of restoration.

The loss of income refers to the net income or pretax profit (before income taxes) that a business would have earned plus normal continuing operating expenses, including payroll.

In order for Business Income Coverage to apply, the interruption of business must be caused by direct physical damage to property at the described premises.

The period of restoration begins on the date of the actual physical damage to the insured property and ends on the date when the property should be repaired with reasonable speed and similar quality.

Additional Coverages

Extra Expenses

These expenses are necessary to continue a business in operation. An example can include renting temporary offices to continue the business so as to reduce further losses.

Civil Authority

Under this coverage the policy is extended to cover loss of business income and extra expense for a period up to two weeks caused by a action of civil authority.

Alterations and New Buildings

This coverage provides for the actual loss of business income due to direct physical loss by a covered peril to new buildings, alterations, machinery, equipment, supplies used in construction, alterations or incidental to the occupancy of new buildings.

Extended Business Income

This automatically extends the period of restoration up to another 30 consecutive days to cover additional loss of earnings as long as the insurance policy limits have not been exhausted.

4.10 Commercial Package Policy (CPP)

Policies containing a single coverage part is a monoline policy while a policy containing two or more coverage parts qualifies as a package. The new package approach is intended to simplify and standardize the process of assembling policies.

To qualify as a Commercial Package Policy, a policy must contain the Common Policy Declarations From, the Common Policy Conditions Form and ***two more of the following coverage parts***:

- Boiler and machinery
- Commercial auto
- Commercial property
- Crime
- Farm
- Inland Marine
- Commercial general liability
- Pollutant liability

  The cost of extracting pollutants from land or water is another additional coverage if the discharge, dispersal, seepage, migration or escape of the pollutants is caused by a covered cause of loss.
- Products Liability

Property coverage forms establish the conditions for coverage and describe the types or kinds of property insured. Each coverage form is designed to insure specific types of property or losses. Coverage forms identify the subject of the insurance, describe coverages, additional coverages and optional coverages, and state exclusions and conditions.

4.11 Businessowners Policy (BOP)

This is a policy designed for small and medium sized apartment, office and mercantile risks as an alternative to the Commercial Building and Personal Property Coverage Form. Tenants of offices and stores can insure business personal property. As BOP is a complete package policy by itself, it is not attached to some other coverage or package.

The following processing and service type businesses are also eligible for coverage;

- appliance dealers
- bakeries
- barber shops
- funeral homes
- printers
- photographers

On the other hand the following businesses would ***not*** be eligible;

- service stations
- auto repair centers
- contractors
- bars
- household personal property
- places of amusement
- wholesalers
- banks and other financial institutions

The BOP is a ***multi-peril policy*** including basic property and liability coverages. If needed, there are optional coverages that can be used to custom design a policy for the small business.

Property coverage can be written on either a standard or special form. Most coverages of the two forms are identical except for "covered causes of loss". The standard form is like the basic coverages found in other commercial forms while the special form is all risk coverage. Optional coverage is available to include burglary, robbery, money, securities, outdoor signs, exterior grade floor glass, mechanical breakdown and employee dishonesty.

Eligibility is available for the following risks:

1. **Apartment buildings** to include mercantile, service or processing occupancies not in excess of 15,000 square feet and incidental offices. Residential condominium associations are eligible.

2. **Office Buildings** not higher than 6 stories and limited to 15,000 square feet. Office condominium associations are eligible.

3. **Mercantile Risks** with gross sales not exceeding $1 million and having no more than 15,000 square feet of space. Incidental storage buildings or occupancies in connection with an eligible risk and not exceeding 15,000 square feet are eligible.

4. **Service and Processing businesses** with gross sales not exceeding $1 million and having no more than 15,000 square feet in total floor area and incidental storage facilities not exceeding 15,000 square feet.

Businessowner liability coverage form protects against loss from bodily injury, property damage and for personal and advertising injury.

4.12 Boiler and Machinery Insurance

The Boiler and Machinery policy can be written by itself or in conjunction with a broader commercial lines property coverage. If written on a specific basis, each boiler or machine to be insured is listed and described in a schedule, which is then attached to a policy. If written on a blanket basis, all boilers and machines of a certain class are insured. Emphasis of this type of policy is prevention. Prevention of losses are a result of frequent boiler inspections which are carried out by trained engineers.

Coverage

Covered property means any property that the insured owns, is in the care, custody or control of the insured and for which the insured is legally liable. The policy promises to pay for direct damage to covered property by a covered loss. Covered causes of loss are accidents to machines shown in the Declarations. An accident is defined as a sudden and accidental breakdown of the insured boiler or machine necessitating repair or replacement of the boiler or machine. An accident does not include any of the following;

- wear and tear
- depletion
- deterioration

- depletion
- corrosion
- erosion
- leakage of a valve
- breakdown of tubes
- breakdown of electronic computers
- breakdown of structures or foundations supporting the boiler or machine
- the functioning of any safety device
- explosion of gas or unconsumed fuel within the furnace or any of its passageways

Expediting Expenses

This coverage reimburses the insured for any reasonable extra expenses involved in making temporary repairs and of expediting the repair of the damaged property. Examples can include employee overtime and the extra cost of express shipments. Policy limit is $5,000.

Defense, Settlement and Supplementary Payments

This policy will pay all cost of legal fees, interest on judgments and premiums for appeal bonds as is customary for liability insurance coverages. The amount paid by the company under this coverage is in addition to the face amount of the policy.

Inspection Service

The company provides periodic inspections of the insured boilers and machines as a free service. These inspections often detect dangerous conditions that can prevent accidents from happening. If an inspection detects an unsafe condition the unit can be shut down.

Small Business Boiler and Machinery Policies

The Basic Form may be written for the following small businesses having insurable boilers and/or machines valued at no more than $5 million.

- apartment buildings
- churches
- motels
- hotels
- office buildings
- garages

- retail stores
- schools
- banks
- restaurants
- nursing homes
- theaters
- funeral homes

Expanded Benefits

The Broad Form expands the eligibility requirements for insurable risks to include much smaller boilers, refrigerator units, air conditioning systems and other mechanical or electrical equipment used for the maintenance or service of the premises.

4.13 Marine Insurance

Ocean Marine Insurance

Oldest form of property insurance which provides property coverage in the event of a marine loss to the hull (ship itself), cargo (freight), loss of income and protection and indemnity (liability insurance).

Inland Marine Insurance

This is an outgrowth of Ocean Marine Insurance where coverage was extended to loss from movable property that is transported on land. Some of the risks that may be covered are;

- imports
- exports
- domestic shipments
- bridges and tunnels
- instrumentalities of transportation and communications
- personal property floater risks
- commercial property floater risks

Personal Floaters

Written on an all risk or open perils basis. A floater is coverage on property that moves from one location to another. Most personal floaters limit the insured's settlement to actual cash value at the time of loss or the cost to repair or replace the property in question. The following perils are excluded from coverage;

- wear and tear from ordinary use

- war
- mysterious disappearance
- loss of market due to delay in delivery
- flood
- earthquake
- dishonesty of employees

In order to form a policy, the following floaters must be attached to the personal inland marine floater;

1. **Personal Property Floater: (PPF)** This policy covers all of the insured's unscheduled personal property, worldwide on an all risk basis. Specific or scheduled items of personal property can be covered on an endorsement basis.

2. **Personal Articles Floater: (PAF)** This covers all risk protection from physical loss or damage on certain specified classes of property. This is a separate policy but it is similar to the scheduled personal property endorsement that is added to homeowners policies. Typical property which may be insured under Personal Articles Floater include: Fine arts, Jewelry, furs, cameras, musical instruments, silverware, golf equipment, binoculars, microscopes, personal furs, stamp collection, coin collection and any other item valued at $100 or more. An appraisal is necessary before the article is insured which must contain a detailed description and a value of the property.

3. **Personal Effects Floater: (PEF)** This policy is for individuals who want to have unscheduled all risk coverage for their belongings while traveling or on vacation. The policy is designed only for property that is normally carried by travelers. There is no coverage when the property is being stored, is in the home, or when the insured is not traveling. A policy can be purchased for each trip, or be a permanent form of insurance for the who travels constantly. Excluded from coverage are such things as automobiles, bicycles, motorcycles, boats, securities, money, tickets, passports and valuable papers.

Commercial Floaters

These floaters can be written on a scheduled or blanket basis for named perils or all risk of loss. There are numerous commercial floaters designed for every conceivable segment of the business market. Examples of some commercial floaters would include;

- Physicians and Surgeons Equipment (medical equipment)
- Radium
- Salesperson's samples
- Installation risk (individual business' interest in the property it owns and intends to install for purchase)
- Contractor's equipment (off the road heavy equipment)
- Accounts receivable (inability from collecting debts)
- Electronic data processing (businesses owning, renting or leasing data processing equipment)

Bailees

These are individuals who have temporary custody of the property of others for the purpose of performing some types of service to the property such as repairing, cleaning etc.
Some commercial property floaters are designed to cover the liability of bailees while holding the property of others such as a Jeweler's Block Policy, Furrier's Customers Policy and Bailees' Customers Policy.

Transportation Insurance

These policies insure individuals with insurable interests in goods shipped by rail, air or land. Policies are designed for the owner of the goods in question as well as the individuals who ship them.

4.14 Flood Insurance

Neither personal nor commercial lines property contracts protect insureds against flood damage. The National Flood Insurance Program (NFIP) is a federal program enabling property owners to purchase flood insurance in return for their community's adherence to a flood plan.

Any owner of property in an approved community is eligible for flood insurance. A building and its contents, residential and commercial may be insured under the Flood Program with the following exceptions;

- livestock

- roads
- gas and liquid storage tanks
- wharves, piers and bulkheads
- growing crops
- motor vehicles

In the event of loss, the insured must notify his agent who will then notify the NFIP.

National Flood Insurance sponsored by the Federal Government, by way of the National Flood Insurance Act of 1968, offers flood insurance to homeowners and businesses. Flood losses are generally **EXCLUDED from most policies**. The plan is only available to those persons who live in communities, which have met the plan requirements and have instituted land use and water control measures. The communities must provide these improvements before their inhabitants can buy insurance. A flood is described as a temporary, partial or complete inundation of normally dry land areas by either an overflow of inland or tidal waters, an unusual and rapid accumulation or runoff of surface waters, mudslides and mudflows.

Flood insurance has a $500 deductible and there are two plans available, Basic and Regular.

4.15 Watercraft Insurance

Since a homeowner policy offers only small protection against the loss of the watercraft, a separate policy package is necessary. Important points to remember are property and liability protections are needed by the insured, limited property and liability coverages are available under the Homeowners Program; more, under the Boat-owners Policy; most, under the Yacht Policy. There are three types available, which are based on need;

1. **Outboard Motor and Boat Insurance:** This covers the physical damage exposure to boats. This policy is written under the all risk inland marine floaters.

2. **Watercraft Package Policies:** This combines property, liability and medical payment coverage on an All Risk Basis. This is also known as a boatowner policy.

3. **Yacht Policy:** This is Ocean Marine Insurance and is usually written as a business policy because of the

general use of yachts in business. The policy is designed to insure yachts, sailboats and inboard motor boats used solely for private pleasure purposes. Coverage is written on an all risk or named perils basis. The two basic coverages are;

- Damage to the hull (physical loss) collision liability insurance is included for the damage done upon a collision.
- Protection and indemnity, which protects against bodily injury and property damage not otherwise covered under the damage to the hull policy.

5. Business Interruption Issues

5.1 Overview

Some business situations are not cut and dry. Let's suppose you are the owner of a thriving training company. In your corporate office is an inventory of workbooks, computer programs, video and audiotapes as well as computer and telephone equipment. One night there's a fire, which totally destroys your corporate office, and everything is lost including your business records and computer data.

While you have insurance for your company you finally realize that with the total destruction of all of your records you are basically out of business.

The contractor you hired to rebuild your physical building tells you it will take about nine months to rebuild. What about that income stream that you are used to? How will you survive while the rebuilding takes place?

The loss of income is known as an indirect loss and at times can easily exceed the amount of physical losses sustained. This important issue concerns itself not only with the loss of income experienced but how long will it take to reestablish the income. Time element coverages make up the most important group of consequential loss coverages. The term "time element" means that the amount of the loss is directly linked to the time it takes to repair, rebuild or restore the damage property.

Business interruption insurance is designed to cover many of the costs associated with temporary loss of access to office space, customer traffic or the ability to satisfy customer needs.

5.2 Business Income Coverage Form

Coverage applies to the actual loss of business income sustained due to the suspension of the business operations and to any other expenses sustained to minimize the loss of business. The suspension of the business must be the result of a direct physical loss or damage to the property at the business location.

This type of insurance protection applies to losses and expenses related to an interruption of normal business operations.

The period of restoration begins on the date that the direct physical loss to property occurs and it ends on the date that the damage is repaired. While speed of repair is not necessarily required, the insurance company may limit the period of coverage if "reasonable speed" is not used.

5.3 Policy Expiration

What would happen if while the business is being rebuilt the insurance policy expires? Well, expiration of the policy will not cut short the period of restoration. The period of restoration does not include any increased period required due to any law regulating construction, use or repair or any other activity related to same.

5.4 Important Policy Definitions

Rental Value

Rental value means total anticipated rental income from tenant occupancy of the described premises, all other charges which are the legal obligation of tenants but which would otherwise be the business owner's obligations and the fair rental value of any portion of the premises occupied by the business owner.

Insurance Benefits

The maximum the insurance company will pay for any loss in any one occurrence is the limit of insurance listed in the declarations portion of the insurance contract.

Business Income

The business income form includes five types of coverages. Four of these are identified as additional coverages but these do not increase the limit of insurance. The coverages are as follows;

- Business Income
- Extra Expense
- Civil Authority
- Alterations and New Buildings
- Extended Business Income

5.5 Business Income Coverage

This type of coverage pays the actual losses of business income. Business income is defined as net income (net profit or loss before income taxes) plus continuing operating expenses. Gross revenue is not covered because many expenses such as utilities may be discontinued while the business is shut down. Continuing expenses such as taxes and rent are covered because the net profit or loss is what is left after continuing expenses are paid. If the revenue to cover continuing expenses is not replaced, it reduces the net income.

The purpose of the business income coverage is to restore the business owner to the position that would have existed had there been no disruption of operations.

5.6 Types of Business Interruption Coverage

There are three options available for the business income coverage that applies. One or more options may be selected if coverage applies at different locations.

Option 1 – Business income coverage including rental value
Option 2 – Business income coverage other than rental value
Option 3 – Rental value coverage exclusively

If an individual owned a building occupied by tenants, and if a direct loss results in a loss of rental income, the lost rental income could be covered as a business income loss.

If a person is an owner/occupant of a building, and if a direct loss makes the building uninhabitable and makes it necessary to rent alternative facilities, the rent could be covered as an extra expense. There could also be a recovery of rental income as a business income loss. As a tenant with a direct loss that makes the premises uninhabitable and a lease that requires the tenant to continue paying rent, the rent at a temporary replacement facility could be covered as an extra expense.

5.7 Coinsurance Issues

Business income coverage is usually written with a coinsurance requirement. This coinsurance only applies to the business income coverages, not to extra expense coverage. The amount of insurance required to be carried to satisfy the coinsurance condition is the coinsurance percentage multiplied by the sum of the net income and all operating expenses that would have been earned by operations during the current policy year that had no loss occurred.

An appropriate coinsurance percentage for this type of insurance can be 50% and is not unreasonable for business income coverage. In effect, it provides full coverage for six months, certainly time enough for most businesses to restore full operations.

5.8 Resumption of Business

An insured business has the obligation to resume operations as quickly as possible. The insurance company will not pay for loss of business income caused by loss or damage to media and records after the longer of:

- 60 consecutive days after the date of direct physical loss or damage, or
- the period, beginning on the date of direct loss, necessary to repair, rebuild or replace with reasonable speed and similar quality property other than media or records, which suffered loss or damage in the same occurrence.

5.9 Profits Insurance

Businesses may purchase insurance to cover the risk of lost profit on finished merchandise or goods. When finished stock is damaged or destroyed, the direct loss will be settled on the basis of actual cash value (ACV) or the manufacturer's replacement costs for the materials.

The difference between the recovery amount and the price at which the finished goods could have been sold is therefore at risk.

6. Commercial General Liability Policy

6.1 Overview

This is liability insurance for most types of commercial or business exposures. The Commercial General Liability Policy is part of the Commercial Package Policy and can be sold in conjunction with other coverages or can be purchased independently. There are many different coverages available under the CGL policy, each designed for a particular type of exposure. Under a CGL policy the named insured, spouse, partners, officers, directors and shareholders, and SPOUSES if acting within the scope of business as well as employees, managers or anyone acting with authority within the business can be covered.

6.2 Coverage Triggers

Occurrence means an accident, including continuous or repeated exposure to substantially the same general harmful conditions. This requires notification promptly when a situation occurs which may lead to liability. Covers **Injury or Damage** done during the policy period.

Claims Made requires the insured to notify the company as soon as practical which must include the nature and location of any injury or any damages which arose from the occurrence. Covers **claims** made during a policy period.

Covered Territory includes all parts of the world if the injury or damage basically arises out of goods or activities of a person whose home base is in the United States, its territories and possessions.

6.3 Claims

A claim by a person or organization seeking damages will be deemed to have been made when notice of such claim is first received and recorded by any insured or the insurer.

6.4 Coverages

The Commercial General Liability Policy provides the following three coverages on an occurrence or claims made basis;

- Coverage A - Bodily Injury (BI) and Property Damage (PD) Liability
- Coverage B - Personal and Advertising Injury Liability
- Coverage C - Medical Payments

6.5 Coverage A: BI and PD Liability, Coverage B and C

Coverage A

Coverage A is for bodily injury and property damage liability. This includes premises and operations liability, products and completed operation liability, contractual liability.

Property damage means physical injury to tangible property, including resulting loss of use of that property as well as loss of use of tangible property that is not physically injured.

Under Coverage A the company will pay any sums that the insured becomes obligated to pay because of BI and PD. Liability exposures covered under A include;

- premises and operations
- products and completed operations
- contractual liability for insured contracts (incidental contracts)

Other liability exposures such as fire legal liability, nonowned watercraft are also covered. The policy will pay those sums that the insured becomes legally obligated to pay as damages because of bodily injury or property damage to which the insurance applies. The insurer has the right and duty to defend any suit seeking those damages.

Exclusions

Coverage A does not apply to BI and PD caused by;

- expected or intentional acts
- work related
- automobile, aircraft or watercraft activities
- dram shop (liquor liability)
- personal property of others in the insured's care
- discharge of pollutants
- war

- assumption of liability by contract
- transportation or use of mobile equipment
- property damage to the insured's product or work
- property damage to impaired property
- loss, cost or expense incurred by the insured for the recall of a product because of a known or suspected defect

Coverage B - Personal and Advertising Injury Liability

This coverage will pay those sums which the insured is legally obligated to pay for damages, due to personal injury or advertising injury. Coverage applies to personal injury if it arises out of the conduct of the insured's business. Personal injuries are not covered if they result from the insured's personal life.

Personal Injury includes malicious prosecution, libel, slander, false arrest, defamation of character, unlawful eviction or entry and violation of the right to privacy.

Advertising mistakes can result in exposure to vast sums of liability due to improper advertising. An injury which can be labeled an advertising injury is one which is created due to one or more of the following;

- stealing the advertising ideas or style of another
- copyright, title or slogan infringement
- written or oral publication material violating a person's privacy rights
- oral or written publication leading to slander or libel of a person or of his/her organization's goods, products or services.

Coverage B Exclusions

When the insured;

- knows the oral or written publication is false
- has published material which is the focus of a personal injury claim before the inception of the policy
- willfully violates the law
- assumes liability in a contract or agreement

Not covered if the injuries results from;

- a breach of contract
- the failure of goods to conform to advertised quality

- the wrong description of the price of goods, products or services
- an offense committed by an insured whose business is advertising, broadcasting, publishing or telecasting

Coverage C

The coverage agrees to pay medical expenses which are incurred within one year of an accident during a policy period when bodily injury occurs on the premises owned or rented by the insured, or for bodily injury which results from the insured's operations.

Negligence does not have to be established in order to make a policy pay a claim. It is no fault coverage with no reimbursement for medical payments for necessary hospital, ambulance, funeral expenses, professional nursing care, first aid which is given when an accident occurs, any necessary medical, surgical, prosthetic devices, x-ray and dental services.

Exclusions

Medical payments will not cover expenses for bodily injury to;

- insureds
- persons hired to work for the insured or a tenant of an insured
- tenants of the insured
- persons entitled to workers compensation
- persons involved in an athletic event
- persons injured resulting from the products-completed operations hazard
- persons excluded under Coverage A
- persons due to war

Supplementary Payments

Under Coverage A and B the insurance company will also pay the following;

- all reasonable expenses and up to $100 per day of lost wages when the insured is incurring expenses at the insurer's request to help in an investigation or defense of a claim or lawsuit.
- up to $250 for cost of bail bonds required because of accidents or traffic law violations arising out of the use of any vehicle to which the bodily injury liability coverage applies. The insurer does not have to furnish these bonds.
- any expenses incurred by the insurance company

- all costs levied against an insured in a lawsuit
- reasonable expenses insured in defense of a claim
- interest payments, both pre-judgement and post judgement

Insureds include individuals, partnerships and other organizations which may be insured under the CGL. Employees of these insureds acting within the scope of their employment are also covered. The insured's legal representative is considered an insured if the insured dies, but only with respect to duties as the legal representative.

Limits of Insurance are shown in the Declarations with the limits defined below;

Aggregate Limits of liability are established for all coverages to include two sets: The first set is for products-completed operations claims and the second for all other coverages.

General Aggregate Limit is the most the insurance company will pay during the policy period for BI and PD except those provided for under Products-Completed Operations coverage.

Personal and Advertising Injury Limit is a per person or organization limit. The amount shown is the most the company will pay for the sum of all personal and advertising injuries to one person or organization.

Each Occurrence Limit is the most the insurance company will pay for any one occurrence, subject to the General Aggregate.

Fire Damage Limit is a per fire limit.

Medical Payments Limit is a per person limit.

Conditions found in both the occurrence and claims made forms

Bankruptcy condition states that if the insured becomes bankrupt or insolvent the insurer cannot refuse to pay claims that may be covered under this policy.

Duties in the event of occurrence, claim or suit requires that the insured promptly notify the insurance company of an occurrence that may result in a claim or suit and give written notice to the insurer of any claim that has been made or suit that has been brought against the insured.

Legal action against us states that no person or organization has the right to join the insurance company as a party or bring the insurance company into a suit.

Other Insurance condition states that if the insured carries more than one CGL policy, coverage A and B will be effected as follows;

- ***primary insurance***: if the policy were written with the intent that it respond to a claim first, it will do so, until its limits of insurance are exhausted. Another primary policy will pay its share in accordance to the method of sharing provision described in the policy.

- ***excess insurance***: this policy will respond after other policies have responded and exhausted their limits of insurance.

- **method of sharing insurance**: this policy will pay its portion of the loss.

Premium Audit is computed by the insurer. Premium shown as advance premium is a deposit premium only. At the close of each audit period the insurer will compute the earned premium for that period. Audit premiums are due and payable on notice to the first named insured. Excess premium will be returned by the insurer if the sum of the advance and audit premiums is greater than the earned premium.

Defense Costs incurred by the insurer in defending a suit is a very important benefit. Settlement of a case prior to suit is seen as a preferable course of action to all concerned for the following reasons;

- the illogical basis for many court settlements
- the costly and lengthy nature of litigation for both sides
- the changing strength of a case based on tie
- legal fees mount up quickly

6.6 Other Liability Coverages

These specialized coverage forms may be added to the Commercial General Liability Forms.

Owners and Contractors Protective (O&CP)

This policy has been designed to cover an insured's independent contractor exposure. It provides liability protection in those situations where the law holds the owner or principal contractor liable for the negligence of an independent contractor, especially when the work is unlawful, very dangerous and such that the liability for it cannot be transferred or delegated. Bottom line, the O&CP is designed to cover one liability exposure and one liability exposure only: the independent contractor or contingent liability exposure. All other liability exposures are excluded from coverage.

Claims will be paid according to the insuring agreement under O&CP insurance for bodily injury or property damage due to operations which are performed for an insured who is named by a contractor (as designated in the declarations agreement and only at the designated location). This policy will also help pay for defending a lawsuit.

Professional Liability

Professional liability arises from a failure to use due care and the degree of skill required and expected in a particular profession. A profession is a vocation, calling or occupation involving labor, skill, education and special knowledge of an intellectual nature. As an example, hospitals can be sued for unauthorized release of information; doctors can be sued by injured patients; attorneys can be sued for giving bad advice, etc.

Typical professionals include physicians, attorneys, accountants, engineers, architects, securities and insurance professionals.

The two broad types of professional liability insurance is malpractice and errors and omissions.

Malpractice insurance addresses the professional liability needs of the medical and allied professions. There are specific malpractice policies for physicians, surgeons, dentist, hospitals, druggists, nurses, opticians etc.

Errors and Omissions insurance addresses the professional liability needs of lawyers, engineers, architects, insurance agents, real estate agents, registered representatives etc.

Both of these are limited policies. In order to have a full range of liability protection it would be necessary to purchase some other general liability policy.

Examples of specific professional liability policies;

- Physicians, Surgeons and Dentists
- Partnership
- Hospital
- Lawyers
- Insurance agents and brokers
- Directors and Officers - Although generally excluded from other types of liability coverage, this coverage will cover their decisions, action and/or inaction.

Umbrella Liability Coverage

These policies are designed to protect an insured individual or business agent against catastrophic or disastrous claims. This type of policy provides coverage over and above or an excess of primary coverage. The umbrella usually provides coverage in some dollar amount, normally at least a million dollars over and above the primary amount carried. The purpose of an umbrella liability policy is to provide low cost coverage due to exposure of businesses because of a greater variety of liability hazards.

In recent years, umbrella liability policies have become quite popular with professionals and members of middle and upper management for their business and personal liability exposures.

Remember, primary insurance pays first, up to the policy limits, regardless of other insurance in effect. Excess insurance, like an umbrella policy, begins to pay after primary insurance has been exhausted.

Personal Umbrella Coverage

This type of insurance policy provides individuals and families with high limit/excess protection over basic Comprehensive Personal Liability (Section II of the Homeowners Policy), automobile liability and other liability insurance carried with respect to property of a personal/family nature, as distinguished from business and professional activities and property. Personal Umbrella Liability insurance is written with a minimum limit of liability of $1 million with higher limits available.

Commercial Umbrella Coverage

This policy provides excess general liability, automobile liability, employers liability limits and also protects the insured firm from exclusions and gaps in the primary liability policies which serve as underlying insurance.

7. Crime & Employee Dishonesty

7.1 Overview

Crime insurance provides a vital form of protection for businesses as well as individuals. Depending on who you listen to or what statistics you choose to believe, modern society suffers from a serious crime rate involving a high degree of the theft of money, securities or other property.

Insurance cannot by itself prevent these crimes from taking place. However, insurance coverage can protect policyholders against financial losses resulting from the dishonest acts of others.

With todays high tech world and smarter criminals getting more sophisticated business owners must develop some form of risk management programs.

Keep in mind that not all theft losses involve breaking and entering or even robberies. Some losses are more difficult to control and more difficult to detect.

Many different types of dishonest acts may be the subject of crime insurance. Some policies even provide coverage for loss by “mysterious disappearance”.

Losses generally fall into one of the following categories;

- Employee dishonesty
- Forgery
- Theft
- Robbery
- Burglary

Commercial crime coverages may be written as a separate policy or as part of a commercial package policy.

Crime forms were included by the Insurance Services Office (ISO), and the coverages may now be written on the new commercial forms. Some of the coverages are written on Surety Association of America (SAA) forms. However, both

SAA and ISO forms may be attached to the same commercial policy.

7.2 Coverage Forms

Currently there are 17 coverage forms which are designated by letter. The forms are as follows;

- Form A – Employee dishonesty
- Form B – Forgery
- Form C – Theft, disappearance and destruction
- Form D – Robbery and safe burglary
- Form E – Premises burglary
- Form F – Computer fraud
- Form G – Extortion
- Form H – Premises theft and robbery outside premises
- Form I – Lessees of safe deposit boxes
- Form J – Securities deposited with others
- Form K – Liability for guest's property – safe deposit box
- Form L – Liability for guest's property – premises
- Form M – Safe depository liability
- Form N – Safe depository direct loss
- Form O – Public employees dishonesty – per loss
- Form P – Public employees dishonesty – per employee,
- Form Q – Robbery and safe burglary – money and securities

Any combination of the available crime forms included in the same policy completes what is known as a Commercial Crime Coverage part.

Whether crime coverages are issued as a monoline policy or as part of a package, a crime coverage part must be attached to the common conditions of the commercial lines program.

The crime coverage part will consist of;

- Crime declarations page (Form A or B)
- Crime general provisions form and/or safe depository provisions form
- One or more crime coverage forms
- Any applicable endorsements

7.3 Declarations Page

The crime declarations show the policy number, applicable coverage forms, limits of insurance, deductible amounts and endorsements which are attached to the coverage part.

Declarations Form A is to be used when crime coverages are being issued as a monoline policy. The Form has a place for the named insured's name and address, the policy period, and the identity of the insurance company and the producer.

Declarations Form B is to be used when crime coverages are being issued as part of a package policy. It does not identify the named insured, insurance company or producer, cut that information will be found on the Common Policy Declarations.

7.4 Crime Insurance Policies

Crime insurance policies cover specific types of property against loss by specific perils. For example, burglary and robbery are specific perils. Whether or not a loss is covered may depend upon whether a burglary or robbery, as defined in the policy, ahs been committed.

This insurance is designed to cover losses which are not expected and cannot be fully eliminated, such as theft by employees, burglars or robbers. Intentional criminal acts by a named insured or partner are not covered.

Losses resulting from the execution of an order by any government body is not covered such as the police seizing illegal drugs or stolen property which the business owner was holding for sale.

Additional employees or premises acquired by purchase or merger will be automatically covered for 30 days. Written notice must be given and additional premium paid within that time period.

Crime coverages are subject to a discovery period because losses are not always immediately apparent. However, certain limitations will apply. In order for a loss to be covered it must be discovered not later than one year after the end of the policy period.

7.5 Once a Crime is Discovered

The insured has the obligation and duty to notify the insurance company as soon as possible, submitting to an examination under oath and signing a statement of the answers given, providing a sworn proof of loss within 120 days, and cooperating with the investigation and settlement of claims.

Most forms also require the insured to notify the police.

With multiple insureds, knowledge of any insured person is treated as knowledge by all insured parties and an employee of any insured is treated as an employee of every insured person.

Suing the insurance company to recover for a loss is not allowed unless all policy provisions have been satisfied and proof of loss has been filed for at least 90 days. No suit may be brought more than two years after a loss is discovered.

7.6 Multiple Coverage

If more than one coverage apply to the same loss, the insurance company will pay the actual amount of loss or the total of the applicable limits of coverages, whichever is less.

Under certain conditions, the insurance company will pay under the current policy for a loss that occurred under prior insurance when the loss could have been recovered except for expiration of the discovery period under the prior insurance. This applies only when the current policy took effect on the date the prior policy terminated and provides seamless coverage across time, as long as a crime policy is renewed immediately upon expiration.

If a loss is covered partly by the current policy and partly by a prior policy issued by the same insurance company, the most that will be paid is the amount of recovery under the current policy or the prior policy, whichever is greater.

Generally, coverage will not apply to any loss that is also covered by another policy. However, if the amount of the other insurance is insufficient, this coverage will apply as excess over the other insurance. It will not pay any deductible amounts of the amount of loss that exceeds the limit of insurance shown in the declarations.

7.7 Recovery of Stolen Property

After an insurance company pays for a loss, if property is recovered it will be distributed first to the insured for amounts above the limit of insurance, then to the insurance company up to the amount of any settlement, and then to the insured to reimburse any deductible assumed.

Example:

An insured has a $40,000 loss of money and coverage of $20,000 above a $1,000 deductible. After the insurance company pays its $20,000 limit, the full $40,000 is recovered. The first $19,000 goes to the insured to compensate for the uninsured loss. The next $20,000 goes to the insurance company to reimburse it for its settlement. The final $1,000 goes to the insured to reimburse the deductible.

7.8 Right To Recovery

Any rights the insured has to recover damages from another party are transferred to the insurance company and is known as the subrogation right.

Example:

After settlement of a theft loss, the thief is found. The stolen funds have been squandered, but the thief has other assets. The insurance company has the right to take legal action to recover its payment.

7.9 Valuation of Money

Loss of money will be paid at face value while foreign currency may be paid at its face value in that other currency or in the American dollar equivalent determined by the exchange rate on the day the loss was discovered.

A loss of stock will be paid at their value at the close of business on the day the loss was discovered. However, the insurance company has the option of replacing them in kind or purchasing a lost securities bond in connection with issuing duplicate securities.

If property other than money and securities is lost or damaged in another country, the insurance company has the option of paying for the loss in the currency of that other country or in the U.S. dollar equivalent as determined by the exchange rate on the date the loss was discovered.

7.10 Disagreement in Value

If the insured and the insurance company cannot agree as to the value of the stolen property, the value or cost will be determined by arbitration.

7.11 Theft and Disappearance Insurance

This Form provides a common type of commercial crime insurance. It protects the insured against a broad range of exposures to the loss of money and securities which arise from external threats of loss, such as burglary and robbery. However, coverage applies both inside and outside of the premises. This form is frequently issued in conjunction with employee dishonesty coverage, which protects against internal threats of loss.

It should be noted that loss resulting from accounting errors or omissions is excluded because this is not a crime. While losses resulting from criminal acts of employees, directors or trustees are excluded under this form, coverage is available under the Employee Dishonesty Coverage Form.

7.12 Employee Dishonesty

Employee dishonesty coverage is one of the most common types of commercial crime insurance. It protects the insured against the internal exposure to loss when employees have access to money, securities and other covered property.

The extent of an employer’s exposure to employee dishonesty losses depends upon the type of business. The risk appears greater when employees handle large volumes of money or merchandise having high values.

7.13 Crime General Provisions

This form outlines the exclusions, conditions and definitions common to most crime coverages. These are additional exclusions, conditions, and definitions specific to the Employee Dishonesty Coverage Form.

There will be no coverage for the following;

- Loss caused by any employee for whom prior similar insurance has been cancelled.
- Loss which is revealed or shown only by an inventory or profit and loss calculation.

7.14 Fidelity Bonds

Occasionally an employee may attempt to steal a large sum of money or merchandise. These are the types of losses covered by a fidelity bond. Since an employee is personally liable for his/her own dishonest acts, an insurance company that makes payment under a fidelity bond always has the right to seek recovery from the employee responsible for loss.

While there are both fidelity and surety bonds, only the surety bonds actually fit the technical definition of bonds.

Every bond involves the following persons;

- Principal – the party who has agreed to fulfill an obligation
- Obligee – the party for whose benefit the bond is written, and to whom payment is made if the principal defaults
- Guarantor – the surety or insurance company providing the bond and agreeing to pay damages if the principal defaults.

In the surety field, it is the principal who applies for and pays for a bond, and three parties are clearly involved in forming the contract. These bonds guarantee that specific obligations will be fulfilled. The obligation may involve meeting a contractual commitment, paying a debt or performing certain duties. This is not always true of fidelity bonds. Many fidelity bonds are issued to cover losses resulting from employee dishonesty.

A fidelity bond will pay the employer if a bonded employee steals company funds, but it is the employer (obligee) who arranges for the bond and pays the premium. The employees are not part of the contract.

A typical fidelity bond agrees to indemnify the insured (employer) for losses resulting from employee dishonesty. It covers direct loss of money or other personal property belonging to the insured or for which the insured is legally liable.

STUDENT NOTES

