Study Note for Commercial Lines Coverages

Commercial lines policies are distinctly different from personal lines insurance [homeowner's and personal auto] in the following ways:

HO policies have an 80% coinsurance provision --- a commercial property insurance policies requires 90% in order to be fully covered for small loss.

HO policies generally are written on a named perils basis, whereas, commercial property utilizes open-perils or all- risk coverage requiring the insurer specifically identify all excluded coverages.

The HO policy is an all or nothing coverage ---- the insured is covered for all perils named in the policy and can not choose specific areas for insurance, avoiding certain others where they may not be subject to much risk. However, with the commercial package policy [CPP]--- there are six different areas for coverage and if the insured buys 3 of the 6 they can get the CPP and retain the economies of scale and lower rates due to some diversification.

CPP Insurance Coverages:

Focus: Protection of

The Firm's Assets and Cash Flows

Continuation of the firm after a major loss

Remaining competitive in the aftermath of a property loss

Types of insurance protection: (1) Commercial Property

(2) Commercial General Liability- business liability due to negligence

(3) Crime

(4) Inland and ocean marine

(5) Commercial Auto

(6) Boiler, Farm/Agricultural Insurance

Commercial Property – Identifies covered property on the declarations page and gives the named location of what is being covered, also added are the insured's personal business property. Exclusions related to items where loss may be difficult to prove or it could be hard to define the value of what was lost.

Business Income Coverage: The building and person property form as part of commercial property coverage is used to handle both direct and indirect [consequential]loss.

Indirect loss may include: (1) Loss of Income to operations (2) Reimburse the firm for continuing expenses and (3) Extra expenses related to research and development costs and/or obligations to others in fulfillment of a contractual agreement

When looking at both direct and indirect loss for a business operation, it is important to consider the differences among the various types of inventory and this factor might alter insurance and risk management policies.

Types of inventory --- (1) Finished Goods Inventory --- the business is using completed goods that are being sold to an end-user, so inventory is being stored prior to sale. In order to maintain the business, insurance should be purchased to allow for insurance funds after loss to be used to replenish lost inventory and continue selling items to the public.   On way around this inventory problem may be to go with just in time inventory modeling --- however, the risk management plan needs to consider the concerns related to concentration of inventory in the hands of few suppliers --- e.g. the Japanese car parts problem after the earthquake and tsunami of March 11, 2011.

(2) Goods in Process Inventory – represents inventory that is kept in storage until it is needed when completing a long term product such as an airplane, farm tractor or skyscraper. While you may be able to insure against the cost of the items lost, there needs to be a risk management plan for determining how materials that are replaced can be acquired on a timely basis to avoid delays in completing the product.

Property Insurance Rating Methods:

Stated rates are on the basis of: Rate = cost/$100 of exposed value

Premium = Rate x # hundreds of $ in the value of what is being covered

There are 2 different methods for creating rates and these may be combined to form a hybrid rating system – (1) Class Rating (2) Schedule Rating

Class Rating --- combines comparable exposure units into a single group and then charges a general class rate reflecting loss experience and expenses for that particular set of insureds.

E.G. Property located in Florida – Dade County Miami

Size of Dwelling ---- 1 or 2 Room <u>3 Room</u> 4 Room

Type of Occupancy ---- <u>Tennant</u> Owner Occupied

Construction ---- <u>Frame</u> Brick Block

Fire Protection --- Below Average <u>Average</u> Above Average Excellent

1.25	<u>.90</u>	.75	.65

If this apartment building owner has a structure worth $1,000,000, the annual premium would be quoted at:

Annual Premium = $1,000,000/$100 x .90 = $9,000 per year.

Schedule Rating = a rating system based primarily on the individual characteristics of the property being covered using a clearly defined method for identifying risks with commercial buildings.

E.G. Base Rate==================================➔$.60

May be determined using statistics along the lines of a class rating for a group of buildings in a similar risk category.

Charges relating to particular additional risk factors on a particular building:

Type of Construction – Wooden Frame ========➔ $.10

Areas of Deficient Flooring ===➔ $.20

Building Use============================➔ <u>$.20</u>

Total Additions for Increased Risk <u>$.50</u>

Regular Premium Rate: $ 1.10

Less Discount for:

Fire Sprinkler System [20%] <u>(.22)</u>

<u>Premium Rate per $100 of Exposure: $ .88</u>

Ocean marine insurance – provides coverage for items shipped overseas having four types of coverage:

Hull --- covering the value of the ship and equipment

Cargo --- the value of goods that are shipped

Loss of freight --- loss of income to the ship owner due to the inability to deliver goods or lost income from passengers diverted as the result of an accident on the seas.

Liability loss – loss to the ship owner if the ship is held to be legally liability for injury to others as a result of a shipping/transportation accident. [these losses may be significant due to the catastrophic nature of some accidents such as the Exxon Valdez shipping accident on March 24, 1989.

Types of loss --- Particular Average Loss –losses to the ship or cargo as the result of a direct damage accident; General Average Loss --- loss to property as a result of items thrown overboard to save the ship --- with the loss shared on a proportional [or pro-rata] basis with all participating --- ship owner, owner's of the cargo, investors.

Ocean marine rating --- based on judgment of underwriting factors involving an assessment of:

Seaworthiness of the ship; experience and ability of the captain and crew; potential for loss [fragile cargo is more highly rated than others], route scheduled to be traveled [shipments in areas subject to piracy or war have very high premiums from time to time], and extent of coverage [in some cases there will be limitations of the maximum loss coverage].

Inland marine insurance – intended to cover items shipped within inland waterways on an "open perils" [all-risk] basis. The coverage provides for all direct physical loss that is not specifically excluded in the policy – with the burden on the insurer to show if an exclusion is applicable in loss settlement.

This policy is unique in the US in that casualty insurers specialize in fire insurance coverage while marine insurers seek to cover transportation risks.

The nationwide definition of inland marine insurance was developed by the National Association of Insurance Commissions in 1933 and later approved by the various states by 1953. This definition includes 5 types of property for coverage: (1) Property for Export – items domestically produced that our bound for export (2) imported property in transit – items shipped overseas that come into the US and are transported within the country (3) Domestic property in the process of shipment – goods that are produced domestically and are being carried to locations within the US (4) Property used to facilitate transportation – such as bridges, pipelines, transmission towers, cellphone towers or telephone lines – note that coverage is broad enough to include transmission of a physical product such as gas or oil, as well as, electronic information such as telephone communications (5) Personal property that can easily be moved --- jewelry, coin collections, furs, fine arts, musical instruments.

One other additional l type of coverage that has significance to certain businesses is insurance for Bailments -- A bailment is property that belongs to one party [the bailor] that is entrusted temporarily to another [the bailee] in which there is liability if the property is not returned in good order.

E.G. Parking garage, dry cleaners, restaurants

Note that the extent of liability may depend on the type of operation: If a parking garage is using a Valet service where there is a fee for parking cars the standard of car is much higher than when some may be parking an auto in a garage and is responsible for locking the doors.

If an individual has extensive personal property that is difficult to value --- they may add an endorsement [floater] on their current HO policy that includes appraisals of the items to be insured and is designed to reimburse for loss to jewelry, gun, coin or stamp collections.

The individual would be purchasing a scheduled floater to cover an item of significant value -- painting, vase, violin, etc.