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Business Finance 749
Spring Quarter, 2007

I. Crime Insuring Agreements – Review

1. Crime coverage forms can be added to a CPP or written as monoline crime policies.
2. The principal difference between the coverage forms and the policy forms is that the policy forms include conditions contained in the Common Policy Conditions of the CPP.
3. This eliminates the need to add Common Policy Conditions to the monoline crime policy.
4. Each crime coverage form and policy form comes in two versions:
 - a. Discovery form
 - b. Loss sustained form
5. The discovery form covers losses that are discovered during the policy period, even though they may have occurred earlier.
6. The loss sustained form covers losses that are actually sustained during the policy period and discovered no later than one year later.
7. The commercial crime coverage forms and policies are designed for insuring any type of non-governmental commercial or nonprofit entity other than financial institutions.
8. A separate set of government crime forms and policy forms are used to insure government entities, such as states, counties, public utilities, fire districts, transit authorities, state universities, schools and boards of education.

II. Basic Crime Insuring Agreements

The commercial crime form and policy contains seven insuring agreements.

1. Employee Theft
 2. Forgery or Alteration
 3. Inside the Premises – Theft of Money and Securities
 4. Inside the Premises – Robbery or Safe Burglary of Other Property
 5. Outside the Premises
 6. Computer Fraud
 7. Money Orders and Counterfeit Paper Currency
- ✓ The Insured may select one or more of these insuring agreements – or none at all, if the insured wants coverage under another insuring agreement that is added by endorsement.

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- ✓ The phrase “Not Covered” is inserted on the declarations page for those coverages that are not included.

III. Insuring Agreement # 1: Employee Theft

1. Insures employer against theft of employer’s property by its own employees.
2. The policy defines theft as “the unlawful taking of “money”, “securities” or “other property” to the deprivation of the insured.”
3. An unlawful act is one that is not authorized by law or is a violation of civil or criminal law.
4. The definition of employee theft does not require that the employee be convicted of a crime.
5. Employee theft does not even need to be reported to the police to qualify for coverage under insuring agreement
6. The act must be unlawful, but the proof does not have to meet the standards needed to obtain a criminal conviction.
7. According to the policy definition of employee, a person must meet all three of the following criteria to be considered an employee:
 - a. The person must be currently employed by the insured or be an ex-employee whose employment ended in the last 30 days.
 - b. The person must be compensated by the insured by salary, wages, or commissions.
 - c. The person must be subject to the control and direction of the insured.
8. The definition of employee includes:
 - ✓ Temporary personnel furnished to the insured either to substitute for permanent employees who are on leave or to meet seasonal or short-term work conditions.
9. The definition of employee excludes:
 - ✓ Leased employees (Regular workers who are nominally employed by a labor-leasing firm, but subject to day to day control by the insured firm)
 - ✓ “Any agent, broker...factor, commission merchant, consignee, independent contractor or representative of the same general character.”

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10. Money is defined as
- ✓ Currency, coins and bank notes in current use and having a face value; and travelers checks, register checks and money orders held for sale to the public.
11. Securities are defined as
- ✓ Negotiable and non-negotiable instruments or contracts representing either “money” or other property.

 - ✓ Examples of securities include stocks, bonds, tokens, tickets, stamps in current use (including unused value in a postage meter), and evidences of debt issued in connection with charge or credit cards.
12. Other property is defined as all tangible property, other than money and securities that has intrinsic value and the coverage form or policy does not exclude.
- ✓ Tangible is an important qualification.

 - ✓ Copyrights, patents, intellectual property and other intangible items can be very valuable, but they are not *tangible* property. Therefore, they are not covered property under this coverage form or policy.
13. Limit of insurance
- ✓ The most the insurer will pay depends on the limit of insurance provision and the policy definition of occurrence.

 - ✓ The definition of occurrence is “all loss caused by, or involving, one or more ‘employees’ whether the result of a single act or a series of acts”.

 - ✓ If the applicable limit is \$50,000, the most the insurer would be obligated to pay for one embezzlement – regardless of how many employees were involved in the crime – is \$50,000.

 - ✓ Note well that the limit of liability applies to a single act or a series of acts.
 - a. Example revisited: The bookkeeper of a small insurance agency embezzled \$190,000 by pocketing cash receipts and inserting her name as the payee on customer checks.
 - This was spread out in over 100 separate incidents.
 - The insurance agency had a limit for employee theft coverage of only \$10,000.
 - It claimed that the limit should be applied to each act. This would have enabled it to collect the full loss, since no incident exceeded \$10,000.
 - The insurer contended it was all one series of acts.
 - The court sided with the insurer and the insurer paid \$10,000.

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14. Territory

- ✓ The employee theft insuring agreement is subject to a special extension of the coverage territory.
- ✓ Coverage is provided for loss caused by any employee while temporarily outside the regular territory (U. S., including its territories and possessions, Puerto Rico, Canada) for a period of not more than 90 days.
- ✓ Firms having employees permanently located in other parts of the world can arrange to obtain coverage either by requesting that the standard endorsement, Amend Territorial Limits, be added, or by purchasing a nonstandard policy that provides the desired coverage territory.

Summary of Employee Theft Coverage	
Cause of Loss	“Theft” committed by an employee
Property Covered	“Money”, “securities” and “other property”
Where Coverage Applies	U. S. (including its territories and possessions), Puerto Rico, Canada, plus ninety day world-wide travel extension

IV. Businessowners Policy

A Background

1. Most small to medium-sized businesses have similar and relatively uncomplicated property and casualty risk exposures. They dislike having to purchase multiple policies.
2. In addition, insurers find processing costs too high to handle the insurance needs of small to medium-sized businesses in separate, individually underwritten, low-premium policies.
3. To meet these challenges, insurers invented the businessowners policy (BOP) in the early 1970’s. The first BOP’s were developed by individual insurers rather than rating bureaus.
4. In response to pressure from its member companies, the Insurance Services Office (ISO) introduced a BOP program in 1976.
5. Later, the American Association of Insurance Services (AAIS) also developed a BOP program.
6. Although these forms are readily available, many insurers, including some of the largest writers of BOP’s, use their own, independently developed, BOP forms and rules.

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7. Our discussion will focus on the typical characteristics of the BOP policy. The emphasis will be on the differences between the BOP and the CPP.

B BOP Forms – A BOP is a freestanding package policy. It cannot be added to a commercial package policy (CPP). A typical BOP consists of the following:

1. Policy declarations
2. One or two optional property coverage forms for insuring buildings and personal property – a named perils form and a special (“all risks”) form.
3. A number of other coverages, such as:
 - Business income
 - Employee dishonesty
 - Mechanical breakdown
4. These coverages are either included as part of the form or available as options
5. Liability coverage that resembles the CGL form
6. Endorsements specifically developed for use with the BOP program
7. Common policy conditions either as a separate form or as part of other forms
8. Endorsements specifically developed for use with the BOP program

C BOP Property Coverage Differences versus BPP.

The major differences in property coverage between the BOP and the Building and Personal Property Coverage Form (BPP) pertain to the following:

- Perils covered
 - Replacement cost as standard valuation provision
 - No coinsurance provision
 - Shorter list of property not covered
 - Automatic seasonal increase in amount of insurance
 - Business income and extra expense coverage included
 - Other property types of coverage included as options
 - Some property coverages available as options under BPP not available in BOP
1. Perils Covered
 - a. Recall that the BPP offers three causes-of-losses forms: basic, broad and special

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- b. In contrast, BOP property coverage is offered by most insurers with only two cause of loss forms:
 - Named-perils form similar to the BPP broad form
 - Special form
 - c. The special form predominates.
 - d. Some insurers (as well as the 2002 ISO businessowners program) offer only the special form. In these programs, named perils coverage is provided by adding an endorsement.
2. Replacement cost as standard valuation provision
- a. For BOP's, the standard valuation provision is replacement cost
 - b. The standard valuation provision for the BPP is actual cash value (ACV)
 - c. Most insurers offer ACV as an option for BOP's, just as replacement cost is an option in the BPP.
3. No coinsurance provision
- a. BOP's are characteristically written without a coinsurance or other insurance to value requirement.
 - b. In contrast, most other commercial property forms, including the BPP are written subject to coinsurance.
 - c. In the mid 1990's, ISO incorporated an insurance-to-value provision in its BOP forms similar to the ITV provision in homeowners policies.
 - d. Many insurers chose not to follow ISO in their own BOP policies.
 - e. Because many BOP insureds persist in not carrying adequate amounts of insurance, an insurance-to-value provision is becoming more widespread with insurers who have their own independently filed BOP forms
4. Shorter list of property not covered
- a. In most BOP's, the list of property not covered is considerably shorter than in the BPP.
 - b. For example, wharves or docks are often not excluded because the types of insureds eligible for BOP coverage rarely have them.
 - c. In addition, cost of excavations, underground pipes and foundations, which are excluded under the BPP, are generally not excluded in the BOP.

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- d. The main reason for this has to do with the lower risk nature of the insureds eligible for BOP coverage.
 - e. Insurers perceive BOP-eligible businesses as generally lower-risk, more homogeneous types of businesses.
5. Automatic Seasonal Increase Provision
- a. Some BOP's incorporate a solution for fluctuating values directly into the policy language.
 - b. They do this by including a seasonal increase provision, which acts somewhat like a peak season endorsement added to the BPP.
 - c. The seasonal increase provision is usually subject to the condition that the insured carry an amount of insurance at least equal to its average monthly personal property valued for the last 12 months.
 - d. If this condition is met, the business personal property limit will automatically increase by 25%.
 - e. Some BOP insurers offer a peak season endorsement in addition to the automatic coverage afforded by the seasonal increase provision. Its purpose is to enable the insured to cover a seasonal surge in values that is expected to exceed 25%.
6. Business Income and Extra Expense Coverage Included
- a. A chief distinguishing characteristic of the BOP is the automatic inclusion of business income and extra expense coverage.
 - b. In the BPP, business income and extra expense coverage is provided by a separate form, which is subject to its own underwriting requirements.
 - c. Insurers seldom require special underwriting requirements for business income in the BOP.
 - d. In the BOP, business income is not usually subject to coinsurance, monthly limitation or dollar limit.
 - e. Rather, most BOP's apply a time limit that is not present in the BPP.
 - A typical BOP might provide business income and extra expense for only 12 consecutive months following the occurrence of direct physical damage.
 - In some cases, ordinary payroll is covered for only 90 days.

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- f. Other insurers apply a dollar limit in addition to the 12-month limitation.
 - To illustrate, business income and extra expense coverage might be limited to 20% of the building insurance limit plus 20% of the personal property insurance limit.
 - This can be a significant difference from the 12-month limitation.
 - g. Example: An office tenant with a \$25,000 personal property limit sustained a business income loss in excess of \$1 million.
 - Since the loss was incurred in less than 12-months and its BOP did not have a dollar limit, the insurer paid over \$1 million.
 - Under the alternative approach, the loss payment would have been limited to \$25,000.
 - h. Some include business income coverage for dependent property exposures, others do not.
 - i. Under the BPP, dependent property coverage is available through the dependent property endorsements to the business income coverage forms attached to the BPP.
 - j. Dependent property exposure usually result when an insured has a business relationship with:
 - A contributing location, which furnishes materials or supplies to the insured.
 - A recipient location, which purchases materials or services from the insured.
 - A manufacturing location, which manufactures products for delivery to the insured's customers.
 - A leader location, which attracts customers to the insured's location (for example, a major department store in a shopping mall).
 - k. Dependent property coverage can be important for a small retail business, if the small business depends on one or more "anchor" stores to draw customers to the insured's store.
7. Other Property Coverages Included or Available as Options
- a. Many coverages that require separate coverage parts or policies in the CPP or BPP are included as part of the BOP or available as options.
 - b. Other coverages that are often included or available as options in the BOP include:
 - Employee dishonesty
 - Money and securities, when special-form property coverage applies
 - Burglary and robbery, when named perils property coverage applies
 - Forgery
 - Interior and exterior glass

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- Outdoor signs
 - Mechanical breakdown (boiler and machinery coverage)
 - Money orders and counterfeit money
 - Accounts receivable
 - Valuable papers and records
- c. The trend has been for an ever-increasing number of coverages and endorsements to be added to be included in the BOP program.
- d. This trend conflicts with the goal of simplification. However, it makes the BOP suitable for a broader set of insureds.
8. Property Coverage Options Generally Not Available in BOP's
- a. Some coverage options are almost never offered under BOP's.
 - b. The bulk of these are omitted because they are either:
 - not needed by small businesses that the BOP is intended for, or
 - they require individualized underwriting attention.
 - c. For example, blanket coverage for separate locations, which is used to cover large, multi-location risks under the BPP is not permitted because insureds that need blanket coverage do not fit well into the class-rated, simplified underwriting structure of the BOP:
- D Eligibility for BOP's
- 1. BOP policies are class rated. Because of this, insurers issue policies only to insureds that fit within the contemplated class.
 - 2. In addition, BOP policies are rated on the amount of property coverage. Liability is not separately rated.
 - 3. Given this, a BOP is not suitable for classes that have more complex liability exposures.
 - 4. Every insurer has its own eligibility rules that limit the types of businesses that it will write under the BOP.
- E Typical BOP eligibility rules include the following classifications:
- 1. Main Street businesses
 - a. Furniture stores
 - b. Hardware stores
 - c. Offices

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- d. Usually an eligible building must:
 - Be occupied principally for retail, wholesale, service or processing purposes
 - Contain not more than a certain maximum total floor area, such as 15,000 to 25,000 square feet
 - e. Coverage for building and personal property owned by the same firm can be covered in one BOP policy.
 - f. In the case of leased premises, separate policies are issued to the owner and each of the tenants.
2. Apartment buildings and residential condominium buildings
- a. Insurers commonly restrict eligibility for a BOP to a particular size, such as not more than 6 stories or 60 apartments.
 - b. Incidental office occupancies are also permitted, usually with the stipulation that they do not exceed a certain number of square feet in total.
 - c. The commercial tenants of the building (the incidental office occupancies) are also generally eligible for BOP's.
 - d. How should the personal property and personal liability coverage needs of the residential tenants be handled?
3. Office building, including office condominiums
- a. Insurers typically restrict eligibility to a certain height (such as 6 stories) or a certain total floor area
 - b. As with apartment buildings, the office building class allows incidental apartment occupancies, as well as incidental retail, service or processing occupancies.
 - The incidental occupancies usually must meet the stipulation that they do not exceed a certain number of square feet in total, such as 15,000 to 25,000 square feet.
 - c. Most tenants in office buildings are eligible for BOP's.
 - d. Even when the building itself is too large to come within the insurer's BOP eligibility rules, the tenants in the building will often be eligible for a BOP.
 - e. For example, the Sears Tower in Chicago would be ineligible for a BOP, but many of its tenants are likely eligible for a BOP policy.
4. Contractors
- a. Small construction contractors are generally eligible for BOP coverage.
 - b. There is usually a limit on total receipts and payroll.
 - c. Example:
 - Not more than \$3 million in annual receipts, and
 - An annual payroll not exceeding \$300,000
 - d. General contractors are generally not eligible for the BOP
 - e. Higher risk contractors are also generally not eligible
 - f. Examples of contractors requiring specialized underwriting and therefore not eligible for the BOP:
 - Demolition or wrecking contractors

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- Contractors that use cranes
 - Contractors that have engaged in insulation work
5. Restaurants
- Fast food restaurants and restaurants with limited cooking facilities are generally eligible for the BOP
 - Underwriters do not perceive these restaurants as posing the same underwriting problems as traditional restaurants.
 - Eligible fast food restaurants, for example, may include cooking processes as long as the restaurant maintains an automatic fire extinguishing system equivalent to that recommended by the National Fire Protection Association (NFPA).

F Ineligible operations – The following types of risks are usually not eligible in BOP programs:

1. Automobile business
2. Bars, grills and large restaurants
3. Manufacturing firms
4. One-family or two-family dwellings other than multiple unit garden apartments
5. Places of amusement
6. Financial institutions

Risk Categories Generally Eligible for BOP's	
“Main Street” businesses	Retail, wholesale, service or processing buildings and personal property – not exceeding certain total floor area
Apartment buildings	Not exceeding certain number of floors or units
Office buildings	Not exceeding certain number of floors or total floor area.
Contractors	Not exceeding certain amounts for total receipts and payroll. General contractors and hazardous trades usually ineligible.
Restaurants	With limited cooking facilities

V. BOP Liability: Coverage Comparison to CGL

- A BOP liability coverage is similar to the occurrence version of the Commercial General Liability (CGL) Coverage Form.
- B BOP liability insurance usually provides Bodily Injury and Property Damage for:
1. Premises and operations
 2. Products and completed operations
 3. Liability assumed under insured contract
- C However, there are several differences between BOP liability coverage and the CGL.
1. Limits
 - a. Insurers usually offer fewer limit options in the BOP than in the CGL
 - Few insurers offer BOP occurrence limits greater than \$2 million

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- In many cases, the general aggregate limit of the BOP is fixed at twice the occurrence limit.
 - In addition, the Products and Completed Operations limit is typically made equal to the occurrence limit.
- b. In contrast, CGL aggregate limits (both general aggregate and products and completed operations) often can be any amount in excess of the occurrence limit, subject to the insurer's underwriting guidelines.
- In some cases, CGL aggregate limits are as high as \$20 million
- c. BOP insureds that want higher aggregate limits can solve this problem by purchasing an excess liability or umbrella policy.
- d. However, commercial excess and umbrella liability policies are typically subject to minimum premium requirements.
- e. Once the minimum premium is imposed, the combination of the BOP and excess liability (or umbrella) makes this approach disproportionately expensive for smaller insureds.
2. Professional Liability
- a. BOP liability coverage usually specifically excludes professional liability in the basic contract language.
 - b. When a CGL policy is issued to a provider of professional services, a professional liability exclusion is added to the policy.
 - c. So, effectively there is little difference between the BOP and the CGL in this regard.
 - d. However, some BOP's automatically provide professional liability for retail drug stores.
 - e. The biggest difference is that many BOP's can be endorsed to cover the professional liability exposures of certain less volatile types of professions.
 - f. There is no counterpart to this in the CGL.
 - g. Examples of professional liability exposures that can be covered under the BOP by endorsement include barbers, beauticians, pharmacies, veterinarians, funeral directors, optical and hearing aid stores and printers.
 - h. If one of these professions purchases a CGL instead of BOP, they would need to purchase a separate professional liability policy or purchase an independently filed package policy designed for their particular kind of business.
3. Hired and Nonowned Autos Liability Coverage

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- a. Hired and non-owned auto liability coverage (symbols 8 and 9 of the Business Auto Coverage Form) is usually provided under the BOP, either as part of the form or by endorsement.
 - b. This is a major advantage because it eliminates the need for a separate policy.
 - c. Often this exposure is overlooked by smaller insureds or they have difficulty obtaining a separate auto policy for hired and non-owned autos only.
 - d. Almost every business has at some time rented or leased autos or borrowed employee autos.
4. Other Liability Options – Some BOP's include other liability options. The 2002 ISO BOP program offers:
- a. Coverage to self-storage facilities for damage to customers' goods. This is otherwise written on an inland marine form
 - b. Coverage to motels for damage to guests' property. This is otherwise written as part of crime coverage.
5. Key Liability Coverage Options Not Available in BOP's – Claims-made
- a. Claims made coverage is usually reserved for liability exposures that need special underwriting.
 - b. Therefore, claim-made coverage would not be suitable for BOP programs.

VI. Rating of BOP Coverage

- A Rating a BOP is much less complicated than rating a CPP. The methodology resembles homeowners rating.
1. BOP's are class-rated. Specific rates are not used
 2. Rating procedures are generally based on the amounts of coverage provided for building and personal property.
 3. The property rates include "loadings" (built-in charges) for business income, liability coverage and any additional coverages that are automatically included.
 4. In addition, the rating of optional BOP coverages is much simpler than rating comparable coverages in the CPP.
 5. Some insurers use a different rating procedure for BOP liability coverage. This is especially the case with contractors.

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6. Insurers who rate contractors separately for BOP liability coverage apply a separate liability rate to the insured's payroll, receipts or number of full-time and part-time employees.
7. If rating manually, the rater looks up the applicable building and personal property rates in simple rate tables.
8. More likely, the rater enters the basic data into a computer program and the premium is calculated automatically.
9. Insurers' rating of BOP's takes into the following variables:
 - Territory (different geographic locations impact losses from wind, hail, theft etc differently)
 - Construction (such as frame, joisted masonry or fire resistive)
 - Public fire protection
 - Occupancy of the building
 - Whether the building is sprinklered
 - Deductible. The standard deductible for most insurers is \$250 or \$500.

Rating A BOP versus Rating A Commercial Package Policy		
Coverage	Businessowners Policy (BOP)	Commercial Package Policy (CPP)
Building	Rates based on appropriate factors	Rates based on appropriate factors
Personal Property	Rates based on appropriate factors	Rates based on appropriate factors
Business Income	Often included in base rate	Separately rated
General Liability	Included in the basic rate for standard limits	Separately rated
Employee Dishonesty	Sometimes included in the base rate. If not rating is usually simple.	Separately rated
Hired and Nonowned Autos	Simplified rating to calculate the additional premium	Separately rated