Guide to Commercial Insurance

Introduction

Operating a successful business today requires knowledge in many different areas, and one of the most important things to consider are the types and amounts of insurance coverage your business requires to be properly protected. Adequate insurance coverage is imperative for a firm to be successful, and without it your business is subject to financial ruin by property loss or legal action.

This guide is designed to help educate you on how to identify, minimize, and in some cases eliminate risk, and how to find a commercial insurance provider who will help you to get the right insurance coverage for your business

Risk and Your Small Business

Do you consider your business to be a risky one? If not, you should - every small business faces a certain amount of uncertainties. Some are predictable in that you can plan for and control them to a certain extent. Things like labor costs, expected revenues, taxes, and pricing are examples of factors you have some amount of control over.

Every small business has risks that need to be managed, whether predictable or not

Other risk elements are those that are **unpredictable and generally beyond your control.** These can include what your competitors are doing, changing trends, and outside economic factors like the stock market. Still other events can directly impact your business operations, decrease profits, and create financial issues serious enough to seriously cripple**, if not bankrupt your company.**

Most likely you've already identified the most obvious risks such as fire or injury, and currently have some type of coverage for these losses. Unfortunately there are a myriad of other perils businesses face on a regular basis, **many of which are often either overlooked or ignored.**

Risk Management

Often larger companies employ the services of a full-time risk manager whose job it is to identify and analyze possible exposures to loss or liability. The risk manager then takes action to minimize the financial consequences of unpreventable or unavoidable loss, and to protect against preventable or accidental loss. But **most small businesses can't afford the services of a risk manager** even part time, so the owner often has to take on that responsibility.

An experienced commercial insurance agent is familiar with the exposures of many different businesses. Just as you rely on an accountant to guide you through the maze of tax regulations and record-keeping requirements, **you can rely on an experienced insurance professional to help you identify the exposures to loss that your business may face.**

Identify Your Exposures

Risk management consists of **identifying** and **analyzing the perils** that may cause a loss to your business, then selecting the best way to deal with each potential loss. Identifying exposures to loss is the first, most important step in the risk management process: **If you are unaware of the scope of each potential loss, you'll never be able to develop an effective strategy for preventing them.** For example, unless you've experienced an earthquake, you may not realize how extensive losses can be. Damage to the building and its contents are pretty obvious, but you should also consider

- Water damage from sprinkler systems
- Damage to employees' personal property
- Damage to leased office equipment
- Temporary loss of customers during repairs
- Permanent loss of customers to competitors

Begin the process of identifying exposures by looking closely at each of your business operations and determining what could cause a loss. If there are dozens of exposures you may find dozens of answers. For each exposure you identify, ask yourself - **how serious would that loss be to your business operations?** This question focuses on the possible severity of each exposure and also the cost. The purpose is not to determine the source of replacement or repair funds, rather the full cost of the loss.

A loss exposure questionnaire can help you to identify your business exposures. A qualified and competent Commercial Insurance Agent can also be a great asset in analyzing your situation, and by utilizing their expertise and experience, you're **less likely to overlook any exposures.**

Property and Liability coverage provide for losses resulting from your business activities

Property Insurance

One of the largest components of your financial investment is the building in which your business is housed and its contents. A **general property insurance policy will provide coverage for buildings, contents, equipment,** and other real and personal property owned by your business.

Two types of property insurance policies are **"named peril"** and **"all risk"**. A "named peril" policy provides protection for specific events such as fire, windstorm, hail, vandalism, or sprinkler leakage. The policy **only covers those events named in the policy** and is usually less expensive because it provides less coverage.

Physical Damage

Property damage can be caused by many common events, such as fire, windstorm, lightning and vandalism. To deal effectively with the possibility of physical damage to property, you should **consider more than just damage to or destruction of a building,** as the contents may be even more susceptible to loss. Any business might lose valuable accounting records or computer data making it difficult to bill or collect from customers. Vital office equipment may become inoperable, and in the event replacements can't be found and installed immediately, the business may be forced to temporarily shut down.

Loss of Use

You can lose the use of your business property for reasons other than physical damage. A government agency can close a manufacturer for violating health and safety regulations. A gas-main break or a downed utility line may shut down an entire city block for a day or more. These are **normally uninsurable losses unless caused by an insured peril** like smoke damage from a fire.

Criminal Activity

Small businesses may also be susceptible to crimes such as burglary, employee theft, embezzlement and forgery. Merchants, in particular, may need protection against losses caused by forged checks or unauthorized use of credit cards. Obviously **different businesses are going to have different property loss exposures.**

Business Interruption Losses

We have already described how a direct loss from fire can shut down a business temporarily. Although insurance provides money for repairing or rebuilding property damaged as a direct result of fire, most policies do not cover indirect losses, such as income that is lost while the business is interrupted for repairs.

Business interruption insurance **covers indirect losses** that occur when a direct loss (that results from a covered peril, such as fire) forces a temporary interruption of business. This type of insurance reimburses policyholders for salaries, taxes, rents, and other expenses - **plus any net profits that would have been realized** during the period of interruption.

Always make sure to protect your business against loss of income and unusual expenses that may result if an indirect loss forces your business to close for a period of time.

Determining Property Loss Values

Property insurance can either be purchased on a **"replacement cost"** basis or an **"actual cash value"** basis. Replacement cost is the amount it would take to replace or rebuild your business, with materials of like kind and quality, without deducting anything for depreciation. **Replacement cost does not include the value of your land.** Actual cash value is the amount it would take to repair or replace the damaged or stolen property after deducting for depreciation.

Whether your business is insured at replacement value or actual cash value, it is important to **keep track of the value of your property.** Inflation tends to increase the replacement cost of your property, while the actual cash value may decrease over time. The value of your property can be determined by using the original construction costs, regional construction costs guidelines, or by hiring a professional appraiser.

Coinsurance

Although individual situations vary, most business people should insure their property for at least **80 percent of its value.** This percentage, called "**coinsurance**," reflects the minimum amount of insurance you must have before most companies will fully reimburse you for partial losses. Remember**, most losses are partial losses.**

Check with your agent periodically as well as **whenever new property or operations are added** to make sure your policy provides adequate coverage. You may be able to add an endorsement to the policy that automatically increases policy limits to keep pace with inflation.

Other Types of Property Insurance

Depending on the size of your business and the nature of your business operations, there are many related policies which you may wish to incorporate into your total insurance package. These include the following:

- Business Interruption
- Commercial Crime
- Boiler and Machinery
- Flood and Earthquake
- Building Ordinance

Liability Insurance

A lawsuit could mean a catastrophic loss to your business. Therefore, it is important that you carry enough liability insurance to protect your business from financial loss because of injuries, deaths, or property damage caused by your products, business operations, or employees. A liability policy generally **will provide for your legal defense and will pay on your behalf if you are liable,** up to the limits of your policy.

Public Liability

A business may be held liable for injuries or other losses suffered by a member of the general public **as the result of the business or its employees' negligence or fault.** Examples include a customer in a firm's building trips on a broken step, a defective product causes injury to its user, or improper installation of a product causes injury to a customer.

A firm that is found legally liable for harming a third party must pay damages to compensate the injured party. **Sometimes the court also imposes punitive damages** and, in cases involving violation of statutes designed to protect the community, the court may levy fines in order to discourage future violations.

Regardless of who wins or loses a law suit, litigation is time consuming and expensive. No matter how ridiculous or unfounded the suit may be**, productive business hours are lost, lawyers must be retained and paid and other related costs and expenses must be met** while the suit is being contested.

Key Person Losses

What would happen to your business if an accident or illness makes it impossible for you to work? What if one of your partners or your sales manager suddenly died? Most of us would rather not think about such a what if, but it is **important for you to prepare your business for survival** long before a key person dies or is disabled. Here are some 'key people' policies to consider:

- Serious Illness or Death of Owner
- Serious Illness or Death of Partner
- Serious Illness or Death of Major Stockholder
- Loss of Other Key Person(s)

The answers to these questions can best be determined with the help of your business's planning team: your attorney, accountant and insurance agent. Their expertise in estate planning, financial planning, and current legal and tax codes will help you develop a plan for your business's survival in the event of catastrophic loss.

Liability to Employees

Every state has enacted workers' compensation laws. These laws require most employers to compensate employees for loss of income or medical expenses resulting from work-related disease or injury (except for certain self-inflicted injuries). Should an employee die as a result of a job-related accident or disease, the employee's family also collects a specified amount. Although workers' compensation laws in some states do not apply to all kinds of businesses, **a successful private lawsuit may require a normally exempt firm to compensate employees for losses** resulting from work-related injury or disease.

Determining Liability Losses

Be sure you know how your liability policy pays claims. These policies may be written on either an **"occurrence basis"** or on a **"claims-made basis."** A policy written on an occurrence basis covers incidents that occur during the policy period, regardless of when the claim is reported to the insurance company (even if it is reported after the policy expires). A policy that is written on a claims-made basis covers only those claims reported during the policy period.

If a claims-made policy expires, it may be necessary to purchase **"tail coverage."** Tail coverage covers claims resulting from incidents which occurred while a claims-made policy was in force but which are reported after the policy has expired.

Make sure you know how your commercial liability insurance policy pays claims

Types of Liability Insurance to Consider

Many different types of liability policies are available, but the most common is a **Commercial General Liability (CGL).** This policy provides many liability coverage's under one policy, with two common types of liability almost always written on one form:

Premises and Operations coverage pays bodily injury and property damage claims to members of the public as a result of an accident on your premises or arising out of your operations.

Products and Completed Operations covers liability arising from the handling, use of, existence of any condition in, or warranty of any goods or products manufactured, sold, handled or distributed by your business after the product is given to others and is away from the business premises.

The following are some other liability policies you may wish to consider:

- Directors and Officers Liability - protects corporate officers from claims
- Umbrella Liability - protects over and above limits of basic CGL policies
- Professional Liability - protects from wrongful acts, errors, and omissions
- Owners and Contractors Protective Liability - covers acts of contractors

As you can see, you may need to purchase many separate insurance policies to cover a single business operation. Rather than purchasing each type of insurance individually, you may want to buy a **multi-peril** or **package policy.**

This is a comprehensive policy which can be **tailored to suit your business needs** and will provide both property and liability protection. For many businesses, it is the most efficient and economical way to buy insurance. One package policy frequently purchased by small to mid-size businesses is the **Business Owners Policy (BOP)**.

Business Owner's Policies

BOP's are **insurance packages that provide both property and liability coverage** at one affordable premium. These packaged policies are available to most small and medium-size companies and can be a good alternative to purchasing separate policies for liability and property insurance.

Large companies and businesses that are considered high risk usually **don't meet the criteria for a BOP** (Business Owner's Policy). The criteria for BOP eligibility include the size of the premises, the required limits of liability, the type of business and the extent of offsite activity. Premiums for BOP policies are based on similar factors, including business location, financial stability, building construction, and security features and fire hazards.

Generally there are **three types of insurance** are available to protect your business: **Property, liability and workers' compensation.** Even though property and liability insurance are not always mandatory, it makes sense to protect all of your company assets with property and liability insurance. Workers' compensation insurance is **required by law** in all 50 states.

All small business with annual revenues under 1 million dollars should consider a BOP

BOP Coverage's

Like general property insurance coverage, the property portion of the **BOP offers either named peril or all risk coverage.** Some policies will even include other types of property related insurance as part of the overall package.

Under a BOP, a business **selects the amount of liability coverage it needs** based on its assets, and the liability portion of the BOP is structured in much the same manner as a stand alone CGL policy. The main difference is that the **BOP offers you much less flexibility in determining your coverage limits** for certain types of claims. It's also important to note that BOP's do not include professional liability insurance from claims of errors and omissions.

Business interruption insurance is usually included as part of the overall package. This policy covers lost income and expenses that are incurred after a catastrophic loss. **BOP's typically provide reimbursement for up to a year of lost revenue** resulting from an insured property loss.

Who Should Consider a BOP?

Almost every small **business with revenues under 1 million should at least consider a BOP.** While it is the most common type of insurance policy for small businesses, some companies may find the coverage limits to be to low, or may not like the **lack of flexibility on certain options** like coinsurance. However it's this lack of flexibility that allows the BOP to offer considerably lower premiums than if purchased ala carte.

Although BOP's offer a comprehensive list of policies, most small businesses will still require additional coverage such as workers comp coverage. Also you should **consider purchasing additional liability insurance** depending on the type of industry you're in.

Risk Management and Loss Exposures

Businesses may face several types of risks and exposures. Once exposures have been identified and analyzed, and employee benefits have been reviewed, you must decide upon the risk management measures that will best protect your business.

The two considerations here are **how to prevent or limit exposure,** and **guaranteeing availability of funds for unavoidable losses.**

Limiting Exposure to Loss

One principle of loss prevention and control is the same in business as it is in personal life: **avoid activities that are too hazardous.** For example, a merchant may decide not to sell a particular product because it is likely to injure customers; thus, the firm avoids a product-liability exposure. If you can't avoid an exposure completely, do everything possible to minimize it.

Another method of managing exposure to loss is by **transferring the risk.** Although most businesses do this by buying insurance (which transfers some or all of the risk to the insurance company), there are many non-insurance options to accomplish this as well.

A business owner may also decide that the **firm can afford to absorb some losses,** either because the frequency and probability of those losses are low or because the dollar value of the losses is manageable.

Limit your company's exposure by transferring risk and avoiding hazardous activities

Commercial Insurance Agents

Today, very few businesses or individuals **have sufficient cash or financial reserves** to protect themselves against the hundreds of property and liability exposures that most businesses face. What those exposures are, what their dollar value is and how much protection is enough are thorny questions. When you add the need for an employee benefits program or the need to protect the business when its ownership or management changes, **the picture becomes increasingly complex.** That is why a commercial insurance agent is so important.

Typically, the independent agent is a small business owner-manager. Insurance companies are represented by agents who receive a commission for selling the companies' products and services. An agent may represent more than one insurance company.

The professional independent insurance agent **has been trained in risk analysis.** He or she is familiar with the insurance coverage's and financial strategies available in your state and with the regulations that govern them. With this expertise, the agent can **point out exposures you may overlook.**
The agent can suggest options from a vast array of risk-management strategies and **amend a basic policy** by adding special coverages and endorsements. The resulting policy will be custom tailored to your business's unique protection needs.

Your Commercial Insurance Agent should also act as your risk management consultant

Your agent can also **recommend non-insurance strategies** to meet your needs. Where appropriate, he or she will suggest that your accountant and attorney be brought into the decision-making process to review the legal and tax implications of suggested strategies.

Other Services Insurers Provide

You may not be aware of other services that insurance companies provide to policyholders:

- Legal Defense for Liability Lawsuits
- Injured Worker Re-training
- Inspection Services
- Loss and Claims Control Services

Conclusion

Most small business owners look on insurance as necessary but consider it a burdensome expense that should be kept at a minimum. However, utilized correctly, the right commercial insurance can contribute a great deal to your success by reducing the uncertainties under which you operate. It can reduce employee turnover, improve your credit rating at the bank, make it easier to sell customers on favorable terms, and help your business continue in the event an insured peril interrupts operations. The potential benefits of good risk management make it well worth your study and attention.

As you can see, selecting the commercial insurance coverage for your business requires the consideration of many different factors. We hope this guide has helped to inform you on the issues surrounding the selection of commercial insurance coverage, which will in turn help you find the right commercial insurance provider for your business.