DEPARTMENT OF
Professional & Financial Regulation
STATE OF MAINE

- OFFICE OF SECURITIES
- BUREAU OF INSURANCE
- CONSUMER CREDIT PROTECTION
- BUREAU OF FINANCIAL INSTITUTIONS
- OFFICE OF PROF. AND OCC. REGULATION

Insuring Your Business... The Basics of Property & Liability Coverage

Although Maine law does not require you to have property and liability insurance on your business, you may want to buy coverage to protect you, your property, and your financial investment. Without insurance

protection your business could face financial ruin either because of a property loss or a lawsuit. Although there are various types of coverage that a small business owner can or must buy, this brochure describes only property and liability coverage. If you have questions concerning coverage, check with your insurance agent or call the Maine Bureau of Insurance at (800) 300-5000 (in Maine) or (207) 624-8475.

Depending on the type of business, the best policy for you might be a commercial package policy or a businessowners (BOP) policy. With a commercial package policy you and your agent choose the coverages you will buy, whereas businessowner policies contain pre-packaged coverages.

All policies contain exclusions and other limitations of coverage. It is important to review your entire policy to determine if you have exposures that may not be covered. It is also very important to note the coinsurance requirements of your policy. (Coinsurance is the minimum amount of insurance that you must carry before most companies will **fully** reimburse you for a partial loss.) You may want to discuss with your agent optional coverages such as Building Glass, Outdoor Signs, Boiler and Machinery or Mechanical Breakdown, Business Interruption, Extra Expense (to continue operations after a covered loss), Worker's Compensation, Earthquake, Flood, or Peak-Season coverage.

Property Insurance

Your property is the building and equipment that you own. Property insurance is one of the most important types of insurance that you can buy to protect the property, the inventory, and equipment used in running your business.

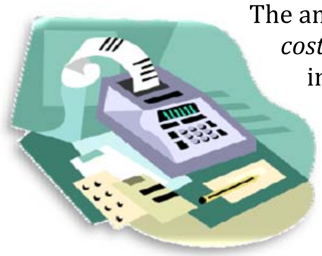
Types of Property Coverage

Basic Form or Named Peril – The "basic form" or "named peril" policy only gives you protection from events that are **specifically listed** in the policy. Examples of these listed events include: fire, hail, vandalism, windstorm, building collapse, or sprinkler damage. The selection of covered perils is a balancing decision between cost of insurance and how much of the risk you are willing to assume or what the property is worth. Because this type of coverage provides more restricted protection, the premium may be lower.

Broad Form – The "broad form" policy includes the covered perils listed in the basic form policy **plus** coverage for losses from additional perils such as collapse of roof due to weight of ice or snow or damage caused by accidental discharge of water or steam. Again, the types of losses that are covered are **specifically listed** in the policy.

Special Form or All Risk – Contrary to its name, the “all risk” or “special form” policy does not actually cover **all** losses. It **does not** cover losses that are **specifically listed as exclusions** in the policy. Businessowner policies are generally written on this basis, while a commercial property or package policy may be written with any of these described levels of coverage.

<u>How is the Value of My Property Loss Determined When I have a Claim?</u>



The amount of your claim payment will depend on whether you purchased *replacement cost* or *actual cash value* insurance. Regardless of the type of coverage purchased, the insurance does not include the value of your land.

· <u>Replacement cost</u> (RC) pays the cost to replace or rebuild your property with materials of like kind and quality without deducting anything for depreciation.

· <u>Actual cash value</u> (ACV) is defined in Maine law as “the replacement cost of an insured item of property at the time of loss, less the value of physical depreciation as to the item damaged.” (Title 24-A M.R.S.A. § 3004-A). Coverage on an ACV basis pays the cost of damaged property or goods after deducting an amount for depreciation. On an ACV basis, the older the property, the less money you will receive when there is a loss.

Note: Do not confuse replacement cost or ACV with *market value* (the amount you paid for your property), or appraisal or assessment values. Insurance coverage is based on the cost necessary to fix or replace the property according to the terms of your contract. *Property value as used in this brochure does not mean market value, real estate appraisal, or assessment value.*

How Much Property Insurance Should I Buy?

Most insurers require that you insure your property for a specific percentage of the replacement cost. This “coinsurance percentage” is stated in your policy and may affect the amount you receive for losses to your property. To have the full amount of a *<u>partial loss</u>* covered, you should buy coverage at least equal to the coinsurance percentage times the cost to repair or replace the property at the time of loss, as explained in the following examples. You **must** carry at least the required percentage or you will be responsible for paying part of the loss out of your own pocket.

To receive full coverage for a *<u>total loss</u>* your coverage should be at least equal to the cost to replace the property at the time of loss.

Most insurers require that the amount of coinsurance on property be at least 80% of its replacement cost; however, some companies may require 100%. It is important that you know what the policy requires. The building value and business personal property/equipment values are separate limits with separate conditions. If your property is not insured to the percentage of its value that is required by your policy and you have a loss, the insurance company will apply a *coinsurance penalty* and you **will not** receive the total value of your loss.

Three factors affect how a coinsurance clause works:

1. **The value of the property at the time of the loss**.
   The value that is important is the cost to repair or replace the property at the time of the loss and not when you first purchased the policy. Review your policy regularly and make adjustments, if necessary, to ensure that the amount of coverage you have will be adequate in case of a loss.

2. **The coinsurance percentage required.**
   The percentage of coinsurance required by the company (generally 80%, 90%, or 100%) affects the amount you receive on a claim.

3. **The amount of insurance selected.**
   The amount of insurance selected should be at least equal to or greater than the value of the coinsurance (the value times the percentage of coinsurance required).

The easiest way to think of how coinsurance works is through the following formula:

HAVE ÷ SHOULD x LOSS = the amount that the company will pay minus your deductible.

That is:
You HAVE this much insurance.

You SHOULD have had this much insurance based on the coinsurance requirement.

The resulting percentage in the above formula (obtained by dividing HAVE by SHOULD) is multiplied by the actual amount of the LOSS. The result is the amount the company will pay minus your deductible (which is the amount that you agree to pay before the company pays). Anything above this amount will be paid by you.

The following examples explain how the coinsurance penalty works when a loss occurs.

Example 1 – Adequate Insurance
The cost to replace your property at the time of loss is $250,000.
The coinsurance percentage required is 80%.
The amount of insurance you have (HAVE) is $200,000.
The deductible is $500.
The amount of the loss is $40,000.

Step 1: $250,000 x 80% = $200,000 – amount required by your policy (SHOULD).

Step 2: $200,000 ÷ by $200,000 = 1.00 (HAVE ÷ SHOULD).

Step 3: $40,000 (loss) x 1.00 = $40,000.

Step 4: $40,000 – $500 (your deductible) = $39,500.

In the above example you are compensated for the entire amount of the covered loss minus the deductible. The amount of insurance that you have meets the coinsurance percentage required by your policy; you are NOT a co-insurer because you kept your promise to insure for at least 80% of the value to replace your property at the time of loss.

Example 2 - Inadequate Insurance
The value of the property (cost to replace it) at the time of loss is $250,000.
The coinsurance percentage required is 80%.
The amount of insurance you have (HAVE) is $100,000.
The deductible is $500.
The amount of the loss is $40,000.

Step 1*:* $250,000 x 80% = $200,000 – amount required by your policy (SHOULD).

Step 2: $100,000 ÷ by $200,000 = .50 (HAVE ÷ SHOULD).

Step 3: $40,000 (loss) x 50% = $20,000.

Step 4: $20,000 – $500 (your deductible) = $19,500.

The insurer will pay $19,500 and you become a co-insurer for the remaining $20,500 of the loss because you didn't meet the requirement of your policy to insure for at least 80% of the value at the time of loss ($200,000). Instead of having a policy for $200,000 of coverage, your policy was only $100,000, which resulted in you paying more out of pocket.

Example 3 - Over-insurance
If you have **more** insurance than is required by your policy, you will not receive more than the amount of your claim. If you have $300,000 of coverage and your policy requires you to have $200,000 (as in the examples above), the insurance company will not pay you more than the amount of your claim minus your deductible. In other words, there is no bonus for over-insuring.

Whether you choose to insure your property on a replacement or actual cash value basis, it is important to keep your coverage current. Check with your agent yearly and whenever new property is added or improvements are made to make sure that your policy gives you enough coverage. You may be able to add a rider or endorsement to the policy that automatically increases your policy amounts to keep up with inflation. Remember, it is *your* responsibility to choose the right amount of coverage.

Other Options

Some companies may offer a special loss settlement form which reduces the coinsurance amount to 70%, 60% or even 50%. This option is useful for older buildings, especially those with elaborate construction. In the case of a large loss, the special loss settlement form provides the cost of repair for partial losses when the owner will replace with lower cost, less elaborate construction following a large loss. Another option that may also be available is functional replacement cost coverage. This option does not change the coinsurance percentage, but instead determines replacement cost of a functionally equivalent building or repair/replacement using less expensive materials.

How do I Cover Loss to my Equipment?
Fixtures and permanently installed equipment and machinery may be covered as part of the building and their value needs to be considered when determining the limit of coverage for the building. This includes such items as fire extinguishing equipment, heating and air conditioning systems, refrigeration equipment, and permanently installed floor and window coverings.

Equipment that is not attached to the building or is used off the premises, such as contractor's mobile equipment, is covered with a Contractor's Equipment Floater. Other specific forms are available for Accounts Receivable, Camera and Musical Instrument Dealers, Jewelers Block, among others. Some of these may require purchase of a separate policy and some may be added to the Property policy by endorsement. (An endorsement is a document that makes a change to an insurance policy to add coverages, policy terms or exclusions to a policy without having to create and issue a new policy.)

Generally, each building and item insured will have its own deductible.

What is Pro-Rata Distribution?
Pro-rata distribution applies when your business involves more than one location, including warehouses or equipment storage. The policy responds pro-rata of the value at the location in proportion to the total value of that type of property at all locations. For example, if you have two insured locations with $100,000 of equipment or stock at each location, it is not sufficient to insure only $100,000 of the property on the assumption that it is unlikely both locations would be subject to the same loss.

With a pro-rata distribution clause, coverage is automatically distributed at the locations in proportion to their value. For example, carrying a limit of $100,000 compared to the $200,000 total value for all your property would result in a payment of only 50% of the value of the loss. This works in the same manner as a coinsurance clause.

Liability Insurance

Liability coverage protects you if someone is hurt while using your product or service or if someone is injured while on your property. Liability insurance can be an important coverage as a lawsuit could mean a large loss to your business. Consequently, you should carry enough liability insurance to protect your business from financial loss resulting from injuries, deaths, or property damage that is caused by your products, business operations, or employees.

What Happens if my Policy is Cancelled or Nonrenewed?

Cancellation means that the insurance company is terminating your policy at some time between the effective date of your policy and its anniversary date.

Nonrenewal is when the company decides that it will not continue your policy after the anniversary date of your current policy.

A company can **cancel** your policy for one of the following reasons:

- Nonpayment of premium;
- Fraud or material misrepresentation made in obtaining the policy, continuing the policy, or in presenting a claim under the policy;
- Substantial change in the risk which increases the risk of loss;
- Failure to comply with reasonable loss control recommendations made by the company;
- Substantial breach of contractual duties, conditions or warranties;
- Determination by the Superintendent that continuation of the class of business will jeopardize the company's solvency or place the insurer in violation of the insurance laws.

If your policy has been in effect for 60 days or more when a notice of **cancellation** is mailed from your insurer, you may request a hearing before the Superintendent of Insurance. You can do so by sending a written request to the Bureau of Insurance by mail or by fax, or by calling us. (See the contact information on the next page.) You must request the hearing within 45 days of your receipt of the notice.
Policies in effect less than 60 days when the cancellation notice is mailed or otherwise delivered do not have the right to a hearing, unless the policy is a renewal of a prior policy with that insurer.

A company may **nonrenew** your policy for any reason after giving a minimum of 30 days' notice before the expiration date of the policy. If the policy has been nonrenewed, you are not entitled to a hearing before the Superintendent of Insurance.

Other Types of Insurance to Consider

There are other types of insurance coverage that are available to business owners besides the two types of coverages described in this booklet. Check with your insurance agent to choose the insurance coverage that best meets your needs.

- Boiler and Machinery pays for loss or damage to your property as a result of a sudden and accidental breakdown of equipment.

- Business Income or Interruption pays for lost earnings if you must close your business because of an insured property loss.

- Cargo and Transportation insurance covers products transported by your company.

- Inland Marine insurance covers your equipment that is used off premises.

- Workers Compensation insurance covers on-the-job injuries of your employees. It may also be possible to cover yourself; check with your agent.

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The Maine Bureau of Insurance
34 State House Station
Augusta ME 04333
207-624-8475
800-300-5000 (in Maine only)
TTY: Maine Relay 711

Visit the Bureau's Website at:
www.maine.gov/pfr/insurance