PRINCIPLES OF RISK MANAGEMENT AND INSURANCE

CLASS NOTES

Chapter 15 Crime Insurance and Surety Bonds

Topics

- ISO Commercial Crime Insurance Program
- Commercial Crime Coverage Form
- Financial Institution Bonds
- Surety Bonds

ISO Commercial Crime Insurance Program

- Crime insurance coverage can be added to a commercial package policy (CPP), or purchased separately
  - There are five basic crime coverage forms, and each can be written in one of two versions:
    - The discovery version covers a loss that is discovered during the policy period or within 60 days after the policy expires even though the loss may have occurred before the policy's inception date
    - The loss-sustained version covers a loss that occurs during the policy period, and the loss is discovered during the policy period or within one year after the policy expires

ISO Commercial Crime Coverage Forms and Policies

- Commercial Crime Coverage Form (discovery version and loss-sustained version)
- Commercial Crime Policy (discovery version and loss-sustained version)
- Government Crime Coverage Form (discovery version and loss-sustained version)
- Government Crime Policy (discovery version and loss-sustained version)
- Employee Theft and Forgery Policy (discovery version and loss-sustained version)

Commercial Crime Coverage Form

- Most property crimes against businesses are due to:
  - Robbery: the unlawful taking of property from the care and custody of a person by someone who (1) has caused or threatens to cause that

- person bodily harm, or (2) has committed an obviously unlawful act witnessed by that person
  - Burglary: the unlawful taking of property from inside the premises by a person who unlawfully enters or leaves the premises, as evidenced by marks of forcible entry or exit
  - Safe burglary: the unlawful taking of property from within a locked safe or vault by someone who unlawfully enters the safe or vault as evidenced by marks of forcible entry upon the exterior
  - Theft: the unlawful taking of property to the deprivation of the insured
    - Includes robbery, burglary, shoplifting, employee theft and forgery
- The commercial crime coverage form (loss sustained version) is used by private firms and nonprofit organizations
  - Firms can select from among eight insuring agreements
  - Employee theft coverage pays for the loss of money, securities, and other property that results directly from theft committed by an employee
    - Includes the theft of other property, besides money and securities, but not computer programs or data
  - Forgery or alteration coverage pays for a loss that results directly from forgery or from the alteration of checks drawn by the insured or the insured's agent
    - Also includes drafts, promissory notes, or similar instruments
    - The coverage does not apply to losses that result from the acceptance of forged documents
  - Inside the premises - theft of money and securities pays for the loss of money and securities inside the premises that result directly from theft committed by a person present inside the premises, or for disappearance, or destruction
    - Coverage also applies to damage to the premises or a vault if related to the actual or attempted theft
  - Inside the premises – robbery or safe burglary of other property pays for the loss or damage to other property inside the premises by the actual or attempted robbery of a custodian, or by safe burglary inside the premises
    - Burglary loss of other property that is not stored in a safe is not covered. These losses can be covered by an inside the premises – robbery or burglary of other property agreement
  - The outside the premises agreement covers the theft, disappearance, or destruction of money and securities outside the premises while in the custody of a messenger or an armored-car company
    - The coverage also includes losses due to the actual or attempted robbery of other property outside the premises
  - The computer fraud agreement covers the loss of money, securities, and other property if a computer is used to transfer property fraudulently from inside the premises to a person or place outside the premises
  - The funds transfer fraud agreement covers the loss of funds that result directly from fraudulent instructions that direct a financial institution to transfer or pay funds from the insured's account

    - The money orders and counterfeit paper currency coverage pays for losses resulting directly from the good-faith acceptance of counterfeit currency
        - Includes money orders that are not paid upon presentation
- Exclusions in the commercial crime coverage form include:
    - Dishonest acts or theft committed by the named insured, partners, or members
    - Knowledge of dishonest acts of employees prior to the policy period
    - Indirect loss
    - Inventory shortages (applies to employee theft only)
        - There is no coverage for any loss if proof of loss depends on an inventory computation or on a profit and loss computation
- The discovery version form is especially valuable for a business firm that has been in business for several years but is uninsured for employee theft losses
    - New coverage written on a discovery version would cover any losses that occurred years earlier but were only discovered during the current policy period
    - If the underwriter suspects that large undiscovered losses might exist prior to the policy's inception date, a retroactive date endorsement can be added to the policy
        - The endorsement limits coverage to only those losses that occur after the retroactive date and are discovered during the current policy period
- A provision for loss sustained during prior insurance covers a loss that occurred during the term of the prior policy but was discovered only after the discovery period under the prior policy had expired
    - This provision enables a business to change insurers without penalty
    - There must not be a break in coverage
- Coverage under the employee theft agreement terminates as to any employee once the insured has knowledge that the employee has committed a theft or dishonest act

Financial Institution Bonds

- Financial institutions, such as commercial banks and credit unions, use some type of financial institution bond to deal with crime exposures
    - In this context, the word "bond" is synonymous with "insurance policy"
- One widely used form is Financial Institution Bond, Standard Form No. 24
    - The bond contains seven insuring agreements
    - The basic bond coverage includes agreements A, B, C, and F
    - Agreement A - Fidelity coverage covers losses that result directly from the dishonest or fraudulent acts of employees acting alone or in collusion with others, with the active and conscious purpose of causing the insured to sustain such loss
        - Excludes losses due to trading or loan transactions
    - Agreement B – On premises coverage covers loss of property on the premises for a broad list of perils, including robbery, burglary, misplacement, mysterious unexplainable disappearance, and theft

- Agreement C – In-transit coverage covers losses to property in-transit for a broad list of perils
    - The property must be in the custody of a messenger or transportation company
- Agreement D - Forgery or alteration coverage covers loss from forgery or alteration of most negotiable instruments
- Agreement E - Securities coverage covers losses to the insured because securities accepted in good faith have been forged, altered, lost or stolen
- Agreement F – Counterfeit currency coverage covers loss to the insured from counterfeit money
- Agreement G – Fraudulent mortgages coverage covers loss that results directly from having accepted or acted upon any mortgage on real property that proves defective because of a fraudulent signature

Surety Bonds

- A surety bond is a bond that usually provides monetary compensation if the bonded party fails to perform certain promised acts
- The parties to a surety bond include:
    - The principal is the party who agrees to perform certain acts or fulfill certain obligations
    - The obligee is the party who receives the proceeds of the bond if the principal fails to perform
    - The surety is the party who agrees to answer for the debt, default, or obligation of the principal
- Surety bonds are similar to insurance contracts in that both provide protection against specified losses

Comparison of Insurance and Surety Bonds

Insurance	*Surety Bonds*
1. There are two parties to an insurance contract.	1. There are three parties to a surety bond.
2. The insurer expects to pay losses. The premium reflects expected loss costs.	2. The surety theoretically expects no losses to occur. The premium is viewed as a service fee, by which the surety's credit is substituted for that of the principal.
3. The insurer normally does not have the right to recover a loss payment from the insured.	3. The surety has the legal right to recover a loss payment from the defaulting principal.
4. Insurance is designed to cover unintentional losses that ideally are outside of the insured's control.	4. The surety guarantees the principal's character, honesty, integrity, and ability to perform. These qualities are within the principal's control.

Types of Surety Bonds

- A contract bond guarantees that the principal will fulfill all contractual obligation
- A license and permit bond guarantees that the principal will comply with all laws and regulations that govern his or her activities
- A public official bond guarantees that public officials will faithfully perform their duties for the protection of the public

- A judicial bond guarantees that the principal will fulfill certain obligations specified by law

Comparison of Five Contract Bonds

Type of Bond	*Obligee*	*Principal*	*Guarantee*
1. Bid Bond	Property owner or party requesting bids	Firm or party submitting the bid	Party whose bid is accepted will sign a contract and furnish a performance bond
2. Performance Bond	Property owner or party having work done	Contractor doing the work	Work will be completed according to contract specifications
3. Payment Bond	Property owner or party having work done	Contractor doing the work	Bills for labor and materials will be paid when due
4. Maintenance Bond	Party having work done	Contractor doing the work	Faulty work of principal will be corrected, or defective materials replaced
5. Completion Bond	Lending institution or lessor	Contractor doing the work	Guarantees completion of the building or improvement

End of Chapter.