Commercial Lines: Property

Interview preparation summary · IN track

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INT.NX.1.a · Property damage and business interruption

For commercial property damage and business interruption cover, explain all-risks versus named perils, sums insured and valuation bases, the indemnity period, deductibles and limits, and how average works when a risk is underinsured.

Commercial property damage cover pays for physical loss of or damage to buildings, plant, stock and contents. An all-risks wording covers any physical loss or damage unless it is excluded, while a named-perils wording covers only the causes it lists, such as fire, storm or flood. Buildings are usually insured on a reinstatement basis, which means the cost of rebuilding as new, while plant and stock may be on replacement cost or on an indemnity basis that allows for age and wear. The customer chooses the sum insured, and if it is lower than the true value the policy normally carries an average condition: the claim is reduced in the proportion that the sum insured bears to the value. Business interruption covers the loss of gross profit after insured damage, for an indemnity period that should match the real time to rebuild and win trade back. Deductibles keep small losses with the customer and limits cap what the insurer pays. Interviewers ask this to see whether you can explain a wording in plain words and see where the customer is exposed. Check current wordings, since practice differs between insurers and countries.

WORKED EXAMPLE: UNDERINSURANCE AND THE AVERAGE CONDITION ON A JOINERY WORKSHOP

Harcombe Joinery, an invented business, insures its workshop building for 800,000 but the true cost of rebuilding is 1,000,000. A fire causes 200,000 of damage to the building. The policy has an average condition and a 10,000 deductible, applied after average (wordings differ, so check the policy). Separately, the business interruption sum insured is based on a declared annual gross profit of 450,000 when the true figure is 600,000, and the interruption loss is 120,000. The building rate is 0.15% of the sum insured. What does the insurer pay, and what does the underinsurance cost the customer?

Answer: The insurer pays 150,000 on the building and 90,000 on business interruption. The building underinsurance left the customer with 50,000 including the deductible, to save 300 of premium.

> **Interview tip:** Say what average does in one sentence, give the proportion first, then the payment, and finish by saying that the cheap saving on premium is what makes underinsurance a poor deal for the customer.

INT.NX.1.b · Property damage and business interruption

For commercial property damage and business interruption, say what a risk survey looks at, how a surveyor's probable and maximum loss estimates are used, and how they change the line you write, the price and the terms.

A risk survey is a visit by an engineer to see the site as it is, not as it is described. Surveyors usually look at construction, occupancy, protection and exposure, often shortened to COPE: what the building is made of, what goes on inside, what fire protection and housekeeping there is, and what lies next door or nearby. They then estimate losses. Names vary between insurers, but a probable maximum loss or estimated maximum loss assumes that protection works as designed, while a maximum foreseeable loss assumes that it fails. Each estimate includes the business interruption that follows. The underwriter uses these figures to size a line against the insurer's per-risk reinsurance retention, to price the risk, and to set conditions such as sprinkler maintenance. The common mistake is to treat the favourable estimate as a cap when it rests on assumptions the insured may not keep up. Interviewers ask this to see whether you understand what an estimate depends on. In the UK, the customer's duty of fair presentation sits alongside the survey, but a survey does not replace it.

WORKED EXAMPLE: PROBABLE AND MAXIMUM LOSS ON A PRINT WORKS

Dornley Print Works, an invented business, has building values of 4.0m, plant of 6.0m and stock of 2.0m, and annual gross profit of 3.0m insured for 12 months. The surveyor assumes that, with working sprinklers, a fire would damage 25% of the property values and interrupt trade for 6 months. If the sprinklers fail, a fire would damage 90% of the property values and interrupt trade for the full 12 months. Your insurer writes a 40% line and keeps 2.0m of its own share, ceding the rest to per-risk reinsurance. Work out the probable and maximum loss and what the insurer keeps and cedes in the worst case. Figures in millions.

Answer: Probable loss is 4.5m and maximum loss is 13.8m. On a 40% line the insurer's shares are 1.80m and 5.52m, and in the worst case it keeps 2.00m and cedes 3.52m.

> **Interview tip:** Name the assumption behind each estimate before you quote a number, and say what in the survey would move you from the probable case towards the maximum one.

INT.NX.1.c · SME and package covers

For SME and package covers, explain how a combined policy is built from sections, how it is priced and distributed, and what aggregators and MGAs change for the insurer.

A package policy combines several covers for a small or medium business in one document, usually as sections such as buildings, contents and stock, business interruption, public and employers' liability, money and goods in transit. Premiums are small, so insurers price them with rating engines that apply a rate to each section's exposure measure, for example sum insured, turnover or wageroll, then add loadings or discounts for trade, location and claims history. Distribution matters as much as price. Brokers, price comparison sites, called aggregators here, and managing general agents, MGAs, which are intermediaries with delegated authority to quote and bind for an insurer, all take a share of the premium or charge a fee. An aggregator makes customers choose mostly on price, which can reward the insurer that mis-prices a section most and raises the risk of adverse selection. A good insurer therefore watches combined ratio by channel and keeps authority, audit and reporting tight for MGAs. Interviewers ask this to see whether you connect price, channel cost and control. Check current regulatory expectations for intermediaries and delegated authority in each market.

WORKED EXAMPLE: PRICING A BAKERY PACKAGE AND TESTING THE CHANNEL COST

Brindle Bakery, an invented small business, buys a package with five sections: buildings 450, contents and stock 450, business interruption 400, public liability 480 and employers' liability 180, all in pounds a year before discount. A 10% multi-section discount applies to the total. The insurer expects claims of 60% of premium and its own expenses are 8%. Distribution through a broker and an MGA costs 25% of premium. If the same policy is sold through an aggregator at 30%, what happens to the combined ratio, and by how much must the price rise to keep the original 7% margin?

Answer: The premium after discount is 1,764. Through the aggregator the combined ratio goes from 93% to 98%, and the price must rise about 7.9% to keep the 7% margin.

> **Interview tip:** Show the build from sections to premium, then show that a change in channel cost moves the margin as much as a change in claims, which is why package insurers manage channels as carefully as prices.

INT.NX.2.a · Construction and engineering

For construction and engineering insurance, explain contractors' all risks, erection all risks, engineering and machinery breakdown cover and delay in start-up, and why a long project makes the exposure change over its life.

Contractors' all risks, CAR, covers physical loss of or damage to works under construction and usually third-party liability for the project. Erection all risks, EAR, does the same for the installation of plant and machinery. Engineering and machinery breakdown cover pays for sudden physical damage to operating machinery and pressure plant, and often comes with inspections. Delay in start-up, called advance loss of profits in some markets, pays the profit lost when insured damage during construction delays opening, usually after a time excess and for a limited indemnity period. Premium is usually charged on the contract value for the build period plus a maintenance period after handover. The exposure is not flat: early civil works carry weather and ground risks, mid-project carries fire and theft, and testing and commissioning is often the riskiest because plant is first run under load. Delays and extensions change that mix. Wordings often exclude faulty design, with different levels of design cover, so read them. In the UK, lifting equipment and pressure systems also have statutory inspection regimes, which engineering insurers often service. Check current practice.

WORKED EXAMPLE: CAR PREMIUM AND A DELAY IN START-UP LOSS ON A PROCESSING PLANT

Calder Quay, an invented project, has a contract value of 50m, a 24-month build and a 12-month maintenance period. The CAR rate is 0.20% of contract value for construction and 0.04% for the maintenance period. Your insurer writes a 25% line. The owner also buys delay in start-up with annual gross profit of 18m, a time excess of 1 month and an indemnity period of up to 9 months. The payable period is the delay less the time excess, capped at the indemnity period. Work out the premium share and the loss payable for a 6-month delay and for a 10-month delay.

Answer: The 100% CAR premium is 120,000, and the 25% share is 30,000. Delay in start-up pays 7.5m for a 6-month delay and 13.5m for a 10-month delay.

> **Interview tip:** Say that the premium is small against the profit exposure, so delay cover needs careful terms, and that exposure changes as the project moves towards commissioning.

INT.NX.2.b · Natural catastrophe exposure and rate adequacy

For natural catastrophe exposure in a commercial property portfolio, explain aggregates, PML and AAL at a general level, how rate change and rate adequacy are judged, and how layers and reinsurance protect the book through the hard and soft market.

A property portfolio is exposed to events such as flood, storm and earthquake that hit many risks at once, so the insurer tracks aggregates, which are the sums insured in each zone, and compares them with limits it has set. Catastrophe models turn that exposure into two headline measures. The average annual loss, AAL, is the expected loss per year, and a probable maximum loss, PML, at a stated return period, such as 1 in 200, is a loss size with a small yearly chance of being exceeded. Both rest on assumptions, so they are guides, not forecasts. Rate adequacy compares the premium charged for catastrophe risk with the technical need: expected loss, the net cost of reinsurance and a charge for the capital held against the retained tail. Rate change is the movement in price for the same exposure, and it follows the market cycle: soft markets with falling rates and loose terms, then a big loss, then a hard market with rising rates and tighter terms. Reinsurance is bought in layers, for example a layer from 120m up to 280m, with an attachment point and a limit. Interviewers ask this to see whether you can explain these ideas without false precision. In the UK, flood cover for homes is supported by a scheme that does not apply to commercial property, so check how commercial flood is treated.

WORKED EXAMPLE: IS THE CATASTROPHE RATE ADEQUATE AFTER THREE YEARS OF RATE CUTS

Ashlar Property, an invented insurer, has total sums insured of 4,000m in a commercial portfolio. Its modelled AAL is 4.0m and its 1-in-200 gross loss is 320m. It buys a catastrophe layer of 160m excess of 120m for 4.8m, with modelled recoveries of 1.6m a year. It charges a capital cost of 5% of the net 1-in-200 loss. The catastrophe premium in the portfolio is 14.0m. Market rate changes over three years were -6%, -4% and +8%. Is the rate adequate?

Answer: The technical catastrophe premium is 15.2m against 14.0m charged, so about 8.6% more rate is needed, while the market has cut rates by 2.5% over three years.

> **Interview tip:** Show that you build adequacy from expected loss, reinsurance cost and capital, say that the model figures are uncertain, and say what you would do next, such as lifting rate, trimming aggregates or buying more cover.

INT.NX.2.c · Large corporate and international programmes

For large corporate and international property programmes, explain master policies, difference in conditions and difference in limits cover, locally admitted policies and the London market's subscription role.

A multinational customer usually buys one master policy covering the whole group, often placed in London, together with local policies in countries where local law or tax makes it necessary to use an insurer licensed there. Many countries restrict cover from insurers that are not licensed locally, so the local policy pays claims in the local currency and the master policy sits behind it. Difference in conditions, DIC, cover picks up what the local policy does not cover, for example a peril it excludes, and difference in limits, DIL, cover pays the amount above the local limit. Premium must be allocated between master and local policies in a way that tax authorities will accept, and local insurers often reinsure the risk back to the master insurers. Large limits are shared. In the London market, including Lloyd's syndicates and company insurers, a placement is made through a broker on a subscription basis: a lead underwriter sets the terms and price and each following insurer writes a share, typically on the same terms. Interviewers ask this to see whether you can follow the flow of a loss through the layers. Check local rules for each country, which change.

WORKED EXAMPLE: A FACTORY LOSS THROUGH THE LOCAL AND MASTER POLICIES

Halvern Components, an invented group, has a master property policy with a 150m limit and a local policy in one country with a 40m limit and a 0.5m deductible. A fire at the local factory causes a loss of 65m. The master policy gives difference in limits cover over the local policy. The master is written 30% by the lead and 25%, 25% and 20% by three followers. Work out what each layer pays and the lead's and followers' shares.

Answer: The customer bears 0.5m, the local policy pays 40m and the master pays 24.5m, of which the lead pays 7.35m and the followers 17.15m.

Interview tip: Walk the loss through in order, local first and master second, and say why the local policy exists, because the fact that some countries require licensed local cover is what interviewers look for.

Summary of the Charta interview-preparation topic. Companies and figures in the examples are invented. Draft content, not yet expert reviewed.