The Importance of C.O.P.E.

Contents

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C.O.P.E INTRODUCTION

Underwriting commercial property exposures always begins with **C.O.P.E**.

This is the acronym for **C**onstruction, **O**ccupancy, **P**rotection, and **E**xposure. Although the primary underwriting concern is the potential for fire, all other causes of loss must also be evaluated.

Property underwriters need information to evaluate a risk.

That information is Construction, Occupancy, Protection and Exposure (COPE).

C: Construction

Construction itself has three subparts:

1. Building or constructions materials
2. Square footage, and
3. Age

BUILDING AND CONSTRUCTION MATERIALS

Building and construction materials affect nearly every other aspect of COPE.

It might even affect a final underwriting decision.

ISO assigns a building's construction class based on the combustibility and damageability (i.e. fire) of a building's materials used to construct the major structural features.

ISO assigns a building class based on the damageability and combustibility of major structural features such as the exterior loadbearing walls, the roof, and the floors.

PRIMARY AND SECONDARY STRUCTURAL FEATURES

The primary structural feature is the exterior loadbearing walls.

In other words, what's holding up the roof and floors?

Essentially, there are four major types of walls or primary structural feature materials:

1. Masonry
2. Fire resistive / modified fire resistive
3. Non-masonry / non-fire resistive
4. Combustible

Masonry is brick and block but only classified as a major structural material if it is what's actually holding up the roof and floors. Brick and block has air holes and spaces.

Fire resistive / Modified Fire Resistive can be masonry if it's solid, no air holes or spaces.

It can be solid concrete called "tilt-up" because a large slab of concrete is laid on the ground then tilted up into place.

Lastly, it could be a metal and steel I-beam construction that is completely spray-coated with a cementitious mixture.

Non-Masonry / Non-Fire Resistive

Basically, an all-metal non-combustible building

Combustible means the material has a flame spread rating of 25 or greater.

CONSTRUCTION

One of the critical considerations in property risk evaluation is to determine the building or structure's susceptibility to damage from the covered causes of loss.

Fire is the primary consideration. Is the building construction wood or frame, meaning is it highly susceptible to fire spreading and causing extensive damage? Or is it built with fire-resistant materials that reduce the spread of fire and the resulting damage if a fire does begin?

Many risks are located in areas of the country subject to tornados, hurricanes, or high winds. Are the buildings designed and built to resist losses these conditions cause (or to at least minimize the damage they cause)?

What about earthquake? If this cause of loss is covered, will the building's construction stand up to the damage likely to result from an earthquake?

Another important element of any type of construction is the building's age and the dates its systems were last updated or replaced. When was the heating system, roof, plumbing, and electrical systems last updated or replaced? When any of these systems or components are not properly maintained or updated on a timely basis, the potential for one of them to cause or contribute to a loss increases.

Construction quality is another important element. Inferior construction that does not comply with building codes is a serious concern. Each structure must have the proper number of properly constructed load-bearing walls.

Green aspects of the building plus any anticipated green replacement after a loss must be taken into consideration. If a building has a green certification the added cost of maintaining that certification following a loss must be included in the valuation. Any vegetative roof landscaping must also be considered.

OCCUPANCY

Another important area of concern is the building's occupancy and use. The main underwriting concern is to determine the nature of the operations conducted in the building that could start or contribute to the spread of a fire. The type of occupancy and the processes it employs determines the nature of the property in the building. What kinds of property, contents, stock, chemicals, flammables, and related materials in the building or on the premises could provide additional fuel if a fire begins?

However, while fire's relationship to occupancy is probably the greatest concern, it is not the only one. An important question to consider is whether the normal business operations use contents and business personal property that are attractive targets for theft.

Do the operations conducted on the premises create a higher exposure to loss or damage from vehicles or aircraft, such as at an auto racetrack or an airport?

It is important to consider if an operation might cause an emotional social response. How does an emotional social response lead to higher loss potential? Consider the medical clinic that also performs abortions. Even though the hazardous processes on the premises are minimal, the potential for loss or damage by vandalism, burglary, and arson are higher simply because of the nature of the business.

If earthquake coverage is provided, the susceptibility to loss or damage by even relatively minor tremors must be evaluated. Even a minor shake could result in a large loss to a business that manufactures or sells glassware and statuary.

Damageability of contents must also be considered. Are the contents so delicate and sensitive that even a small flame or amount of heat could cause a disproportionately significant amount of damage? Electronic equipment, high quality clothing, and sterile equipment are examples of contents susceptible to significant loss from even a small amount of smoke or a minor nuisance fire.

Is a fire that does start difficult to extinguish? A fire that involves scrap tires is difficult to extinguish and it could take weeks or even months to burn itself out. Some operations are considered too risky for firefighters to enter under any circumstances and are fought only from the outside or are allowed to burn out.

PROTECTION

The two areas of concern in this category are public protection and private protection.

Public Protection

When considering fire as the cause of loss, the nature and extent of the protection available, the water supply, and fire department response time are the most important factors. Public protection in the form of fire departments can range from the volunteer fire department whose availability and equipment is questionable to the fully paid and well-equipped service available around-the-clock.

The water source, supply, location, and the rate of flow or pressure are all important elements to consider. Public grading systems grade and evaluate fire protection based on a scale of one to ten. In this system, one represents the best public protection available and ten means that there is no reliable public protection available. Understanding all the grading system’s components and how they fit together in addition to the public protection class at risk is essential to evaluate the fire loss potential of a given risk.

Private Protection

It is important to understand the type of private protection available and how it coordinates with the public protection. For example, a sprinkler system offers valuable protection but only if its water supply is adequate. Does the risk have a sprinkler system, standpipes, and hoses, any kind of fire suppression system, sprinkler alarms, pressurized or gravity water tanks, fire alarms, fire brigades, or similar types of protection? Is the fire department aware of the private protection systems provided so that it can coordinate its response with them?

What about exposure to loss due to theft or criminal acts? What types of safes, alarms, watch service, locks, fencing, lighting, and similar deterrents are in place to protect the premises? Does the alarm sound both on premises and at a central station or reporting center?

When evaluating wind and hail, what protective devices are installed or procedures initiated to reduce or eliminate damage to windows, glass, and property in the open? Are hurricane blinds and shutters used on risks in coastal areas?

EXPOSURE

Adjacent or Surrounding Properties

What is the construction and occupancy of adjacent properties? What is the distance between the covered risk and those properties? A hazardous exposure can have a significant negative effect on the loss potential of an otherwise acceptable property risk. An extreme example to illustrate the point is the relatively low hazard retail men's clothing store located a few feet away from the fireworks manufacturing plant. The point is that part of an overall risk evaluation must include the risk's exposure that adjacent or surrounding occupancies and operations present. This issue affects the tenants within a building as well as the building itself. A clothing store located next door to a restaurant is considerably different than the clothing store located next to an office supplies store. Exposure evaluation must also include analysis of fire walls, fire doors, each structure's construction, vegetation that grows between buildings, and differences in building height, to name a few.

Geographic Location

Another major consideration in risk evaluation and underwriting is the risk's geographic location and the corresponding increase in certain hazards because of it. Some common examples are:

- Coastal properties susceptible to hurricanes, wind driven water, wave damage, or storm surge and resulting tornados
- The "tornado belt" that affects a number of Midwestern states
- Earthquake damage in certain areas near known fault lines
- Areas susceptible to forest fires, brush fires, or flash floods

LOSS HISTORY

Once the hazards and exposures have been identified and analyzed, the loss history must be reviewed. The loss history should have a minimum of three complete years, but because of the infrequency of property losses, the more years, the better. This history should include all details on the type of property losses, the date of their occurrence, the cause of loss, circumstances, amounts paid, and deductibles. It is also valuable to gather information on what has been done to prevent future losses of the same type. Both the frequency and severity of the losses are important considerations.

Accurate and complete loss information is critical for use in forging the relationship between the agent, insured, and insurer that is necessary to set up an affordable insurance program.

FINANCIAL UNDERWRITING

The insured's financial condition can lead to moral and morale exposures that can destroy an operation. The moral exposure hazard is one where the insured or members of the insured’s team take active steps to fraudulently create a loss for gain.

Example: Paula is really stressed out. She realizes she cannot meet this week's payroll. Sales are not keeping pace with expenses and there is no way out. She decides to “accidentally” leave a space heater operating and places it too close to the curtains. Once the curtains begin smoldering, she leaves the premises. The building owner calls her a few hours later to inform her that the entire building burned down.

Morale hazards are less obvious than moral hazards but their effect may be even more insidious. For example, the insured becomes lackadaisical in monitoring potential loss exposures. In these situations, the insured does not actively cause a loss to occur but also does not take the necessary steps to prevent losses. A business strapped for cash may start taking the trash out every other day instead of every day. Doing so adds to the fire load in the building. The filters above the cooking areas in a restaurant kitchen are cleaned less frequently, allowing grease residue to build up. Employees with time on their hands replace the professional cleaning crew. Small losses begin to appear in the loss history.

Example: Benny’s shop did well initially but the past year has been especially difficult. He cuts back from three shifts to one and his maintenance crew goes from five men to one. Greasy rags continue to accumulate in the back of the shop but nobody has time to remove them. Benny is almost relieved when they catch fire and cause a major loss.

Major losses can and do occur once an insured is no longer actively concerned about the business continuing.

PRICING

Rating establishes the manual property premium for an operation.

Related Article: ISO Commercial Property Program Rating Considerations

Pricing begins immediately after the rating process ends. Pricing evaluates parts and features of the operation that rates do not necessarily reflect. The most important of these is the insured's management. How long has the current management team been in place? Does the loss history reflect its involvement and leadership? What is the risk's financial condition? How does it address loss exposures that have been identified? Does the insured have an active loss prevention or safety program in place? Are the risk and its values sufficiently spread so that a total loss is unlikely? Are employees properly trained and is turnover low? Is there a plan for updating and maintenance? Is the insured aware of any geographic-related concerns and has it taken steps to minimize loss?

Example: Phillipe's restaurant is located close to the North Carolina coast. He endured one bad hurricane and decided that once was enough. He purchases heavy-duty storm shutters for the windows, inspects the exterior of the building to be certain it is structurally sound and removes loose hanging decorations. He upgrades his exterior lighting so it will withstand the next big windstorm. He works with a contractor and anchors his sign so that it can withstand even the highest winds that might be expected. He even purchases a generator to keep the refrigeration operating and a separate generator just for the sump pump to prevent water backup. Phillipe deserves credit for being proactive in loss prevention.

Credits and Debits

These factors are applied after the initial premiums are developed. They reflect individual risk characteristics such as the management issues stated above but could also include an alarm system not otherwise contemplated in the rate used and other unique loss prevention initiatives and techniques. Duplicate credits and debits are not allowed. For example, if a class loss cost or rate is used based on the public protection at risk, an additional credit or debit that reflects the same characteristic cannot be used. Debits are applied when a generally acceptable risk does not have the management, loss prevention, or other features expected of an average risk.

Limits, Coinsurance, and Deductibles

Even if the rating is completely accurate and the pricing appropriate, the premium is still wrong if the exposure basis is not accurate. If a building worth $1,000,000 is insured for only $500,000, the premium charge is automatically 50% low. To encourage proper insurance to value, the coinsurance provision requires carrying insurance to a certain percentage of the property value. The normal options are 80%, 90%, or 100% of the full property value. If the limit at the time of loss is inadequate, the insured "co-insures" the loss along with the insurance company. In other words, the insured is responsible for the portion of the loss that is not covered because the limit of insurance is inadequate.

However, it is not just the insured's responsibility to verify that the values are adequate. The agent and the insurance company underwriter should also verify them. The insured may think saving a few premium dollars by not insuring to value is a good idea. However, when a loss occurs and it winds up sharing part of it, the decision no longer looks wise, especially if the financial impact of the loss is significant. Insuring to value and keeping values current are important for the insurance company to collect the adequate premium, for the insured to receive full recovery when a loss occurs, and for the agent to keep a satisfied customer.

Deductibles are another important underwriting tool. The ISO Commercial Property Program incorporates a standard $500 minimum deductible. Credits for higher deductibles are available for the insured that wants a higher deductible. Deductibles are a practical and effective option for both the insured and the insurance company because they make the insured responsible for small frequent losses below the deductible threshold or to participate to the extent of the deductible on losses that exceed the deductible. This encourages the insured to engage in proactive loss control and loss prevention and to properly maintain the property. Proper use of deductibles places some control of insurance costs directly into the insured's hands. The main reason for insurance is to protect the insured from major financial loss. Higher limits and higher deductibles assist in reaching that goal.