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Small Business Insurance Basics

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Insurers often combine a number of insurance coverages into a package that is sold as a single contract. The most common policy for small businesses is the Businessowners Policy (BOP).

The BOP combines coverage for all major property and liability insurance risks as well as many additional coverages into one package policy suitable for most small businesses. The term "BOP" specifically refers to insurance policy language developed (and revised as needed) by experts at ISO. ISO provides sample insurance policy language, research and a variety of other products to insurance companies.

The BOP includes business income insurance, sometimes called business interruption insurance. This compensates a business owner for income lost following a disaster. Disasters typically disrupt operations and may force a business to vacate its premises. Business income insurance also covers the extra expense that may be incurred if a business must operate out of a temporary location.

To cover specific risks associated with a business, a variety of additional coverages may be added to the basic BOP. For example, if a business has an outdoor sign, the BOP doesn't cover it unless coverage is specifically added for an additional premium. If a business relies on electronic commerce, the owner can add coverage for lost income and extra expenses in the event the ability of the business to conduct e-commerce is slowed down or stopped due to a computer virus or hacker.

Only small- to medium-sized businesses that meet certain criteria are eligible for a BOP. Factors insurers consider 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 those factors plus business location, financial stability, building construction, security features and fire hazards.

Major Coverages

Most small businesses need to purchase at least the following four types of insurance.

1. Property Insurance

Property insurance compensates a business if the property used in the business is lost or damaged as the result of various types of common perils, such as fire or theft. Property insurance covers not just a building or structure but also what insurers refer to as personal property, meaning office furnishings, inventory, raw materials, machinery, computers and other items vital to a business's operations. Depending on the type of policy, property insurance may include coverage for equipment breakdown, removal of debris after a fire or other destructive event, some types of water damage and other losses.

2. Liability Insurance

Any enterprise can be sued. Customers may claim that the business caused them harm as the result of, for example, a defective product, an error in a service or disregard for another person's property. Or a claimant may allege that the business created a hazardous environment. Liability insurance pays damages for which the business is found liable, up to the policy limits, as well as attorneys' fees and other legal defense expenses. It also pays the medical bills of any people injured by, or on the premises of, the business.

3. Business Auto Insurance

A business auto policy provides coverage for autos owned by a business. The insurance pays any costs to third parties resulting from bodily injury or property damage for which the business is legally liable, up to the policy limits.

4. Workers Compensation Insurance

In all states but Texas an employer must have workers compensation insurance when there are more than a certain number of employees, varying from three to five, depending on the state. Workers comp insurance, as this coverage is generally called, pays for medical care and replaces a portion of lost wages for an employee who is injured in the course of employment, regardless of who was at fault for the injury. When a worker dies as a result of injuries sustained while working, the insurance provides compensation to the employee's family. An extremely small business, such as one operated by one or two people out of a home, may not need workers compensation insurance. But it often needs more property and liability insurance than is provided in a typical homeowners policy.

Other Types of Business Coverages

1. Errors and Omissions Insurance/Professional Liability

Some businesses involve services such as giving advice, making recommendations, designing things, providing physical care or representing the needs of others, which can lead to being sued by customers, clients or patients claiming that the business's failure to perform a job properly has injured them. Errors and omissions or professional liability insurance covers these situations. The policy will pay any judgment for which the insured is legally liable, up to the policy limit. It also provides legal defense costs, even when there has been no wrongdoing.

2. Employment Practices Liability Insurance

Employment practices liability insurance covers (up to the policy limits) damages for which an employer is legally liable such as violating an employee's civil or other legal rights. In addition to paying a judgment for which the insured is liable, it also provides legal defense costs, which can be substantial even when there has been no wrongdoing.

3. Directors and Officers Liability Insurance

Directors and officers liability insurance protects directors and officers of corporations or not-for-profit organizations if there is a lawsuit claiming they managed the business or organization without proper regard for the rights of others. The policy will pay any judgment for which the insured is legally liable, up to the policy limit. It also provides for legal defense costs, even where there has been no wrongdoing.

4. Key Employee Insurance

Life or disability income insurance can compensate a business when certain key employees die or become disabled. These coverages cushion some of the adverse financial impact that results from losing a key employee's participation.

5. Umbrella Policies

As the name implies, an umbrella liability policy provides coverage over and above a business's other liability coverages. It is designed to protect against unusually high losses. It provides protection when the policy limits of one of the underlying policies have been used up. For a typical business, the umbrella policy would provide protection beyond the general liability and auto liability policies. If a company has employment practices liability insurance, directors and officers liability, or other types of liability insurance, the umbrella could provide protection beyond those policy limits as well.

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