COMMERCIAL PROPERTY INSURANCE RATING METHODS[1]

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The insurance industry uses two main rating methods, Class Rating and Specific Rating, to determine the premium an insured will pay. As a business, insurers must charge a rate adequate to cover losses and expenses and to earn some profit. But to be competitive, insurance companies must also offer the lowest premium for a given coverage.

To remain competitive, insurers have become increasingly sophisticated in their use of property information databases created by insurance industry advisory organizations. These databases allow insurers to develop specific loss costs (LCs) for commercial properties across the United States.

An advisory organization (also called a rating bureau) is a company that collects data to sell to insurance companies. There are two major advisory organizations for Property & Casualty insurance companies in the United States: ISO (formerly known as the Insurance Services Office) and the American Association of Insurance Services (AAIS).

In addition to these two national organizations, some states have their own rating bureaus that serve as that state's official property insurance rating organization. Some insurers are large enough that they utilize internal data and do not subscribe to a rating organization.

TYPES OF PROPERTY RATING: CLASS RATING AND SPECIFIC RATING

In Class Rating, buildings having similar characteristics are grouped together and are charged the same rate. Class Rating establishes an average rate for the group and is modified depending on specific characteristics of the structure.

Buildings eligible for Class Rating typically are:

- 25,000 square feet or less.
- Do not have a fire suppression (sprinkler) system.
- Are not of fire-resistive construction.
- Are not used for manufacturing.

[1] The Metal Building Manufacturers Association (MBMA) provides these insurance bulletins as informational guides. The information contained in these bulletins is general in nature and is not intended to serve as legal advice. Readers are advised to consult with their own counsel and/or insurance broker on matters specific to them.

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The factors insurers consider when determining the premium for a property:

Construction
- Type of construction, (e.g., frame, noncombustible, fire-resistive)
- Building height (number of stories)
- Support for walls, roofs and floors
- Interior construction, such as vertical openings and interior finishes
- Roof geometry, covering and age
- Amount and type of glass/windows

Occupancy
- Ranking of combustibility and susceptibility to fire, smoke and water damage
- Floor level (height) and square footage
- Building hazards, such as heating (boilers), electrical systems, flammable liquids, cooking equipment, chemicals and gases

Public and private fire protection
- Automatic sprinklers
- Extinguishers and alarms
- Water supply
- Public Protection Classification (rating local fire departments' capabilities)
- Building Code Effectiveness Grading Schedule (building code adoption and enforcement)

Exposure
- Adjacent buildings
- Exposed walls, hazards, construction and distances
- Adjacent storage tanks
- Natural hazards (e.g., hurricanes, earthquakes)

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Specific Rating is used when the structure is not eligible for Class Rating. Buildings that are Specifically Rated generally:

- Are larger than 25,000 square feet.
- Are more complex in nature.
- Are more expensive (higher value/square foot).
- Require a field evaluation/survey to verify the structure's attributes.

Each rating organization has its own method for rating buildings but the basic characteristics that influence insurance rates are the same: Construction, Occupancy, Protection and Exposure. These four characteristics are often abbreviated COPE.

ISO, AAIS and the state rating bureaus do not actually publish rates but rather provide LCs by classification. LCs are that part of the premium that covers only the loss (damage and replacement). In order to calculate the full rate for each classification, insurers add their own overhead costs: a loss cost multiplier (LCM).

A key amount considered by insurers of commercial property policies is the Total Insurable Value (TIV). TIV is the total amount of insurance available for a single-loss event and is calculated by adding the replacement cost of the structure, business interruption LCs, and the value of personal property (e.g., inventory, non-fixed equipment, etc.) at risk. The TIV is applied to the calculated rate to determine the premium.

Example: $1,000,000 (TIV) x $0.4 (commercial property insurance rate per $100 of TIV)/100 = $4,000 annual premium

Class Rating

Most businesses are eligible for Class Rating (also known as Manual Rating). Similar businesses have similar risks, including exposure to loss and probability of sustaining damage. These risks are able to be statistically analyzed to produce LCs that reflect the predictable chance of loss for a typical business in each class. Each class is then assigned a Commercial Statistical Plan code.

Class Rated properties are not typically surveyed (inspected). The class LCs consider average conditions of occupancy, maintenance and typical construction. Charges may be applied for substandard conditions such as unsafe electrical wiring, poor physical condition, and housekeeping or exposure.

National databases now allow insurers access to COPE information and other variables that allow for more accurate underwriting and pricing. For instance, ISO's commercial property database scores each building's fire risk and provides insurers with LCs, ratings and loss exposure information, and can be used to assist with risk selection.

Specific Rating

The Specific Rating method (also known as individual rating) establishes rates for a specific property. This method is only used when: (1) the premium for the property will be great enough to justify the additional expense of the site survey and the development of a specific insurance rate, and/or (2) the loss exposure is so unique that it does not fit within an existing class and therefore cannot be Class Rated.

The advisory organizations, some insurers, and state rating bureaus employ field representatives to evaluate these types of properties. ISO utilizes the Specific Commercial Property Evaluation Schedule (SCOPES). SCOPES survey reports contain key information necessary for the insurer to accurately rate the structure, such as:

- Determination of the fire-loss potential for specific commercial buildings.
- Evaluation of the internal fire protection systems, such as automatic sprinkler systems and fire alarms.
- Identification of hazards.
- Recommendations for improvements that mitigate the risk of losses to an insured property.

Whether a structure is Class Rated or Specifically Rated will depend on the property's characteristics and its intended use.

ISO (formerly the Insurance Services Office) is an insurance advisory organization that provides statistical and actuarial information to insurance companies. ISO is a wholly-owned subsidiary of Verisk.

Insurance rates may be adjusted for strategic business reasons and are influenced by the business goals of the insurer, not solely by the characteristics of the building and the relevant risks. For example, insurers may set rates somewhat lower for regular customers or types of buildings that they have decided to pursue as a matter of business strategy. Any rates used herein are for comparison purposes only and should not be treated as actual rates that might apply within any rating jurisdiction.

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