Chapter 15
Crime Insurance Coverages and Surety Bonds

Overview
In addition to the property and liability risks faced by businesses, losses can also occur as a result of crime. Losses attributable to crime take many forms, including burglary, employee theft, arson, shoplifting, embezzlement, robbery, and other types of crime. In response to the need for coverage of such losses, the Insurance Services Office (ISO) has developed a number of crime insurance forms that are discussed in this chapter. This chapter also examines surety bonds. These bonds provide monetary compensation if a bonded party fails to perform a promised obligation. A variety of surety bonds, each designed for a special purpose, are discussed.

Learning Objectives
After studying this chapter you should be able to:

• Define theft, robbery, burglary, and safe burglary.
• Identify the insuring agreements in the commercial crime coverage form (loss sustained form).
• Explain the difference between the discovery form and the loss sustained form.
• Identify the basic insuring agreements in a financial institution bond for a commercial bank.
• Show how surety bonds differ from insurance.
• Identify the major types of surety bonds and give an example where each can be used.
• Define the following:
  Attachment bond  License and permit bond
  Bail bond  Loss-sustained form
  Burglary  Loss sustained during prior insurance
  Commercial crime coverage  Obligee
  (loss sustained form)  Other property
  Contract bond  Outside the premises
  Court bond  Performance bond
  Discovery form  Principal
  Fidelity coverage  Public official bond
  Fiduciary bond  Retroactive date endorsement
  Financial institution bond  Robbery
  Inside the premises—theft of money and securities  Safe burglary
  Inside the premises—robbery or burglary of other property  Surety bonds
  Judicial bond  Surety (obligor)
  Termination as to any employee
  Theft
Outline

I. ISO Commercial Crime Insurance Program

II. Commercial Crime Coverage Form (Loss-Sustained Form)
   A. Basic Definitions
   B. Insuring Agreements
   C. Exclusions
   D. Policy Conditions

III. Financial Institutions Bonds
   A. Fidelity Coverage
   B. On Premises Coverage
   C. In-Transit Coverage
   D. Forgery or Alteration Coverage
   E. Securities Coverage
   F. Counterfeit Money
   G. Fraudulent Mortgages

IV. Surety Bonds
   A. Parties to a Surety Bond
   B. Comparison of Surety Bonds and Insurance
   C. Types of Surety Bonds

Short Answer Questions

1. Name the five basic ISO crime coverage forms and policies.
2. Name the two versions under which the ISO crime coverage form can be written and explain the difference between the forms.

3. For the purposes of insurance, how are burglary, robbery, and theft defined?

4. What exclusions apply to the ISO commercial crime coverage form?
5. What seven insuring agreements are available under a financial institution bond?

6. Many financial institution losses are attributable to employee dishonesty. Which of the seven coverages under a financial institution bond is designed to cover these losses?

7. Who are the three parties to a surety bond, and what is the role of each of the parties?
8. What are the major differences between surety bonds and insurance?

9. What are the major types of surety bonds?

**Multiple Choice Questions**

_Circle the letter that corresponds to the BEST answer._

1. Which statement(s) is(are) true with respect to surety bonds?
   - I. The obligee is the party who is reimbursed if the principal fails to perform.
   - II. The surety has a legal right to recover loss payments from the defaulting principal.
   
   (a) I only
   (b) II only
   (c) both I and II
   (d) neither I nor II

2. A thief gained access to a soft drink distributor’s warehouse by breaking a skylight window. The thief took 300 cases of soft drinks and a computer. This type of taking of property is called:
   
   (a) robbery
   (b) extortion
   (c) fraud
   (d) burglary
3. A bank robber pulled a gun on a bank teller shortly before a bank was scheduled to close. The robber escaped with $10,000 in cash. Which financial institution bond coverage will respond to this loss?
   (a) Insuring Agreement A—Fidelity
   (b) Insuring Agreement B—On Premises
   (c) Insuring Agreement C—In Transit
   (d) Insuring Agreement D—Forgery or Alteration

4. The discovery form of the commercial crime policy covers losses that are:
   (a) discovered during the policy period only
   (b) discovered before the inception of the policy
   (c) discovered during the policy period or within 60 days of the policy’s expiration
   (d) discovered during the policy period or within five years of the policy’s expiration

5. ABC Company changed crime insurers this year. ABC Company’s current commercial crime policy is written on a loss-sustained basis. Which coverage provision extends coverage to losses that occurred before the current policy was in force, but were not discovered until the policy was in force?
   (a) loss sustained during prior insurance
   (b) fidelity coverage
   (c) discovery form
   (d) retrocessionaire clause

6. All of the following are true with regard to commercial crime coverage exclusions EXCEPT:
   (a) An indirect loss that occurs as a result of a covered loss is excluded.
   (b) Loss from the unauthorized release of confidential information is excluded.
   (c) There is no coverage for losses caused by employee theft unless the proof of loss depends on an inventory computation.
   (d) Stock trading losses are excluded from coverage.

7. A builder posted a bond that guaranteed the construction done by the builder would satisfy the requirements of the local building code. This type of bond is a(n):
   (a) license and permit bond
   (b) payment bond
   (c) fiduciary bond
   (d) attachment bond

8. Burglars used a stick of dynamite to gain access to currency stored in a bank vault. Which commercial crime insurance coverage applies to damage to the vault caused by the explosion?
   (a) Inside the Premises—Theft of Money and Securities
   (b) Inside the Premises—Other Property
   (c) Counterfeit Currency
   (d) Outside the Premises

9. All of the following statements are true with respect to surety bonds EXCEPT:
   (a) There are three parties to the surety bond: the principal, the obligee, and the surety.
   (b) If the principal fails to perform, the surety can collect from the obligee.
   (c) The surety theoretically expects no losses to occur.
(d) The surety guarantees the principal’s character, honesty, and ability to perform.
True/False

Circle the T if the statement is true, the F if the statement is false. Explain to yourself why a statement is false.

T  F  1. Theft is a broad term that includes burglary and robbery.

T  F  2. Funds transfer fraud can be covered through a crime coverage form.

T  F  3. If a partnership purchases a commercial crime insurance policy, theft by a partner is covered.

T  F  4. A maintenance bond guarantees work will be completed according to contract specifications by a specified date.

T  F  5. Losses attributable to unauthorized trading in stocks, bonds, and options are excluded under the commercial crime coverage form.

T  F  6. The commercial crime coverages must be purchased separately and cannot be combined in a single policy.

T  F  7. A financial institution bond is a form of surety bond, not a form of insurance.

T  F  8. Under the commercial crime coverage form, the insured must notify the insurer of any theft by an employee, even if the theft does not exceed the deductible.

T  F  9. Coverage is not available under the financial institution bond for losses that occur while money is in transit.

Case Applications

Case 1

Jack-of-All-Trades (JAT) Company is a diversified business with twelve operating divisions. JAT’s risk manager purchased an unendorsed commercial crime form, which included all of the optional coverages. The policy was written on a discovery basis. Several losses were discovered during the coverage period. Will the commercial crime coverage form respond to each of the following losses?

a. An employee embezzled $50,000 two years before the inception of the policy. The embezzlement was discovered by accident when a new accountant was reviewing earlier accounting statements.

b. A disgruntled worker was fired. He was given a check for $1000 in severance pay. The former employee altered the check to read $10,000 and cashed the check. The alteration was discovered during the coverage period.
c. The nephew of the company president was employed in the electronics division. He was caught stealing computer equipment. JAT elected to “keep it quiet” and transferred him to the jewelry division. After the transfer, the nephew took some expensive jewelry and then disappeared. JAT would like to be reimbursed for the stolen jewelry.

**Case 2**

Wendy was a commercial property and liability insurance underwriter for 24 years. She was recently hired by United Contractors Indemnity Company (UCIC) as a surety bond underwriter. The president of UCIC warned Wendy that the surety business differs from the insurance business, and that she would have to “lose her insurance mindset.” What specific differences will Wendy notice between surety and insurance with regard to each of the following:

a. expected losses:

b. subrogation:

c. the degree of control that exists over the loss-causing event:
Solutions to Chapter 15

Short Answer Questions


2. Each of the ISO commercial crime coverage forms and policies can be written on a discovery basis or a loss-sustained basis. The discovery version of the policy covers losses that are discovered during the policy period or within 60 days after the policy expires even though such losses may have occurred prior to the policy’s inception date. The loss-sustained version covers losses that occur during the policy period and are discovered during the policy period or within one year after the policy expires.

3. Burglary is defined, typically, as the taking of property from inside the premises by someone who unlawfully enters or leaves the premises, and there are marks of forcible entry or exit.

Robbery is defined as the unlawful taking of property from a person by someone who (1) has caused or threatens to cause bodily harm to that person, or (2) has committed an obviously unlawful act that is witnessed by that person.

Theft is the unlawful taking of property to the deprivation of the insured. It includes burglary and robbery, shoplifting, employee theft, and forgery.

4. Exclusions in the commercial crime coverage form are:
   — Dishonest acts or theft committed by named insured, partners, or members
   — Knowledge of dishonest acts of employees prior to policy period
   — Inventory shortages (employee theft insuring agreement only)
   — Confidential information
   — Dishonest acts or theft by employees, managers, directors, trustees or representatives
   — Indirect losses
   — Trading losses (employee theft insuring agreement only)

5. The seven insuring agreements that are available under a financial institution bond are:
   — Insuring Agreement A—Fidelity
   — Insuring Agreement B—On Premises
   — Insuring Agreement C—In Transit
   — Insuring Agreement D—Forgery or Alteration
   — Insuring Agreement E—Securities
   — Insuring Agreement F—Counterfeit Currency
   — Insuring Agreement G—Fraudulent Mortgages

6. Many losses under a financial institution bond are fidelity losses caused by employee dishonesty. Such losses are covered under Insuring Agreement A—Fidelity.
7. The three parties to a surety bond include the principal, the obligee, and the surety. The principal is the party who agrees to perform certain acts or fulfill obligations. For example, a construction company may agree to build a bridge for a state and complete construction by a given date. The obligee is the party who is reimbursed if the principal fails to perform. So the state that hired the construction company to build the bridge would be the obligee. Finally, the surety is the party who agrees to answer for the debt, default, or obligation of the principal. So if the construction company purchased a performance bond from Progressive Security Company (the surety), the state would be reimbursed by Progressive Security Company if the construction company fails to complete the bridge by the specified date.

8. There are two parties to an insurance contract, three parties to a surety bond. Insurers expect losses to occur and charge premiums reflecting expected losses. Sureties expect no losses to occur, theoretically, and charge a premium that can be viewed as a service fee to substitute the surety’s credit for that of the principal. The insurer does not have the right to recover loss payments from the insured, while a surety has a legal right to recover payments from a defaulting principal. Finally, insurance covers unintentional losses that are outside of the insured’s control. Surety bonds guarantee the principal’s character, honesty, integrity, and ability to perform. All of these qualities are within the principal’s control.

9. The major types of surety bonds include: contract bonds, license and permit bonds, public official bonds, and judicial bonds. There are some other miscellaneous types of surety bonds, as well.

**Multiple Choice Questions**

1. (c) Both statements are true. If the principal does not deliver promised performance, the surety pays the obligee. The surety has a right to recover loss payments from the defaulting principal.

2. (d) This type of loss is called burglary. Burglary is taking of property from inside the premises by someone who unlawfully enters or leaves the premises, and there are marks of forcible entry or exit (the broken skylight window, in this case).

3. (b) Such a loss, in this case armed robbery of a financial institution, would be covered under Insuring Agreement B—On Premises.

4. (c) The discovery form of the commercial crime policy covers losses that are discovered during the policy period or within 60 days of the policy’s expiration even though such losses may have occurred prior to the policy’s inception date.

5. (a) Under the “loss sustained during prior insurance” provision, the current policy covers losses that occurred during the term of the prior policy but that were not discovered until the discovery period of the prior policy had expired.

6. (c) Employee theft is covered under the commercial crime coverage form. However, there is no coverage if proof of loss depends on an inventory computation or on a profit and loss computation.

7. (a) License and permit bonds guarantee that the person bonded will comply with all laws and regulations that govern his or her activities.
8. (a) “Inside the Premises—Theft of Money and Securities” also covers damage that occurs to a locked safe, vault, or cash register.

9. (b) It is the surety that guarantees the promise of the principal to the obligee. If the principal is unable to perform, the obligee collects from the surety.

**True/False**

1. T

2. T

3. F Losses due to the dishonest acts or theft by partners are specifically excluded.

4. F It is a performance bond, not a maintenance bond, that guarantees work will be completed according to contract specifications. A maintenance bond guarantees that poor workmanship by the principal will be corrected and that defective materials will be replaced.

5. T

6. F The coverages can be combined to meet the specific needs of the purchaser.

7. F Although it is called a “bond,” the coverage is really a form of insurance, and not a surety bond.

8. T

9. F One of the insuring agreements, Insuring Agreement C, covers losses that occur while money is in transit.

**Case Applications**

**Case 1**

a. The “Employee Theft” insuring agreement covers loss of money that is stolen by employees. As the coverage is written on a “discovery form” basis, losses that are discovered during the policy period are covered, regardless of when the loss occurred. The only question about whether this claim would be covered by the policy is whether the policy includes a retroactive date. If a retroactive date is stated in the policy and the loss occurred prior to the retroactive date, the claim would not be covered. If the loss occurred after the retroactive date, the claim would be covered.

b. Forged and altered checks are covered under the “Forgery and Alteration” insuring agreement.

c. As the prior loss was not reported, as required under the conditions of the policy, JAT has jeopardized its right to collect for the loss. If the insurer becomes aware of the earlier unreported loss, the insurer has the right to deny the claim.
Case 2

a. Insurance companies are in the loss payment business. When an insurance policy is written, the insurer expects that some losses will occur. In contrast, a surety company expects no losses will occur. The premium for a surety bond is viewed as a service fee, by which the surety’s credit is substituted for that of the principal.

b. Subrogation is used in some instances in commercial property and liability insurance. However, for the most part, the insurer normally does not have the right to recover a loss payment made to an insured. In the case of surety, subrogation is commonplace in case of default. If the principal defaults, the surety has the right to recover the cost of performance rendered on the principal’s behalf by the surety.

c. Insurance covers many loss exposures that are out of the insured’s control. For example, the insured cannot control whether a hurricane or an earthquake will destroy a production facility. Under a surety agreement, the surety guarantees the principal’s character, integrity, honesty, and ability to perform the bonded obligation. These factors are within the principal’s control.