

# WORKSHOP

## BUSINESS INTERRUPTION INSURANCE – ADVANCE

### APPLICATION & MARKET PRACTICE

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# Workshop Agenda

- Brief overview of Business Interruption Cover
- Calculation of Insurance Gross Profit and Indemnity Period
- Main features of a risk that will influence an underwriter in their assessment of acceptability and rating
- Detailed review of BI Policy wording & applicable clauses
- Describe the typical coverage extensions provided on a Business interruption policy
- Business Interruption Claim – Case Examples
- Current Insurance market trends and new developments

# **Brief Overview of Business Interruption Insurance**

# What is Business Interruption Insurance?

Protects income of business when it is interrupted as a result of

- **INSURED property damage** (may include Machinery Breakdown) **at the premises** (or away from the premises – Contingent Business Interruption)
- As opposed to its assets - buildings, machinery and stock



Advanced Loss of Profit Insurance



Consequential Loss Insurance



Business Interruption Insurance

# What is Business Interruption Insurance?

## What needs to be covered

Charges/costs which continue after damage

+

Net Profit lost following damage

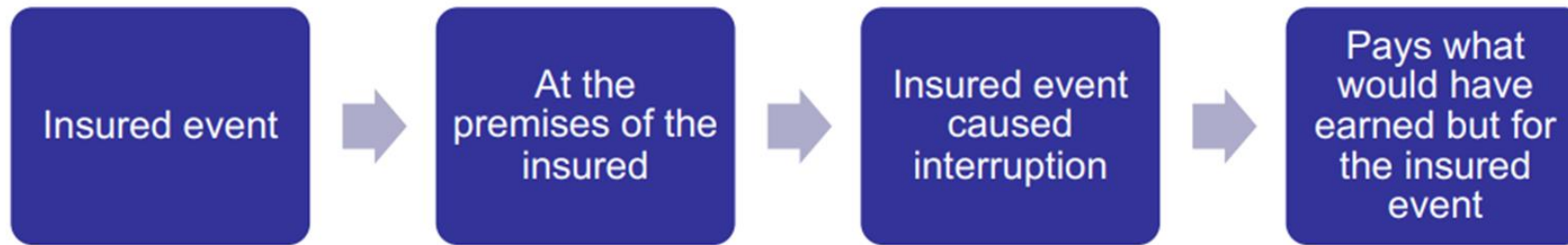
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Additional costs/extra expenses incurred following damage to prevent a loss of turnover/production

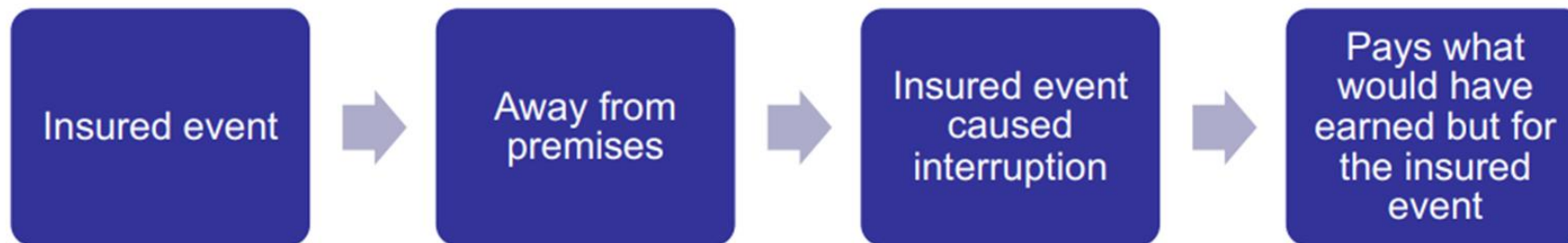
# What is Business Interruption Insurance?

## Two aspects of Business Interruption

### Business interruption



### Contingent Business Interruption



# Basis of Cover

1. Gross profit
2. Revenue (Service operators)
3. Fixed cost + Debt servicing (new ventures)
4. Loss of production income (upstream risks)

**BI trigger: Insured's assets damaged by insured perils under the policy**

# Basis of BI Cover

## Policy Coverage Limits

### Waiting period:

- BI cover is **not** for short duration outages.
- Policy pays out after defined waiting period.

### Indemnity period:

- The period for which the policy cover applies following a loss.
- Wording defines if at point of loss or after the waiting period.

### Sub-limits:

- Scenario or consequence specific limit in the level of coverage (stated as monetary value or time period).

What are markets trying to achieve with a BI deductible?

How important are limits in the event of a loss?

To what extent can an Insured test the policy limits internally?



# **Calculation of Insured Gross Profit**

# Insurance Gross Profit

## Turnover

In every B.I. loss the production interruption leads to reduction in turnover, therefore “business turnover” is at the base of B.I. insurance.

Turnover can be broken down into four elements:



# Insurance Gross Profit

What needs to be insured if a business is interrupted?

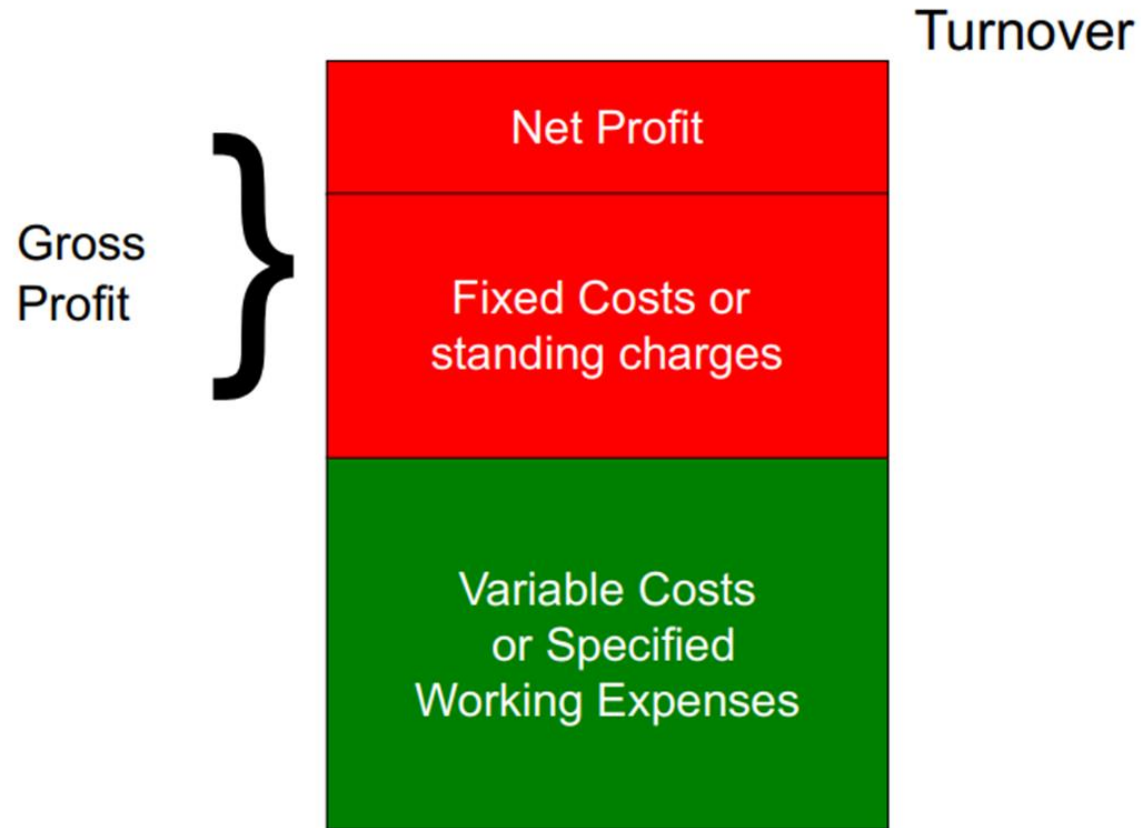


These three elements form = **BI** gross profit

(**not** to be confused with the accountant's gross profit)

# What is Business Interruption Insurance?

## Gross Profit



COMPANY			
INSURANCE GROSS PROFIT	Last year	Estimated	
Turnover (Revenue/Sales)	10,000,000	11,000,000	
Plus			
Closing stock	500,000	600,000	
Plus			
Closing work in progress	100,000	100,000	
<b>A</b>	<b>10,600,000</b>	<b>11,700,000</b>	
Uninsured working expenses (Vary directly with turnover)			
Raw material costs/purchases	6,000,000	6,500,000	
Packing	200,000	200,000	
Carriage	150,000	150,000	
Postage & freight	100,000	100,000	
Bad debts	50,000	50,000	
Other ?	0	0	
Other ?	0	0	
<b>Total uninsured working expenses</b>	<b>6,500,000</b>	<b>7,000,000</b>	
Plus			
Opening stock	450,000	550,000	
Plus			
Opening work in progress	100,000	100,000	
<b>B</b>	<b>7,050,000</b>	<b>7,650,000</b>	
Annual Insurance gross profit (A - B)	<b>3,550,000</b>	<b>4,050,000</b>	

# BI Sum Insured – Example 1

Ashton Chemicals has a financial and insurance policy year from 1st January – 31<sup>st</sup> December.

Maximum Indemnity Period = 18 months

New PDBI Insurance policy starts from 1<sup>st</sup> January 2020

The latest set of accounts are for the financial year ended 31<sup>st</sup> December 2018.

## Projections:

Year-end 31 Dec	Insured Profit	% change YOY	Sum Insured for 18 months
2018	\$ 660,000		2021 Insured Profit = \$ 745,940
2019	\$ 693,000	+ 5%	2022 Insured Profits = \$ 391,603 (For 6 months)
2020	\$ 713,790	+ 3%	
2021	\$ 745, 940	+4.5%	
2022	\$ 783,206	+5.5%	
			<b>Total = \$ 1,137,543</b>

## BI Sum Insured – Example 2

The past 05 years accounts of Amlin Cement and the corresponding returns of insured profit earned are provided to the insurers. The insured has plan to increase production and is installing a new production line which will be operational by 31<sup>st</sup> December 2019. Some of this is very sophisticated and the replacement time, including commissioning, is longer than was the case for the existing plant.

The Insured and the intermediary have reviewed the indemnity period and asked the insurer to extend from **18 to 24 months**. The financial year ends on 31<sup>st</sup> December, which is also the renewal date.

The 2015-2019 accounts show a 5% year-on-year expansion in insured profit over the past five years. For the period 1 Jan 2019 to 31 Dec 2019 the insured profit was \$ 1,200,000. The cover is being reviewed prior to renewal on 31 Dec 2020 and the accounts for 2020 are not yet payable.

The Insured anticipates that the new line will boost insured profit by a further 10% per year, in addition to the general 5% year-on-year trend.

**What should be the Sum Insured be for the 31 December 2020 to 31 December 2021 period of Insurance**

# BI Sum Insured – Example 2

## Projections

Accounts	Amount in USD
Last Certified Insured Profit 1 Jan 2019 – 31 Dec 2019	1,200,000
1 Jan 2020 – 31 Dec 2020	
1 Jan 2021 – 31 Dec 2021	
1 Jan 2022 – 31 Dec 2022	
1 Jan 2023 – 31 Dec 2023	
Total Sum Insured	

# **BI Indemnity Period**



# Indemnity Period

## Definition:

The period beginning with the occurrence of the incident and ending not later than the Maximum Indemnity Period thereafter during which the results of the business shall be affected.

**The Maximum Indemnity Period** (number of months) is stated in the specification of the policy, the usual minimum being 12 months. Choosing of an adequate maximum indemnity period is crucial

*The indemnity of the insurer will be limited either by the **sum insured** stipulated in the policy and evaluated as set out beforehand or by the time agreed to represent the **maximum indemnity period**.*

# Indemnity Period

Factors Influencing the setting of the maximum IP

**Availability of  
Alternate Premises**

**Availability of Raw  
Material**

**Manufacturing the  
Product in another  
group's factory**

**Time Lag in the  
replacement of  
Machinery**

**Estimated Time to  
Recover Customers**

**Ease of Repair or  
Replacement of  
Existing Premises**

# **Business Interruption Policy Wording & Schedule**

# BI Insuring Clause

## Insuring Clause

This Section will *indemnify* the Insured in respect of **interruption or interference** with the Business carried on by the Insured as a consequence of Damage to the Insured Property occurring during the Period of Insurance which is

- (i) Insured by Section 1 Property Damage, or
- (ii) Otherwise insured by a policy covering the interest of the Insured in such property against such damage.

and under which the insurers thereof have paid or admitted liability.

# BI Basis of Cover

## Indemnity

The amount payable as indemnity hereunder shall be;

### (a) In respect of loss of Gross Revenue

The amount by which the **Gross Revenue** during the Indemnity Period falls short of the **Standard Gross Revenue** which would have been achieved had the interruption or interference not occurred.

### (b) In respect of Increase in Cost of Working

The **additional expenditure** necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the reduction in revenue which without such expenditure would have taken place during the indemnity period but not exceeding the amount of the reduction in revenue thereby avoided or diminished.

**Less:** Any sum saved during the Indemnity Period in respect of such charges or expenses of the Business payable out of the Gross Revenue as may cease or be reduced in consequence of the damage.

# Material Damage Proviso

No claim is admitted under a business interruption policy unless the interruption has been caused by material damage for which property insurers have accepted liability, or would have accepted liability, but for the operation of deductibles.

## Wording:

“Provided that... there shall be in force an insurance covering the interest of the insured in the property...and that payment shall have been made or liability admitted...”

# Material Damage Proviso

The material damage proviso is a vital feature of BI insurance, because

- It secures for the BI cover the protection of all the conditions, clauses and warranties stipulated in the material damage section. Without such proviso the relevant wordings of the material damage policy would have to be incorporated into the BI wording itself.
- Material Damage and BI are intended to go together. In case of breach of warranty there will be no payment under either policy!
- A small material damage loss may well be within the deductible (or excess) of the material damage cover and, thus not payable by this insurance, but it could have a serious impact on the production, resulting in huge legitimate claims under the BI cover

# Increased Cost of Working

## Definition:

Increased Cost of Working is an ***additional expenditure*** necessarily and reasonably incurred for the sole purpose of ***avoiding or reducing the shortfall in turnover*** during the indemnity period.

An insured's increased cost of working will be covered by insurers as long as it does not exceed the **economic limit**.

**Economic Limit:** Insurers are not prepared to pay more as "Increase in Cost of Working" than the sum produced by applying the Rate of Gross Profit to the amount of the reduction thereby avoided.



# Basic Underwriting Features

1. source of business / leader
2. name of insured account
3. location address (es)
4. Occupancy
5. protection/ construction information
6. material damage policy in force / material damage proviso
7. perils insured against ( should be the same as material damage policy)
8. period of Insurance
9. indemnity period
10. total sum insured / limits, sub-limits
11. deductibles in days or amount
12. loss history (5 years at least, MD & BI)
13. MD/BI MPL, survey? bottlenecks? contingency planning?
14. Extensions (e.g. suppliers or customers)

# **Business Interruption Insurance - Extensions**

# BI Insurance Extensions

## Alternative Premises

If during the Indemnity Period **accommodation** shall be provided or **services** shall be rendered **elsewhere than at the site** for the benefit of the Business either by the Insured or by others on their behalf, the money paid or payable for such accommodation or services shall be brought into account in arriving at the estimated revenue during the Indemnity Period

## Denial of Access

Loss resulting from interruption or interference in consequence of physical loss or damage as covered herein to property of a type not excluded herein and **within 5 km of the Property Insured site whether the property of the Insured has been damaged or not which shall prevent the use of the premises or access** thereto whether the premises or property of the Insured therein shall be damaged or not shall be deemed to be loss as covered by this Section provided that the liability of Insurer shall not exceed the first number of days (waiting period) of any one occurrence in excess of the Deductible.

# BI Insurance Extensions

## **Material Damage Waiver**

It shall not be a condition precedent to the Insurers liability in respect of interruption or interference with the Business that payment shall have been made or liability admitted under Section I of this Policy if no such payment shall have been made nor liability admitted solely due to the operation of the Deductible under Sections I, or due to a party other than the Insured accepting responsibility for the loss or damage which would otherwise have been so covered.

## **Rent**

Rent relating to any property (for which a commitment to insure arises as a result of the provisions of any lease or other agreement) or any part thereof which is rendered unfit for use in consequence of its loss destruction or damage for the period indicated in such lease or other agreement subject to the limit stated in the Risk Schedule for this item.

# BI Insurance Extensions

## **Authorities clause/ Interruption by Civil or Military Authorities**

It is hereby understood and agreed that, with respect to property insured under Section 1, except as specifically stated herein, Insurers shall not be liable for loss or damage, costs, expenses, fines, or penalties incurred, sustained by or imposed on the Insured at the order of any Government Agency, Court, or other Authority arising from any cause whatsoever. However, in respect of Section 2 hereunder, the coverage is extended to include any increase in the actual loss sustained by the Insured, resulting directly from an interruption of business covered hereunder, during the length of time not exceeding 30 days, when as a direct result of loss or damage to the Property Insured resulting from a cause not excluded under Section 1 of the policy, access to the premises or commencement of repairs is delayed at the order of any Government Agency, Court, or other Authority. Provided that, after the application of all the terms; conditions and provisions of this Section 2 of the Policy the liability of the Insurers shall not exceed the Sum(s) Insured in respect of this Section 2 of the Risk Schedule.

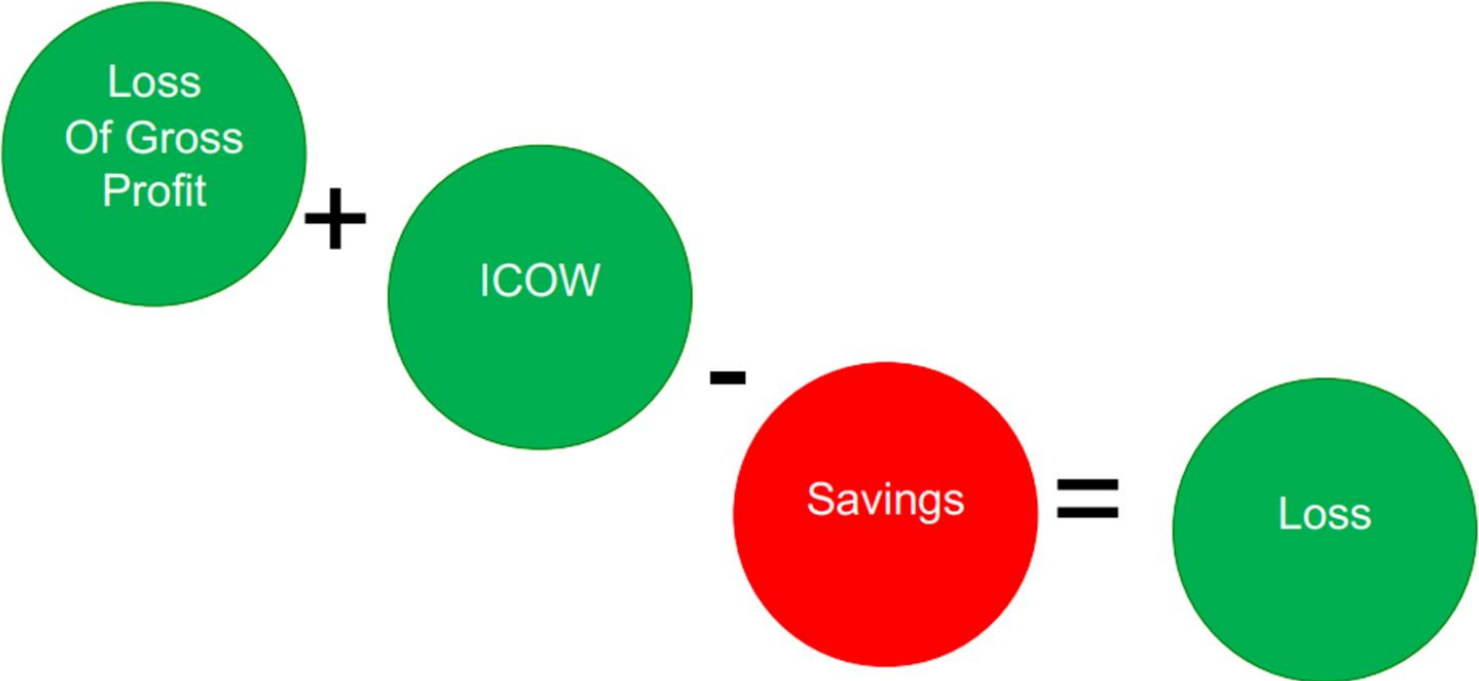
## **Suppliers and Customers**

The Insurance by this Section extends to include loss resulting from interruption of or interference with the Business in consequence of physical loss or damage caused by Fire, Lightning, Explosion and Aircraft only at the premises of Named and Agreed Suppliers and Named and Agreed Customers provided that after the application of all other terms conditions and provisions of the Policy the liability under this Memorandum in respect of any one Occurrence shall not exceed the limits stated in the Risk Schedule for this item.

# **Business Interruption Insurance Claims**

# Business Interruption Insurance Claims

## Components of claim



Subject to average if applicable

# BI Loss Calculation

**The rate of gross profit is the key!**

It indicates how the loss of gross profit due to reduction in turnover is to be calculated.

**Formula (for Gross profit as % of turnover) = Gross Profit / Turnover x 100**

The percentage produced by the formula is applied to the lost turnover and the result – after the necessary adjustments – is as nearly as possible the correct indemnity for paying the standard charges.

The payroll and the net profit that would have been achieved if the incident had not occurred.



# BI Loss Calculation

**But how is the lost turnover established?**

By comparing the turnover after the incident with the “standard turnover”

**Definition of Standard Turnover:**

*The turnover during that period in 12 months immediately before the date of the incident which corresponds with the indemnity period.*

*In order to determine the amount of lost turnover the actual turnover after the incident must be compared with the turnover of the same period before the incident.*

# BI Loss Calculation - Example

## Business Interruption following Fire Incident at Plant

Indemnity Period	:	10 months
Annual Turnover 2021	:	GBP 60,000,000
Gross Profit for the year 2021	:	GBP 12,000,000
Rate of Gross Profit	:	<b>20%</b>
Date of Loss	:	1 <sup>st</sup> January 2021
Standard Turnover (Jan-Oct 2020)	:	GBP 51,000,000
Less Turnover achieved (Jan – Oct 2021)	:	GBP 17,200,000
Reduction in Turnover	:	<b>GBP 33,800,000</b>
Loss of Gross Profit	:	<b>GBP 6,760,000</b>
ICOW	:	GBP 1,000,000
SAVINGS	:	GBP 50,000

**FINAL CLAIM  
PAYABLE  
GBP 7,710,000**

# **Current Insurance Market Trends & Developments**

# Current Insurance Market Trends & Developments

- Appointment of Forensic Accountants for BI Claim Assessment
- Insurers are more concerned on Declared BI Values
- Business Interruption Studies
- Modern BI Policy Form are on the basis of Declaration-Linked Basis
  - Estimated Gross Profit
  - No Average to apply
  - Usually provide cover up to 130% on Monthly Declared values and up to 120% on Annual Declared Value (**BI Volatility Clause**)

**Thank You**