Business Interruption Guidance

Whilst Property insurance covers the physical assets of a business (that is, Buildings, Machinery, Stock, etc.), Business Interruption (BI) insurance covers the lost profit / income following a loss or damage to the physical business assets.

Two items are critical in ensuring BI insurance is arranged correctly; the **Indemnity Period** and the **Sum Insured**.

The Indemnity Period
The Indemnity Period (IP) selected should represent the maximum time that can reasonably be anticipated for a business to be financially affected by an insured loss.

Factors that may impact the length of IP include:

- Demolition of the existing building and site clearance
- Building design, planning permission and tendering
- The actual construction
- The replacement of equipment and machinery, including specialist items
- The replacement of stock
- Restoring supplier and customer base

It is important for a 'worst case scenario' to be envisaged when deciding an adequate IP to ensure that the BI policy will provide cover until the business achieves the same operational level that it would have reached if there had not been the loss.

The Sum Insured
There are different methods of calculating a BI sum insured. This depends on the type of business involved.

Gross Profit
This basis of cover is the most common and is often used for manufacturing risks or those risks which carry large amounts of stock.

The definition of Gross Profit is typically given as:-

Annual turnover, plus closing stock, plus work in progress
LESS
The sum of the amount of the Opening stock, plus work in progress plus the amount of the uninsured working expenses set out in the policy

Whilst the precise definition of 'uninsured working expenses' may vary from insurer to insurer' it is often considered to be any expense that varies in proportion to turnover.

Depending on the insurers policy wording it may include discounts, bad debts and any items described in the policy schedule. Obviously if items are not mentioned in the definition of 'uninsured working expenses' then they will need to be insured.

When an accurate and current Gross Profit figure has been calculated it must also be adjusted upwards to reflect anticipated growth in the business during the period of insurance and for the IP. An important point to bear in mind is that it is possible for a loss to occur on the last day of the period of insurance.

Gross Revenue / Gross Income / Gross Fees
This basis of sum insured is most suitable for professional firms, institutions and others who tend to focus on the provision of services.

This type of insurance will typically extend cover to the total turnover of the business and there may be few, if any, uninsured working expenses.

Gross Rentals
This basis is most commonly used for property owning risks when, typically, there is the need to protect against the loss of rental income following an insured loss.

Increased Cost of Working (ICOW)
It does not provide any cover for loss of income or gross profit. The increased cost of working is included as an option in the settlement of both a Gross Profit and Gross Revenue loss. This is often described as expenditure necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the reduction of turnover following a loss.

However, ICOW only cover may be purchased separately but the basis of the sum insured is only suitable for certain businesses.

This cover is for reasonable costs paid out to avoid or minimise a reduction in turnover in the event of a loss.

This could include:

- The rental of temporary premises or equipment, the expense of moving equipment, the cost of cleaning and utility costs at the temporary premises.
- The uninsured cost of equipment purchased
- The cost of outsourcing labour, special bonuses and overtime payments
- The cost of rental cars and additional transport for employees

The insurers will always apply a pragmatic approach; any insurance claims payment made will not exceed the amount of income/gross profit that is saved, sometimes known or referred to as the Economic Limit.

Additional Increased Cost of Working (AICOW)
In some circumstances businesses will want to do everything possible, even in excess of the Economic Limit to maintain production. The AICOW amount can be included as an additional item to the main basis of BI cover. Whilst the additional increased cost of working must invariably be necessarily and reasonably incurred there may well be no pre-agreed limit.

Other Extensions
Business Interruption cover can be extended to include Customers and Suppliers Extensions and Contract Works Extensions.

Important Note: The cover summaries above are not exhaustive. They provide an outline of the covers generally available. Please contact us if you require further, detailed information or information concerning covers not shown here.