Basically Business Interruption Again

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How does the cover work?

THE BASIC BUSINESS INTERRUPTION BOOK

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CILA

How does the cover work?

- Once the trigger established
- How long will cover last – chosen Maximum Indemnity Period
- Usually starts on date of damage
- After incident normally 3 business impacts aligned to cover

Impact	BI cover
Revenue reduces	Loss of Gross Profit or Revenue
Costs increase	Increase in Cost of Working
Costs decrease	Savings

Calculating BI Indemnity

- Most common forms are Gross Profit or Gross Revenue (Income)
- Both forms start with a reduction in turnover
- Gross Profit form in addition to savings deducts costs assumed to reduce with turnover. Specified in wording as uninsured
- If this assumption is correct then both forms will produce the same result
- Policy wording sets out the calculation as follows:

The Steps

Gross Revenue	Gross Profit
Expected turnover	Expected turnover
Deduct actual turnover	Deduct actual turnover
Reduction in turnover	Reduction in turnover
	Apply Rate of Gross Profit (in wording)
	Loss of Gross Profit
Add – Increased Costs	Add – Increased Costs
Deduct - Savings	Deduct - Savings
BI Loss	**BI Loss**

Turnover Terminology – Standard Turnover

Standard Turnover – turnover in corresponding period from previous year (normally net of VAT)

If damage occurred 1st January 2020, repaired February 2020 business recovered 30 April 2020

Standard Turnover = 1st January to 30th April 2019

This allows for seasonality but the business may have changed

Most policies require trends, variations or other circumstances adjustment

Turnover Terminology – Adjusted Standard Turnover

After adjustment for trend

Trend can be positive or negative

Will vary considerably depending on data used – weekly, monthly, 1,2,3 years

Trends do not carry on forever

No requirement to use same trend for each month of IP

Might be calculable but doesn't make sense

Need to understand the individual business

Trend

	Year	Turnover £
	2018	1,165,775
	2019	1,096,355
Downward trend		**- 5.95%**

Turnover Terminology – Actual Turnover

WHAT THE BUSINESS ACTUALLY ACHIEVES AFTER THE DAMAGE (NORMALLY NET VAT)

SHOULD INCLUDE AT THE PREMISES BUT ALSO ANYTHING MADE GOOD AT OTHER SITES REQUIRED WORDING UNDER ALTERNATIVE TRADING CLAUSE

INCLUDE INTERNET SALES

BESPOKE MANUFACTURERS OF LUXURY GOODS MAY WAIT SO TURNOVER IS DEFERRED NOT LOST. IF DEFERRED CONSIDER IF IN OR OUTSIDE MAXIMUM INDEMNITY PERIOD

STANDARD TURNOVER LESS ACTUAL TURNOVER = REDUCTION IN TURNOVER

Match the Turnover terminology!

A) Reduction in turnover

B) Standard Turnover

C) Adjusted Standard Turnover

D) Actual Turnover

1. Standard turnover after application of trends or variations

2. The turnover achieved

3. Deduct Actual Turnover from Adjusted Standard Turnover

4. Turnover in the period corresponding with the IP from the previous year

Gross Profit Calculation

Needs to be calculated after loss in order to arrive at the Rate of Gross Profit which has to be applied to reduction in turnover

Set out in policy. Normally states that the following should be <u>deducted</u> from Turnover to arrive at Gross Profit

Purchases (adjusted for movement in stock)	Carriage, packing and freight	Bad debts

Gross Profit declarations in accounts <u>do not</u> follow this definition - this leads to major confusion and under-insurance

What is Gross Profit?

- No accounting or statutory definition
- More costs normally deducted in calculating Gross Profit for accounts than for insurance e.g. wages - normally the largest cost to a business. Single biggest cause for underinsurance.
- Insurance Gross Profit normally defined as turnover less uninsured (specified) working expenses adjusted for stock movement
- Another bear trap is what is meant by purchases – just raw materials or including goods, services and even plant and machinery
- Different “departments” of a business may have different rates of Gross Profit – Departmental Clause

P & L Account for year ended 31.3.2019

	£	£
Sales		2,562,500
Opening Stock	15,048	
Purchases	917,775	
Cleaning	65,000	
Other Costs	26,136	
Wages	724,952	
Less Closing Stock	(25,000)	
Cost of Sales		(1,723,911)
Gross Profit		**838,589**
Admin Costs		(306,040)
Net Profit		532,549

Policy Gross Profit – definition turnover less purchases adjusted for movement in stock

	£	£
Sales		2,562,500
Opening Stock	15,048	
Purchases	917,775	
Less Closing Stock	(25,000)	
Cost of Sales		907,823
Policy Gross Profit		**1,654,677**

Calculating the Rate of Gross Profit

- Using the previous slide

$$\frac{\pounds 1{,}654{,}677 \times 100}{\pounds 2{,}562{,}500} = 65.57\%$$

$$\frac{\text{Gross Profit (policy)} \times 100}{\text{Turnover/Sales}} = x\%$$

Departmental Clause – different products with different rates of gross profit. More specific rate may be more applicable

Increase in Cost of Working

Costs should be

- Reasonable
- Necessary
- Solely to avoid reduction in turnover

There must be an actual cash increase in cost incurred

Economic limit – can spend £1 to save £1 and no more

The reduction in turnover avoided must be inside the MIP

If an expense deliberately uninsured can't be an ICW

AICOW

No economic limit

Reasonable/necessary

Test Yourself – Are they ICW's? Yes or No?

1. A holiday booked before the loss has to be cancelled? NO
2. Security Guards. NO
3. Cost of a project manager to drive the mitigation plan YES
4. Cost of training employees to use new equipment. YES
5. Cost of recruiting a new CEO after the current one collapses with stress after a large fire NO
6. Wasted cost of advertising in the week before a large fire NO
7. Overtime payments to employees to recreate destroyed stock after an incident YES

Deductions/Overlap/Interim Payments

- Savings e.g. utilities
- Proportionate Reduction - a different term for Average
- PD and BI can overlap:
  - If stock PD valuation = purchases no overlap. But if stock valuation = purchases plus admin and distribution then double counting as same overheads included in BI claim. Insurers will not pay twice
  - If finished stock valued at selling price then turnover paid in stock claim should be deducted from Adjusted Standard Turnover
- Interim Payments – cash flow
- Salvage sale – may be sold but at lower profit

Declaration Linked Policies

Traditional policies on a difference basis and subject to Average

Declaration linked not subject to Average

Based on “estimated” and sum insured is 133.33%

This up lift is for unanticipated growth at the time of the claim

The declared amount should not be less than the amount at risk

CILA survey (2017) found 44% of declaration linked were underinsured and when understated degree pf adequacy 44%

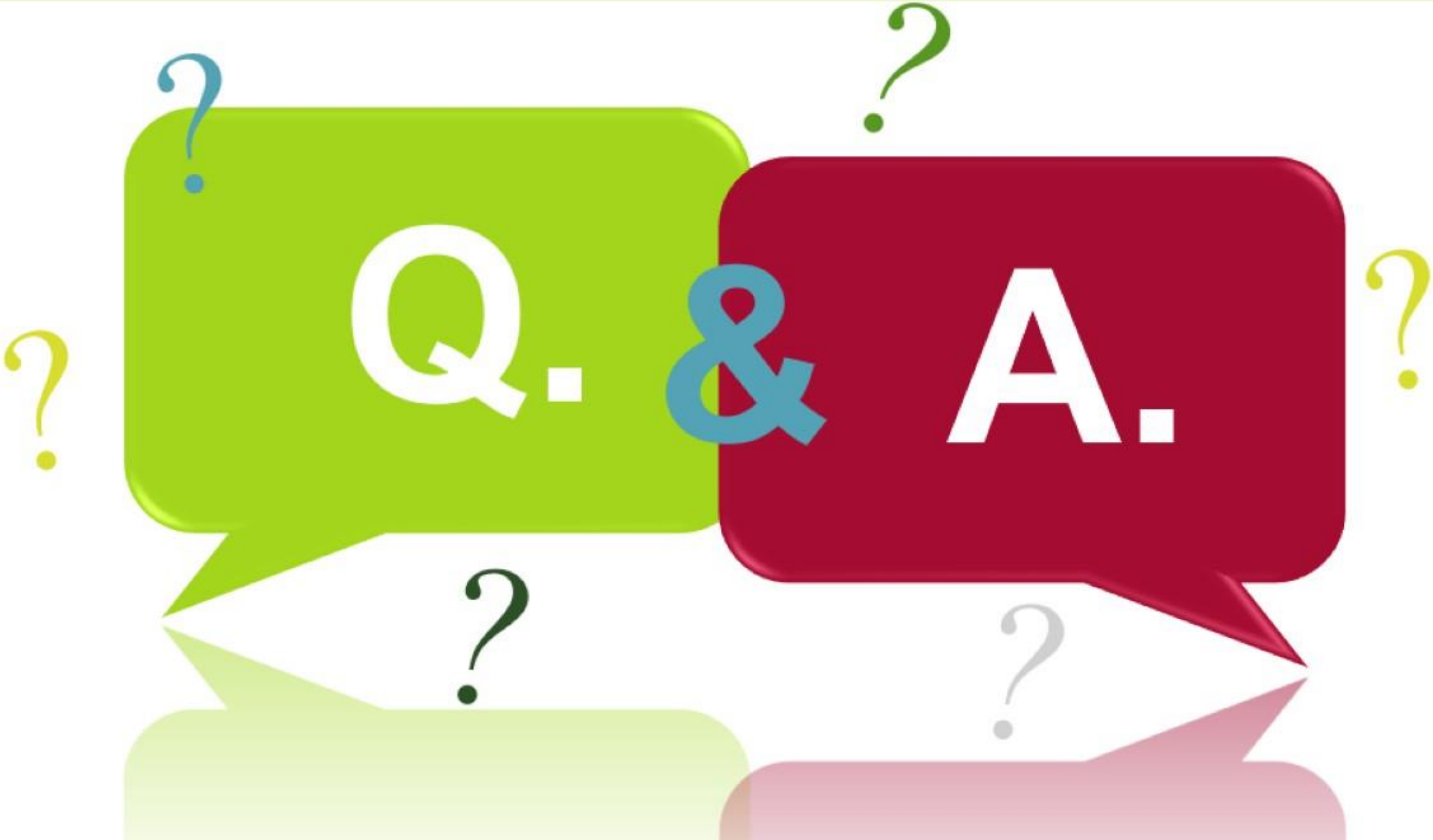
Deliberate breach of Fair Presentation - Insurance Act 2015

Conclusion

CONSIDER WHETHER COVER APPLIES FIRST

PRO-ACTIVE MITIGATION RATHER THAN RETROSPECTIVE MEASUREMENT

SENSE CHECK THE CALCULATIONS REGARDLESS OF ARITHMETICAL CORRECTNESS


Q. & A.

Thank you for attending!
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