



Claims Perspective on Business Interruption

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Housekeeping



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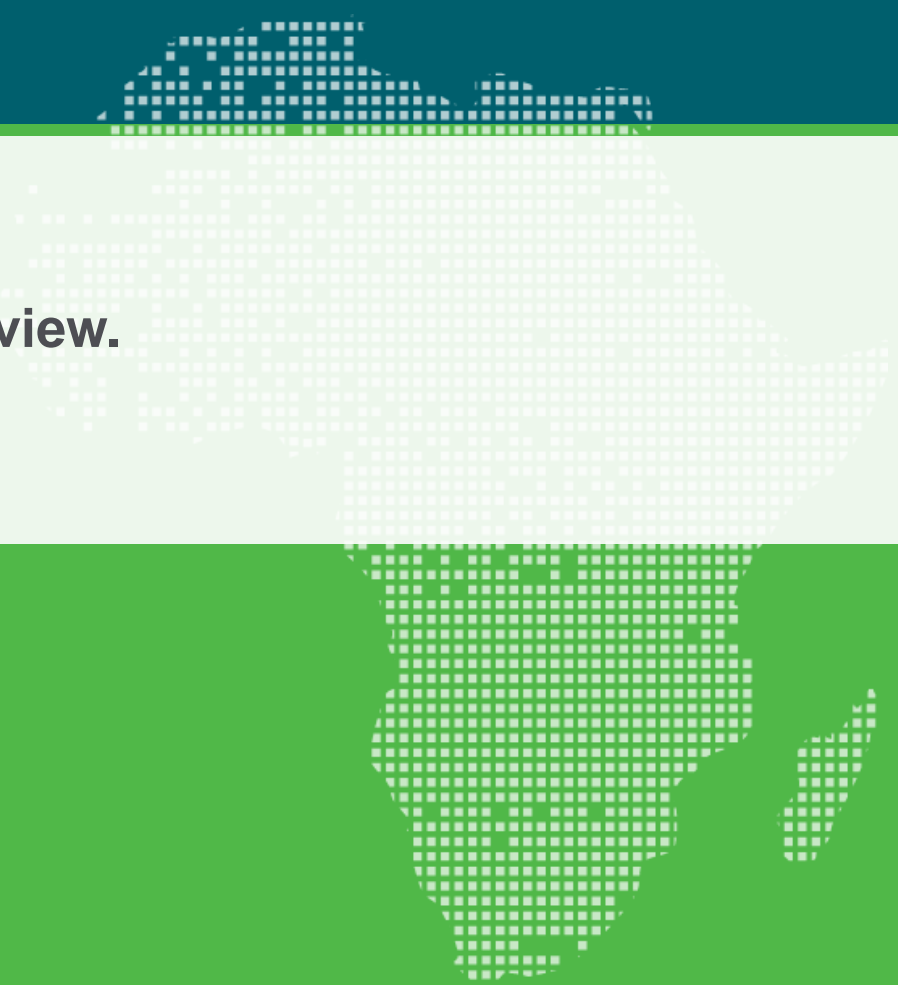
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Business Interruption Overview.

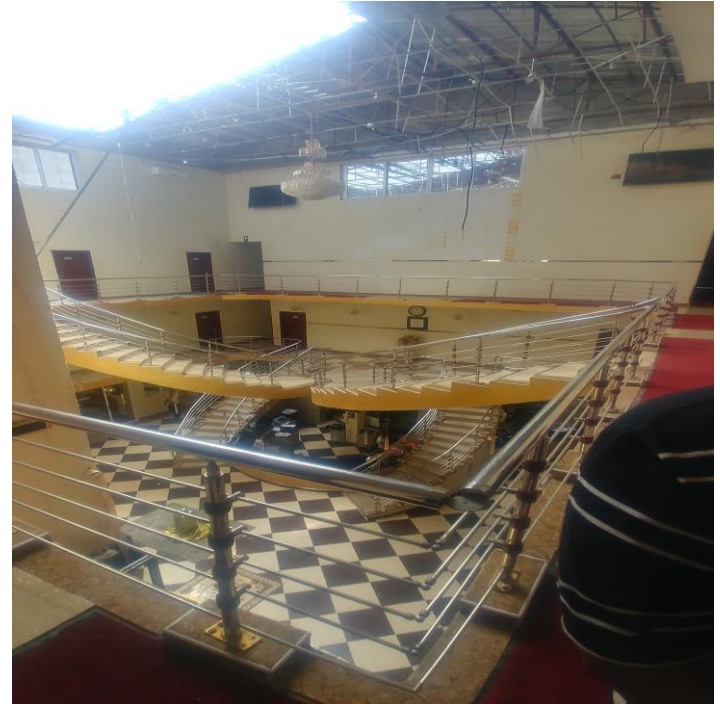


Loss of Income is Dangerously Underestimated

www.sundaytimes.co.za May 19 2019

All that remains after a devastating fire broke out at Clover Factory in Estcourt, KwaZulu Natal, South Africa, on March 13, 2019

A Hotel in Beira after Cyclone Idai made landfall in Mozambique March 14 and 15, 2019.



Business Interruption – Claims Issues

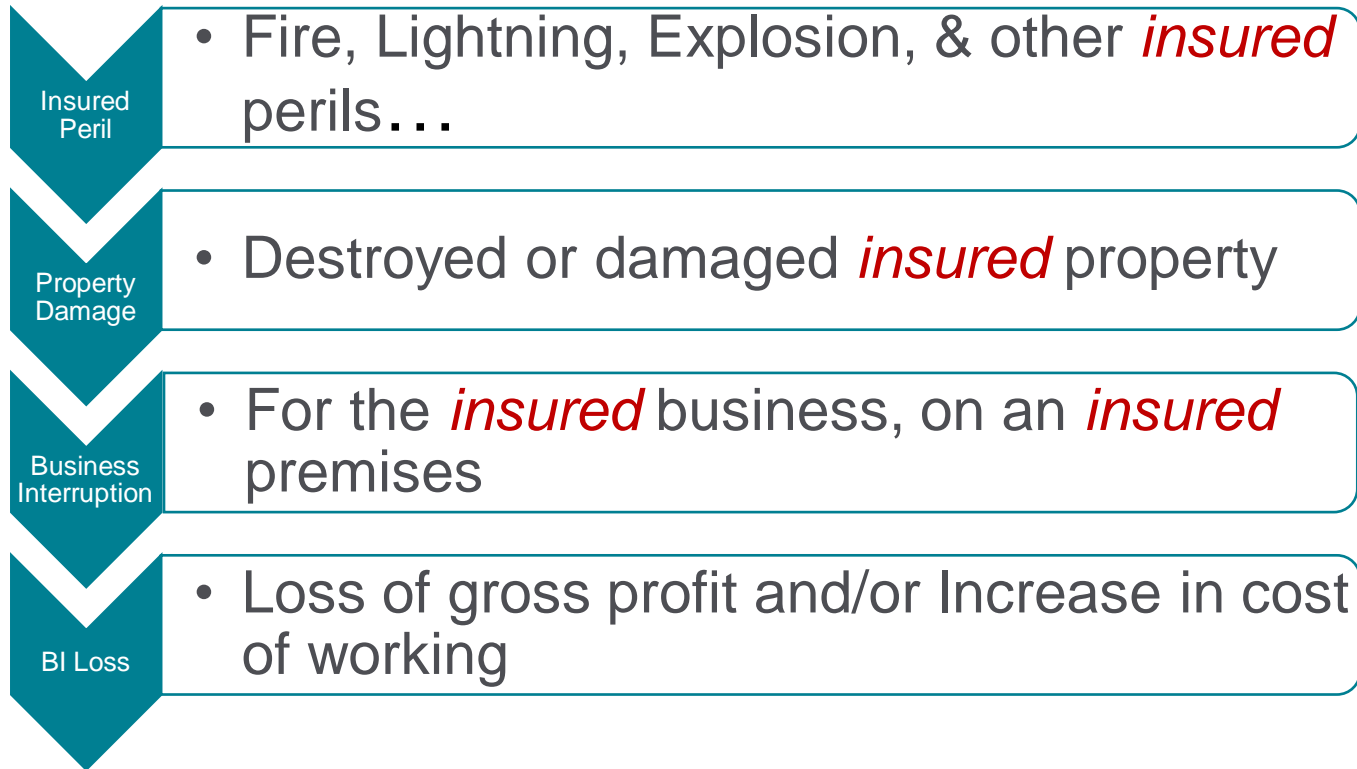
- ❖ Formulation of the business interruption losses.
- ❖ Adequacy of the sum insured.
- ❖ Public adjusters.
- ❖ Understanding of the cover provided by the policy.
- ❖ Application of deductibles.
- ❖ Claims preparation costs.
- ❖ Loss adjusters.

What is Business Interruption insurance?

So, the decision has been made to purchase BI Insurance...

The Objective of the BI Insurance is to pay:.....

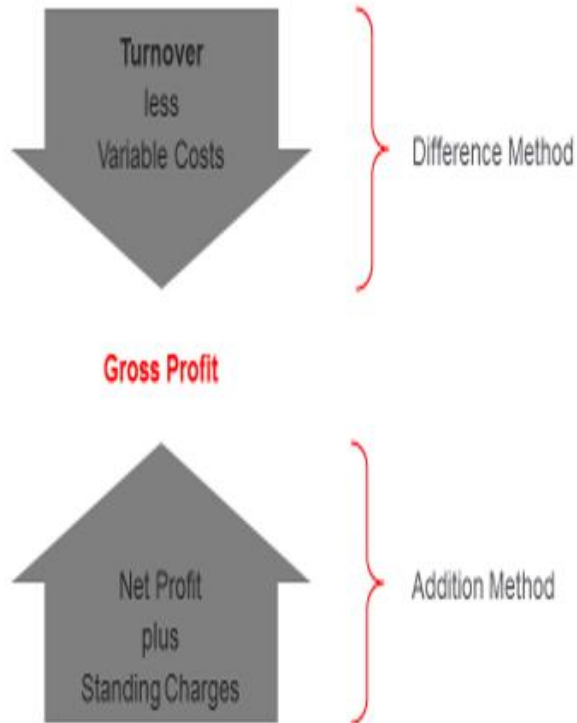
The loss of Gross Profit/ Gross Revenue or Fees resulting from interruption of the insured **Business** in consequence of **Material Damage of Property** used by the insured at the **Premises** for the purpose of the **Business** caused by operation of an **Insured Peril**.



How Business Interruption Insurance Works

- ❖ In case of Business Interruption Loss, the insured should be indemnified in such a way as if no loss had occurred(**Principle of Indemnity**)
- ❖ “Actual loss sustained and no more, no less ”, all material circumstances considered.
- ❖ The “trends” or special circumstances” clause - Unique feature of traditional BI cover allows for upward or downward adjustment provision trends of the business when arriving at settlement. So, if an insured were in a rapidly expanding business with a clearly demonstrable growth potential, and assuming the limits had been correctly arranged, they could expect a settlement based upon a figure far higher than their current turnover. On the other hand, a declining trade could expect a settlement based upon a reduced turnover from that currently being earned.

Determining the Gross Profit Sum Insured



Two approaches for calculating Gross Profit:

1. The Difference basis

$$\text{Gross Profit} = \text{Turnover less Variable Charges}$$

or

2. The Addition basis / Standing Charges basis

$$\text{Gross Profit} = \text{Net Profit plus Specified Standing Charges}$$

- The gross profit sum is always based on a 12 months trading period, and adjustments can be made to this 12 months figure depending on circumstances.

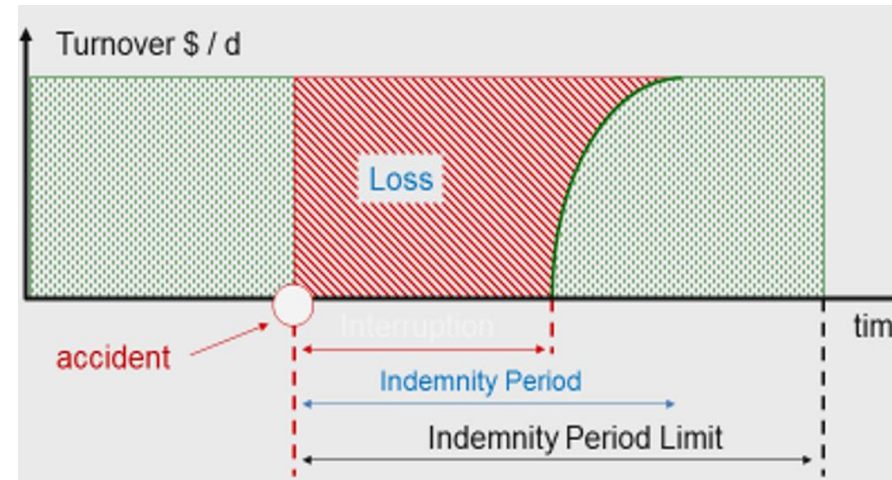
Advantages of the “Difference Basis” Specification.

- ❖ **Easier** to understand and explain.
- ❖ Allows for **adequate Sum Insured**, allowing for fluctuations due to the expansion or otherwise in the amount either of individual Standing Charges or of the Net Profit.
- ❖ **New Standing Charges** are automatically included.
- ❖ **Non-recurring items** are properly reflected within the composite figure of Gross Profit.
- ❖ **No need for debate** on which costs are to be or not to be “a Standing Charge” or Fixed Cost.
- ❖ It clearly specifies which charges (i.e. **Uninsured Working Expenses**) are to be uninsured , leaving no margin for dispute in the event of a claim.

PERIOD OF INSURANCE AND THE INDEMNITY PERIOD

BI policy liability is limited by time, referred to as the Indemnity Period, as well as by a monetary amount (sum insured or loss limit.)

- ❖ Period of Insurance – the annual period during which the insurance company bears the risk eg 01.07.2017 to 30.06.2018
- ❖ Indemnity Period Limit – determined at the time of policy inception as representing the insured’s estimation of the *maximum period* required for normal business operation to be restored, ALTERNATIVELY the *Maximum Indemnity* period during which the *results of the Business* may be *affected or interrupted in consequence of a damage*
 - say Indemnity Period Limit is 6 months
 - if loss occurs on 01.10.2018, the IP will be 01.10.2018 to 31.03.2019
 - Bears no relation to the period of insurance except that the loss incident should occur with the period of insurance
- ❖ Indemnity Period – the period beginning with the commencement of the Damage and ending not later than the Indemnity Period Limit stated in the schedule during which the results of the business are actually affected in consequence of the damage



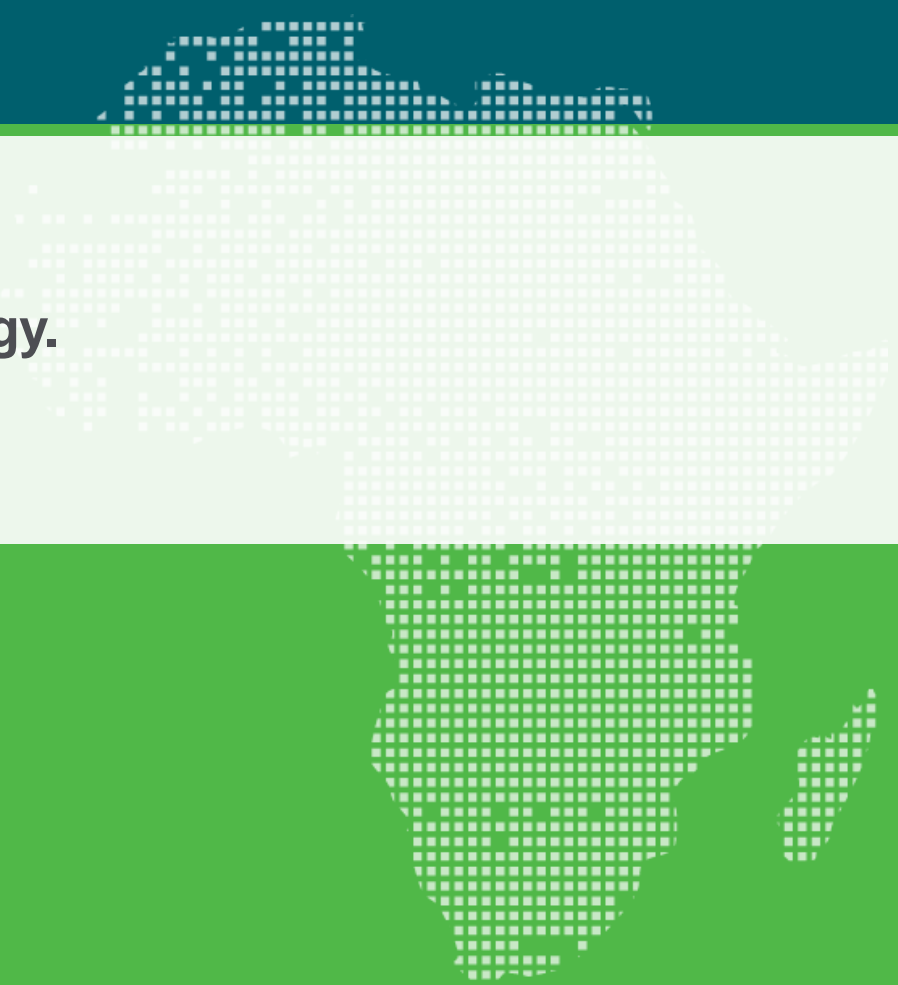
“The additional expenditure necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the reduction in Turnover which but for that expenditure would have taken place during the Indemnity Period in consequence of the damage, but not exceeding the sum produced by applying the Rate of Gross Profit to the amount of the reduction thereby avoided”

Economic Limit!

(Spend up to a Rand to Save a Rand)

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Clauses and B.I Methodology.



- **Rate of Gross Profit**: - The Rate of Gross profit earned on the turnover during the financial year immediately before the date of the incident
- **Annual Turnover**: - The Turnover during the twelve months immediately before the date of the incident
- **Standard Turnover**: - The Turnover during that period in the twelve months immediately before the date of the incident which corresponds with the Indemnity Period

Special Circumstances Clause

To which such adjustments shall be made as may be necessary to provide for the **trend** of the Business and for **variations** in or **other circumstances** affecting the Business either before or after the Incident or which would have affected the Business had the Incident not occurred, so that the figures thus adjusted shall represent as nearly as may be reasonably practicable the results which have been obtained during the relative period after the incident.

Clauses and Definitions.

Alternative trading clause

- ❖ If during the indemnity period , goods shall be sold or services shall be rendered elsewhere than at the premises for the benefit of the business either by the insured or by others on his behalf the money paid or payable in respect of such sales or services shall be brought into account in arriving at the turnover during the indemnity period.

Departmental Clause

- ❖ If the business be conducted in departments the independent trading results of which are ascertainable, the gross profit shall apply separately to each department affected by the incident.

Material Damage Proviso

- ❖ “Provided that at the time of the happening of the Damage there shall be **In Force an insurance covering the Interest of the insured in the Property** at the premises against Damage and that **Payment shall have been made** or **Liability admitted therefore under such insurance**.

Standard Turnover

— Actual Turnover

≡ *Reduction in Turnover*

✘ Rate of Gross Profit

≡ *Loss of Gross Profit*

+ Increase in Cost of Working

— Savings in Standing Charges

≡ Amount payable as **indemnity**
(Subject to average)

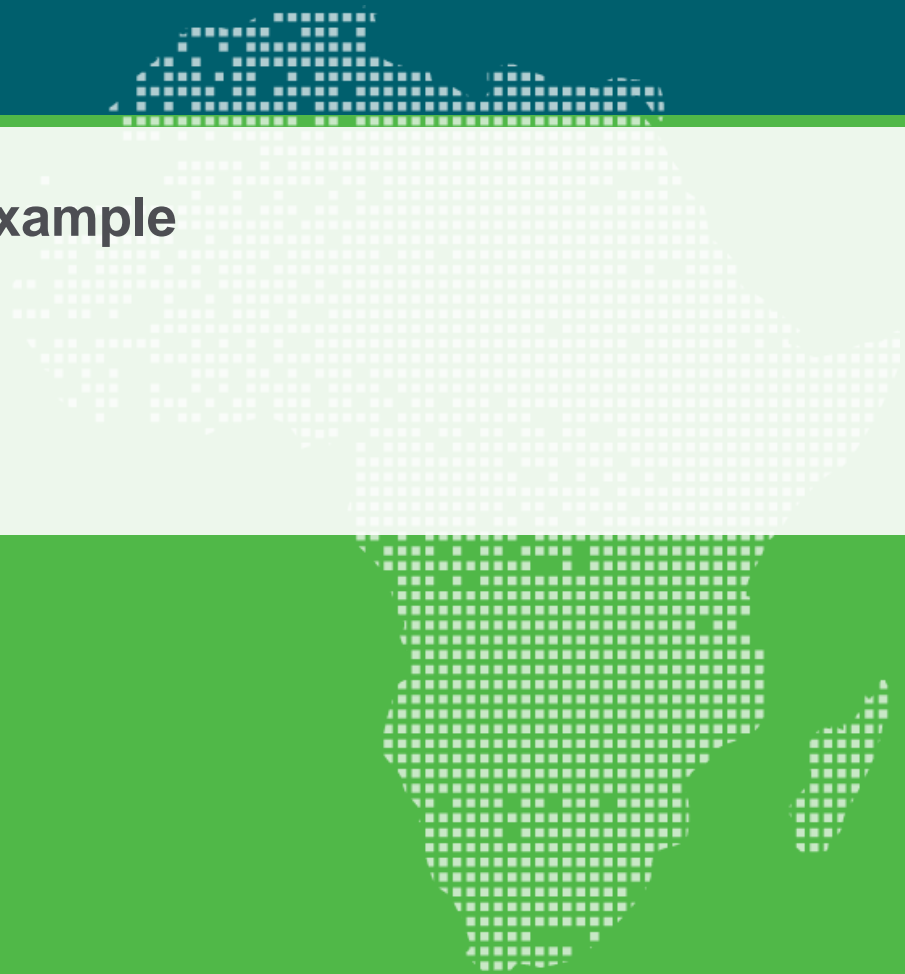
Basic BI calculation.

Basic B.I loss

Description	Amount
	Rand'000
Expected sales	250,000
Less: Actual sales	(150,000)
Loss of sales	100,000
Rate of gross profit	60%
Loss of gross profit	60,000
Increased costs of working	10,000
Savings	(5,000)
Total business interruption loss	65,000
Underinsurance	75%
Total gross loss after underinsurance	48,750
Less: Deductible	(20,000)
Total net of deductible	28,750

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XYZ B.I Loss Calculation Example



XYL Limited Business Interruption loss

Loss Information

Damage take place - April 1 .Business interrupted for seven months (April 1 to October 31).

Turnover in last financial year - December 31 - was R 600 000.

Gross Profit as defined in the specification for the same period totalled= R 132 000.

Therefore the Rate of Gross Profit in the last financial year was 22%.

Sum insured on Gross profit - R 125 000 . Maximum Indemnity Period - 12 months.

Standard Turnover (April to October in year before the damage) – R 280 000.

Turnover during period of interruption – R 52 000

Loss Information

Annual Turnover (twelve months immediately before the damage) - R 650 000.

Increase in Cost of working incurred – R 11 000.

Savings in insured charges and expenses – expenses R 13 000.

In consequence of increased production at lower labour cost, resulting from the installation of new machinery since the end of the last financial year, and an expansion of sales , it is agreed to make two adjustments under the provisions of the circumstances clause: To increase the rate of gross profit from 22% to 25% .To increase the standard turnover by 10%

Calculation of Business Interruption Claims Solution

Clause(a)- Loss of Gross Profit

Standard turnover(seven months-

April to October year before the damage) 280,000

Agreed increase of 10% under other circumstance clause 28,000

Adjusted standard turnover 308,000

Less turnover maintained during the indemnity period 52,000

(April to October)

Reduction in turnover 256,000

Rate of gross profit after agreed adjustment(25%),applied to (256,000)

Loss of Gross Profit **64,000**

Calculation of Business Interruption Claims(Contd.)

Clause(b)- Increase in cost of working

Additional expenditure incurred – R11,000

(Assume further that these expenses were reasonable and necessary, and for the sole purpose of avoiding or reducing loss of turnover during the indemnity period)

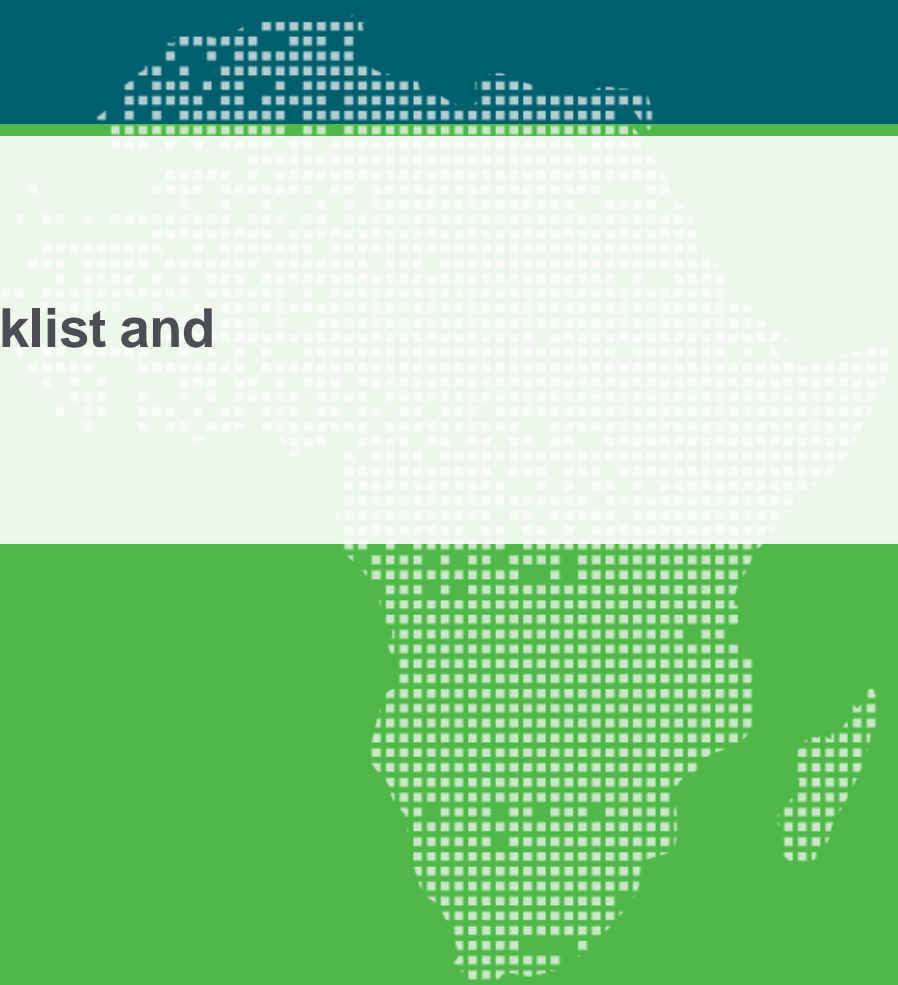
Economic limit test;- Gross Profit saved= 52,000 @ 25% = R 13,000

Therefore, R 11,000 ICOW is economic and allowed in full.

ICOW..... 11,000

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Business Interruption Checklist and Deductibles.



Deductibles

Three main types of deductible are usually applied:

- ❖ Monetary amount.
- ❖ Number of days.
- ❖ Waiting period.

Number of days can be calculated in a number of ways;

- ❖ Average daily value of loss.
- ❖ Average daily Value at Risk.
- ❖ First X days of loss (waiting period).

The policy may not always be clear!

BI Policy Formula- Complete Checklist

1. Calculate/Agree Indemnity Period
2. Calculate/Agree Standard/Expected Turnover
3. Measure Actual Turnover Achieved
4. Calculate Reduction In Turnover
5. Calculate Insurable Rate Of Gross Profit(from last audited accounts)
6. Apply Insurable Rate of Gross Profit to Reduction in Turnover
7. Obtain Loss of Gross Profit
8. Add Increased Costs Of Working(ICOW)
9. Deduct Any Savings In Fixed Costs
10. Consider Adequacy Of Cover(Sum Insured Basis)
11. Declaration Linked Policies(No Average, Loss Limit = 133.3%)
12. Deduct Excess/Deductible
13. Add Any Additional Increase In Cost of Working(AICOW)
14. Obtain Net Claim Payable

5 Reinsurance Aspects





Proportional v Non-Proportional Treaties

- Follow Settlements Clauses
- Insuring Clauses – Loss Occurrence Clauses



Treaty Conditions

- Does treaty cover the risk insured?
- Are any exclusions applicable
- BI with no physical damage trigger
- Limits imposed by the treaty , especially with respect to Contingent Business Interruption



Treaty Clauses

- Claims Notification Clauses
- Claims Co-Operation Clauses
- Claims Control Clauses

19. Contingent Business Interruption cover without a physical damage proviso. The physical damage proviso can be waived in respect of Public telecommunication/Public Utilities - extended cover / Miscellaneous Risks Extension, if all covered perils that do not require a physical damage are subject to a sub-limit of ZAR 20,000,000 or USD 2,000,000 or GBP 1,000,000

6 Questions.

