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Insurance Uncovered

Business Interruption

Here's a quick Q&A, helping you understand some of the complexities surrounding Business Interruption insurance cover...

What is Business Interruption Insurance?

It provides cover for the financial losses due to an interruption to a business **caused by material damage to property**.

Is material damage to property a pre-requisite to cover being triggered?

Traditionally, **yes**. This class of insurance was established to deal with loss of business income (typically loss of Gross Profit but also loss of Gross Revenue eg for professions/services types businesses) following **physical damage to property** such as a fire, flood, theft etc.

What is the difference between Material Damage & Business Interruption Insurance?

Material Damage insurance deals with reinstating/replacing damaged Buildings, Contents, Stock etc.

Business Interruption insurance deals with the **consequent financial losses** of the damage.

Is there a time limit governing for how long an Insurer will pay financial losses following damage?

Most definitely. This is called the Indemnity Period and the responsibility setting that time limit rests with the Policyholder, which Insurers then call the **Maximum Indemnity Period**.

How long should a Maximum Indemnity Period be?

It should represent the length of time a business believes it will take to recover from the material damage and restart deriving the pre damage levels of Gross Profit/Gross Revenue.

What factors should be taken into account when setting the Maximum Indemnity Period?

Consider a catastrophic loss such as fire or explosion damage, then envisage the time taken to clear the site; remove debris; obtain planning permission for rebuild; complete the rebuild; replace machinery (lead in times perhaps from overseas for specialist items; restock and reinstate the order book; win back lost customers; and then secure the pre damage levels of Gross Profit/Gross Revenue.

So, this could be done in weeks?

Most likely not. Significantly underestimating how long this takes is very common and many businesses who underinsure in this way unfortunately never recover. **As a minimum, 24 months should apply** but significantly longer such as 36 months, 48 months or more are often appropriate.

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Why are Maximum Indemnity Periods usually divisible by 12?

When settling claims, Insurers will be heavily influenced by the previous trading results of a business; typically the most recent financial year(s) concurrent with the damage. As financial years run for periods of 12 months, it makes sense to insure loss of income over these same periods. What is being insured is therefore 24 (or 36 or 48) months' loss of Gross Profit/Gross Revenue.

What about income projections during the Maximum Indemnity Period?

Assume that the loss will occur on the last day of the period of insurance so the income to be insured is for the 24/36/48 months after the last day of the period of insurance.

What is Gross Profit?

Turnover less purchases. **Note how this may differ from how the accounting profession defines it.**

In many businesses, wages (which would still need to be paid following a fire) are the largest overhead. Policyholders rightly expect Insurers to pay wages following damage so they must not be deducted from Turnover.

What is Gross Revenue?

Income (i.e. turnover with no deductions).

How then has Business Interruption Insurance evolved?

In more recent times a fiercely competitive insurance market has seen a trend of Insurers widening cover to include some **non-damage extensions**. **Wordings vary significantly by Insurer but appropriate to emphasise that these are typically not specifically "costed" by Insurers and that's reflected in the relatively nominal levels of covers granted by Insurers on these extensions.**

What are these non-damage extensions?

These are 1) notifiable/specified diseases and 2) denial/prevention of access (non-damage).

What is the notifiable/specified diseases extension?

Following an outbreak of a human disease **typically at or within a defined radius of the insured premises**, cover may be triggered. Most Insurers specify the diseases for which they provide cover and pandemic type diseases intentionally tend not to be listed. Far less commonly, Insurers provide cover for notifiable diseases - i.e. those that public health authorities declare as being notifiable.

What is the denial/prevention of access (non-damage) extension?

Typically, this relates to action by the authorities in **closing down or cordoning off the insured premises or those within a defined radius.**

Do Insurers grant the full Sums Insured & Indemnity Periods on these extensions?

Typically, Insurers significantly restrict these. It's quite common for example to have limits of only £100,000 to £250,000 and/or reduced Indemnity Periods of only 1 to 3 months for these extensions.

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What is the trends/variations clause?

It allows Insurers to make adjustments to figures representing business income to take account of trends of the business & for variations in or other circumstances affecting the business either before or after the insured event and which could have affected the business had the event not occurred.

What are the common exclusions on Business Interruption cover?

The key exclusions that apply are those where governmental aid is more appropriate than Insurers providing cover. These tend to be radioactive contamination, war & kindred risks. Damage caused by terrorism is also excluded – it can be separately purchased from specialists Pool Re.

What are the common underinsurance pitfalls on Business Interruption?

Insufficient Maximum Indemnity Periods, Sums Insured being too low (due to misunderstanding the Gross Profit definition) as well as inadequately projecting forward business income.

What next for Business Interruption Insurance?

Policyholders should be alert to the need for specialist advice on this complex class - it's too easy to obtain as an online "commodity" without fully understanding what has been purchased.

COVID-19 perhaps highlights this and the potential need for governmental aid and/or Pandemic Re to be considered as the future specialist equivalent of what Pool Re now provides on Terrorism.

To find out more about the cover you purchase, or to arrange an audit of your existing policies, please **get in touch**.

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