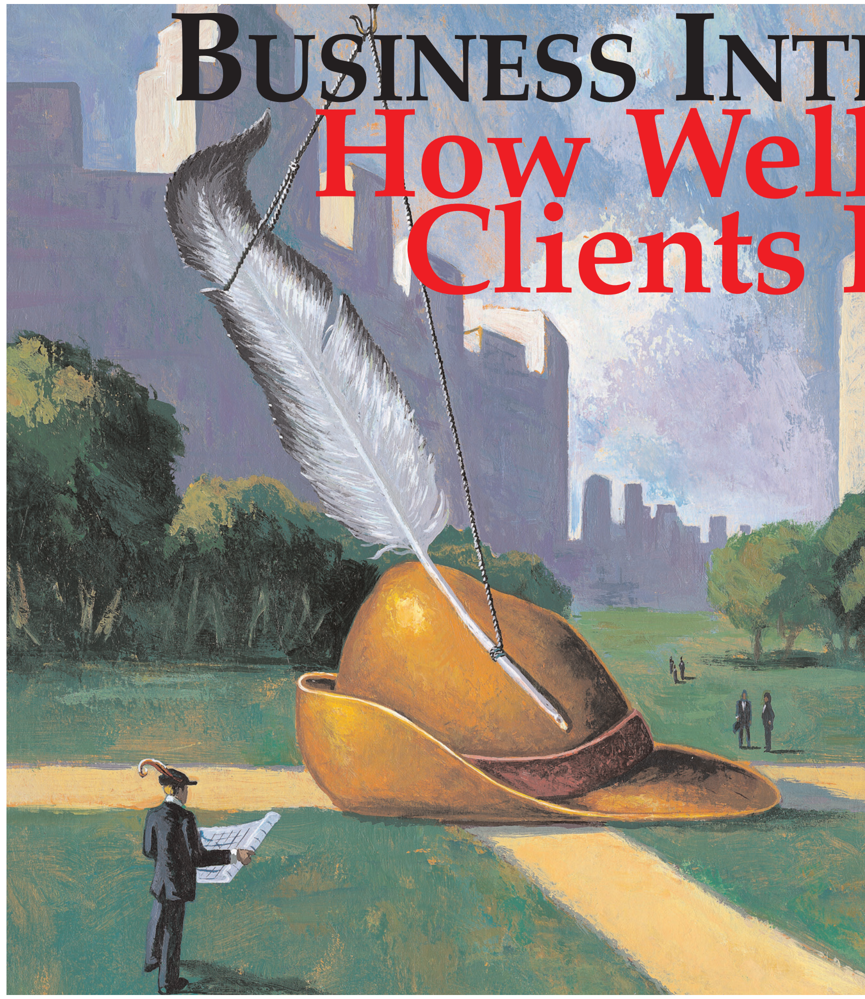
Business Interruption: How Well Are Your Clients Protected?



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Business owners who suffer property damage no doubt breathe a sigh of relief when they know their losses are covered by property insurance. But if those same business owners have failed to protect their profits against losses incurred during the days or weeks when their businesses are shut down, they may find it difficult – if not impossible – to recover. That's when business interruption insurance can make the difference.

Business interruption insurance is commercial coverage that reimburses business owners for lost profits and continuing fixed (versus variable) expenses during the time their businesses are interrupted or impaired as the result of a covered peril, such as fire, flood or power outage. Typically, business interruption insurance is incorporated into the commercial policies purchased by large companies and customized as needed to address their specialized risks. Small and mid-sized companies obtain business interruption insurance when they purchase business owners policies (BOPs), which include property, business insurance and liability insurance in a single package.

The contract that lies at the heart of business interruption insurance reflects a shared commitment:

- The insurer's commitment to "making the insured whole," or returning the insured to a condition without a loss, and
- The insured's commitment to doing what's necessary to get back into operation.

Coverage Variations

In addition to basic coverage for lost profits and continuing expenses, business interruption insurance offers specialized features, which large-lines customers buying comprehensive property policies should evaluate in selecting the best coverage for their operations.

One of the most-purchased features is payroll insurance, which ensures that a company's employees continue to receive paychecks during the time their employer is closed. Payroll insurance can be especially valuable to companies whose workforce is specialized, or would be hard to replace if those employees left to join other companies during a stoppage following a loss. Customers who purchase payroll insurance can stipulate which employees are covered and for what period of time.

Another popular feature is additional expense coverage. Liberty Mutual defines additional expense as "the following expenses you incur during a period of recovery, which you would not have incurred had there been no direct physical damage to property:

continued

- Expenses to continue your normal operations; and
- Expenses to expedite repairs if:
  - the repair will shorten your period of recovery; and
  - the expense will reduce the total foreseeable additional expenses that you would incur without expedited repair."

A good candidate for additional expense coverage might be an airline reservation service center, which, if it lost power, might need to hire another service provider to handle its reservations during the power outage.

Whatever basic and special coverages business interruption insurance provides, the essence of that insurance is the policy between the insurer and insured. And what underlies the creation of the policy is the information provided by customers in the business interruption worksheet. The worksheet is a tool insurers use to measure a customers' exposures, and understand and price risks. It gives business owners a tool to help them fully identify their exposures and expenses in a useful and relatively easy to use format.

The worksheet asks risk managers, or whoever is charged with completing the form, to calculate their companies' business interruption values by listing revenues, net sales value of production, cost of material and supplies, and payroll. While completing the worksheet can place demands on risk managers' time, especially the first time it is prepared, the document establishes the foundation on which the business interruption policy is written and is an essential part of the process.

The Impact of September 11th

Insurers and insureds alike are reminded every day of the impact of September 11th on insurance coverages and prices, especially those affecting major commercial lines like property/casualty and workers compensation. Not surprisingly, business interruption insurance has undergone changes as well, including changes in coverage limitations and deductibles.

Risk managers today are more likely to be asked to complete business interruption worksheets that have been developed by the insurer from whom they're requesting coverage. In the past, it wasn't usual for insurers to use more generic forms, which might have been developed by brokers servicing multiple carriers. Now, in an effort to obtain the best possible information from risk managers, insurers are reverting to more customized forms.

Another change that is directly linked to the events of September 11th concerns blanket coverage. Before September 11th, if a company had operations in 20 different locations, all of those locations may have been covered equally under a blanket provision. Today, the locations would be assessed individually. Many insurers are now tying location limits to the specific values reported by the insured, either by listing the locations and limits individually or by using a margin clause.

Increased Attention on Contingency Planning

Another issue that September 11th called attention to is contingency planning – not only as it relates to business interruption insurance, but also as it relates to all other forms, such as property/casualty and workers compensation. Good insurers and insureds always have their eye on contingency planning as an important means of mitigating risk.

In a 2002 report entitled "Review of the Factors Influencing Business Continuity in the Next Millennium," and prepared by the Risk and Advisory Services unit of KPMG, and Contingency Planning & Management magazine, survey respondents acknowledged being affected by/at risk of the following:

*Power outages – *71 percent* *Hardware failure – *68 percent*
*Software failure – *58 percent*
*Communications failure – *55 percent*
*Human error – *53 percent*
*Natural disaster – *50 percent*
*Service provider failure – *39 percent*
*Info security breach – *34 percent*
* Facilities move – *33 percent*, and
* Terrorist activities – *27 percent*

When they plan effectively for disaster recovery, companies increase their chances of a speedy return to full operation. Good business interruption insurers will always ask customers about their crisis management plans.

The State of the Market

Today, more than a year after the events of September 11th, the final price tag for business interruption claims has yet to be calculated. At mid-year 2002, Swiss Re predicted that business interruption claims would exceed $7 billion, while Lloyd's predicted claims exceeding those associated with property losses. Part of the difficulty in determining a total is in identifying losses associated with contingent business interruption – or, losses associated with businesses that were not physically located at the World Trade Center.

As insurers and insureds consider the changes in the market for business interruption insurance, they should evaluate how those changes could affect the coverages that now apply in their current policies. ❐