INSURANCE BOOTCAMP
back to basics

BUSINESS INTERRUPTION

DURBAN | CAPE TOWN | JOHANNESBURG

[Logos of various organizations]
PLATINUM SPONSOR

INSURANCE learning academy
Points of discussion

1. Business Interruption – an insurer’s perspective
   Presented by Justin Naylor from Etana Insurance

2. Business Interruption calculations
   Presented by Denver Furmage from Online Broker Tools

3. Business Interruption – a broker’s perspective
   Presented by Billy Neethling from Holburn Insurance Brokers

4. Sasria Business Interruption cover
   Presented by Mokgadi Sebola from Sasria SOC Limited

5. Questions and answers
Business Interruption – an insurer’s perspective

Justin Naylor
Head of Independent Brokers, Etana Insurance
Agenda

• Introduction
• Overview of Business Interruption
• Why BI is so important
• A quick survey
• Some common mistakes
• Claims examples
• The BI Calculator poweRED by Etana
Introduction

- Etana – Business, local branches and brokers only
- Brokers only – we want to be the best for brokers
- I am not a BI expert – so why am I here?
- Passionate about insurance and business through brokers
Overview of Business Interruption

• Loss following interruption or interference with the business as a consequence of **damage**
• Loss of gross profit due to a **reduction in turnover** or **increase in cost of working**
• Limited to the **indemnity period**
• **Indemnity** – puts the insured back in the same financial position as if there was no loss
Overview of Business Interruption

- **Damage** – insured peril, liability admitted under fire, buildings or OC but only in respect of fire perils, various extensions
- **Reduction in turnover** – rate of GP is applied to amount by which turnover has reduced
- **Increase in cost of working** – additional expenditure reasonable or necessary for the sole purpose of minimising the reduction in turnover
- **Additional increase cost of working** – with consent of the insurer for maintaining normal operation (not recoverable under ICOW)
- **Indemnity period** – beginning with commencement of damage and ending not later than the number of months stated in the schedule and during which business results remain affected
Why BI cover is important

- Losses that can put an insured out of business
- More to protect than just physical assets
- Protect the income stream that covers continuing costs and delivers profit (reward for being in business)
- International research: every year, one in every 500 businesses will experience a severe disaster (43% never reopen and 29% close within two years)
A quick survey by Etana

- A quick survey of some clients through various brokers
- 95% of clients were under insured for business interruption
- Most of these were underinsured by 30%
- Disputes and negative perceptions at claims stage
- Average and sometimes serious consequences for the businesses
- Reputation and possible PI claims
Some common mistakes

- Indemnity period too short
- Understanding definition of gross profit
- Forgetting to add VAT to the sum insured
- Not projecting the turnover forward to cater for the indemnity period and a loss at the end of the insured period
- In summary: Inaccurate BI calculations
How long should the indemnity period be?

- Not only rebuilding damage, but getting business back to normal
- Insurance company needs time to admit material damage liability
- Finding alternative premises/returning to your original premises
- Council permission/connection of services
- Removal of debris
- Tender phase to repair or rebuild
- Ordering new machinery/commissioning and testing
- Winning back customers
- Think carefully about the indemnity period
Accounting GP vs Insured GP

- **Accounting GP** appears in the company financials – turnover less all costs of the goods sold (e.g. direct materials, direct labour and factory overheads)

- **Insured GP:**
  - **Additions basis:**
    - Net profit (before tax) plus standing charges (continue after a loss)
  - **Difference basis:**
    - (Turnover + closing stock) less (opening stock + uninsured working expenses or variable expenses)
  - If in doubt insure the expense, some expenses may be partially variable
Not adding VAT or projecting turnover

• Always add VAT to the GP sum insured
• The GP sum insured must also be projected for:
  • The indemnity period (e.g. 12 months)
  • The period between the financial year and the insurance period
  • To cater for a loss on the last day of the insurance period
  • Allowances for increasing trends or seasonal business
Claims example

- Fire at a paint manufacturer not insured by Etana
- Supplier’s extension – Etana insured (retailer) suffered a R20 million loss
- Insurer of the material damage loss took its time to admit liability
- Know details of customers and suppliers and where their material damage is insured as well as dependency and alternative suppliers or customers
- ArcelorMittal is another good example
  - Complex loss (machinery breakdown vs fire perils)
  - Long, technical and costly investigation
  - Unique products with minimal alternative suppliers (high dependency)
  - Affects many suppliers
Claims example

- Fire at a nutritional manufacturer
- Approximately R40 million MD and R300 million BI
  - BI is often the big part of the loss
  - More than two years to finalize claim (indemnity period)
  - Specialised plant and machinery
  - Very specific market and market trends
  - Difficulty in locating alternative suppliers
Claims example

- Fire at a shopping centre
- Shopping centre partially cordoned off and access to rest of centre affected
  - Major drop in turnover for many tenants
  - Prevention of access – cover as a result of any damage within a 10 km radius
  - Similar cover for public utilities/telecommunications
BI Calculator poweRED by Etana = The Solution

- www.bicalculator.co.za or BiCalculator@etana.co.za
- Online tool for brokers and clients to accurately calculate BI sum insured
- E-mail link to client to save time – take the debate and worry out of GP sum insured
- Certificate of calculation as proof of sum insured – eliminate disputes
- Step-by-step explanations and important considerations to be used with professional advice of a broker
- Cost R450 ex VAT per month
- Technical assistance and queries/once-off large client calculations
Business Interruption calculations

Denver Furmage
Online Broker Tools
Business Interruption – a broker’s perspective

Billy Neethling
Holburn Insurance Brokers
Matters for consideration

• Possibly the most misunderstood and ill-advised form of cover
• Almost impossible for a business to survive a catastrophic loss, as when the business ceases to trade, the expenses and overheads still continue
• Based on the insured’s actual audited/declared financials
• Every business has a rate of gross profit/revenue/rental
• To protect the business against a financial loss
• To ensure that the business is protected against total potential closure in the event of a disaster
• To ensure that the insurer (underwriter) settles the material loss swiftly
• Based on annual figures and not indemnity period
Defined events

- Loss following interruption or interference of the business where a claim has occurred at the insured premises and is admitted under:
  - Fire section
  - Buildings Combined section
  - Office section
  - Any other material damage (e.g. money/BAR/EE)
  - Limited to the perils insured under the fire section of the policy
Conditions

- Cover ceases if business is wound up or carried on by a liquidator or judicial manager or permanently discontinued, unless agreed in writing by the insurer.

- In addition to general conditions 6 (claims) and 7 (company’s rights after a claim) do all things to minimise the loss.

- At the insured’s expense formulate their claim.
Gross profit (difference basis)

- Limited to loss of gross profit due to
  - (a) Reduction in turnover; and
  - (b) Increase in cost of working
- The amount payable shall be:
  
  the reduction in turnover, the sum produced by applying the rate of gross profit to the amount by which the turnover during the indemnity period shall fall short of the standard turnover
Definitions

- Indemnity period – the period beginning with the commencement of the claim and ending no later than the number of months stated thereafter.
- Turnover – money paid or payable to the insured for goods sold and delivered or services rendered.
Definitions (2)

• Gross profit (difference basis) – the amount by which (1) the sum of the turnover and the amount of the closing stock, shall exceed (2) the sum of the amount of the opening stock and the amount of the uninsured costs.

• Uninsured costs – as specified (e.g. purchases, bad debts, discounts allowed/received).
Definitions (3)

- Standard turnover – the turnover during the period 12 months immediately before the date of the claim, which corresponds with the indemnity period.

- Annual turnover – the turnover during the 12 months immediately before the date of the claim.

- Rate of gross profit – the rate of gross profit earned on the turnover during the financial year immediately before the date of the claim.
Automatic extensions/clauses

- Accountant’s clause
- Accumulated stocks clause
- Departmental clause
- Deposit premium clause
- Output (alternative basis) clause
- Salvage sale clause
Automatic extensions/clauses

• Extensions to other premises (if other premises noted, *not* customers/suppliers)
• Storage/transit and vehicles
• Contract sites
• Prevention of access (insured premises)
• Additional premises (within reasonable time, *not* limited to RSA and surrounds)
Sasria Business Interruption cover

Mokgadi Sebola
Customer Relations officer
SASRIA perils

- Any act (whether on behalf of any organisation, body or person, or group of persons) calculated or directed to overthrow or influence *any state or government*, or any provincial, local or tribal authority with force, or by means of fear, terrorism or violence

- Any act which is calculated or directed to bring about loss or damage in order to further any political aim, objective or cause, or to bring about any *social or economic change*, or in protest against any state or government, or any provincial, local or tribal authority, or for the purpose of *inspiring fear in the public, or any section thereof*
SASRIA perils

• Any riot, strike or public disorder, or any act or activity which is calculated or directed to bring about a riot, strike or public disorder

• Any attempt to perform any act referred to in above clauses

Note: In this policy, the term “public disorder” shall be deemed to include civil commotion, labour disturbances or lockouts

Non-political riots – student riots, soccer hooligans, commuter agitation (train delays, bus delays, price increases)

• Political riot – service delivery riots
SASRIA perils

- Any riot, strike or public disorder, or any act or activity which is calculated or directed to bring about a riot, strike or public disorder

Note: In this policy, the term “public disorder” shall be deemed to include civil commotion, labour disturbances or lockouts

- Strikes – bus drivers’ strike, truck drivers’ strike, security guards’ strike, Metrorail strike, Shoprite strike, taxi drivers’ strike, municipal workers’ strike
- Civil commotion – bigger than a riot but not total insurrection
- Public disorder – bigger than civil commotion but it is not war
- Labour disturbance – riot in the workplace
- Lockouts – mainly factories
SASRIA perils

• The act of any lawfully established authority in controlling, preventing, suppressing or in any other way dealing with any occurrence referred to in above clauses
Business Interruption

Standing charges/working expenses/net profit

• Fixed costs of the business including net profit as at 1 September 2012

• Stand-alone Sasria policy – no conventional extensions, e.g. prevention of access, suppliers and customers, etc.

• Automatically includes CPC (claims costs clause)
Business Interruption

- AICOW may be included for an additional premium – 1.5 times the base rate
- Salvage and departmental clause – include auto
- Rebate clause – if SI is > R1m
- Although the Sasria covers are subject to a declaration clause, the full premium is collected up front and up to 25% refunded at expiry
Business Interruption

Extension to cover (additions)

- Claims preparations costs – automatic
- Dependency loss – btw premises
- New business clause – company that has been trading for less than 12 months
- AICOW – one and a half times policy rate
- Alternate trading clause
- Net profit
Business Interruption

Uninsurable extensions (additions)

- Fines and penalties
- Prevention of access
- Public utilities
- Public telecommunications
- Accountant’s clause
- Accumulated stock clause
- Output clause
- Incompatibility cover
Business Interruption

Indemnity periods

• Domestic: minimum 12 months and maximum 48 months

• Commercial: minimum 12 months and maximum 60 months
Business Interruption

Methods of arranging cover

Specified standing charges
• The list of standing charges must be provided
• There must be a Sasria material damage coupon in force covering the same interest and period
• The sum insured must represent the list of specified standing charges (not the conventional policy sum insured)

Uninsured working expenses
• The list of uninsured working expenses must be provided
• The sum insured must represent the insured working expenses (not the conventional policy sum insured)
• Accepted formula: GP - NP = WE
Business Interruption

Net profit

- Effective 1 September 2012 net profit cover available within the R500 m coupon only

- There must be a material damage coupon to which the BI cover will attach – not available on its own

- SC/WE cover still available without the net profit cover

- Current SC/WE rates applicable to the net profit

- No extensions
Business Interruption

Net profit

Rating:
• Rates are as per the SC/WE, the difference will be the sum insured that the rate is applied to if the net profit (higher sum insured) is taken

Existing insurances:
• With the new product in place, this has to be purchased from Sasria unless dispensation is obtained

Cover:
• Cover is now comprehensive, but it excludes extensions. Clients still have an option to take the current SC/WE cover only, in which case the rate would be applied to the SC/WE value
Claims statistics

The table below shows that the claims we have received as at the end of Dec 2012 is much more than what we received in the past three financial years, both in number and Rand value.

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>New claims year to date</td>
<td>554</td>
<td>504</td>
<td>1 174</td>
<td>1 732</td>
<td>New claims year to date</td>
</tr>
<tr>
<td>Closed claims year to date</td>
<td>433</td>
<td>331</td>
<td>987</td>
<td>832</td>
<td>Closed claims year to date</td>
</tr>
<tr>
<td>Number of outstanding claims (end of period)</td>
<td>121</td>
<td>173</td>
<td>196</td>
<td>896</td>
<td>Number of outstanding claims (end of period)</td>
</tr>
<tr>
<td>Value of new claims received year to date</td>
<td>R146.1 million</td>
<td>R264.7 million</td>
<td>R245.5 million</td>
<td>R371.2 million</td>
<td>Value of new claims received year to date</td>
</tr>
</tbody>
</table>

The claims frequency increased from 44% reported last quarter to 57% as at the end of December 2012. The severity figures also increased from 30% to 40%. Even though the average growth in severity is at 40%.
Claims statistics

A high number of claims were received in 2012 mainly due to the farm workers’, truck drivers’ and mine workers’ strikes.

<table>
<thead>
<tr>
<th>Description</th>
<th>Number of claims</th>
<th>Actual cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Farm workers’ strike</td>
<td>116</td>
<td>R94 717 899</td>
</tr>
<tr>
<td>Mines workers’ strikes</td>
<td>158</td>
<td>R52 651 616</td>
</tr>
<tr>
<td>Truck drivers’ strikes</td>
<td>620</td>
<td>R65 500 118</td>
</tr>
<tr>
<td>Total</td>
<td>894</td>
<td>R212 869 633</td>
</tr>
</tbody>
</table>

Note:
Loss ratio increased by 14.5%: loss ratio as at end November 2012 was 36.4% compared to November 2011 at 22%.
# Claims statistics

High valued claims

<table>
<thead>
<tr>
<th>Farm strikes</th>
<th>Average cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crates used for harvesting/storage</td>
<td>R5 000 000</td>
</tr>
<tr>
<td>Stock in warehouse (damaged)</td>
<td>R7 000 000</td>
</tr>
<tr>
<td>Deterioration of stock (undamaged)</td>
<td>R6 000 000</td>
</tr>
<tr>
<td>Crop with fruit hanging</td>
<td>R5 000 000</td>
</tr>
<tr>
<td>Farm property including plant</td>
<td>R4 000 000</td>
</tr>
<tr>
<td>Business interruption (standing charges)</td>
<td>R3 000 000</td>
</tr>
</tbody>
</table>
Questions

Thank you all for attending today’s seminar.

We trust that you have found it valuable and informative.

Thanks to our panel:

• Justin
• Denver
• Billy
• Mokgadi

Goodbye, until next time.