What is Business Income Insurance?

Your business is your livelihood. Consider a fire that destroys your manufacturing facility or office complex. Your property insurance would respond to the loss of your building or damage to your personal property, but what about the loss of your net income and the expenses that you continue to incur while your business operations are suspended? How are you going to restore your business activities if your employees leave for other jobs because you couldn't pay them during the time you needed to restore your operations? How long will it take to return your business to the previous levels of success? How much and what kind of insurance do you need to respond to the consequential losses resulting from a covered loss to your property? That's where business income insurance comes into play.

Business income insurance helps preserve the future of your business by replacing your income stream and providing needed funds to meet your ordinary payroll and other necessary continuing expenses while you rebuild and repair your property and restore your business to the condition that would have existed had there been no fire/loss.

What is Extra Expense Insurance?

Extra Expense Insurance provides a ready resource to help you continue your business activities while recovering from a property loss by paying necessary expenses, over and above your normal operating expenses, you incur in an attempt to continue operations and thereby reduce the business income loss you would otherwise incur. This may be the money you need to fund your disaster recovery and business continuation plans. The additional costs to rent and insure substitute premises, install new communications equipment at those premises, encourage employees to continue working or work extra hours, or advertise that you are still in business are just some examples of extra expenses you might incur during the time your business is struggling/managing/attempting to stay in the marketplace after a loss.

How do I determine my Business Income/Extra Expense Insurance Needs?

Determining the right amount of business income and extra expense insurance needed may be challenging. It requires careful analysis and calculation of your business needs. "My Business Income Consultation from Chubb" provides the important information to assist in assessing/analyzing the establishment of your business income needs.

What accounting method is used to calculate a business income loss?

The accrual accounting method is necessary. In the event of a covered direct physical loss or damage, your insurance company must analyze the experience of your business prior to the loss. This cannot be properly obtained if business income is calculated using the cash accounting method. The cash accounting method shows all receipts and disbursements and is unacceptable for business income. It may eliminate certain items earned or incurred in the current fiscal period or may include certain items which may apply to a previous accounting period.

What do I do if I have a loss? What documents do I need to produce for the claims adjuster?

Like any other loss, a Business Income/Extra Expense loss needs to be quantified. In most situations, the services of a forensic accountant are engaged. They help you gather the documentation that is needed to prove the loss and expenses. You need to produce current and past financial statements (up to 18 months prior to loss) and forecasted 12 months budgets. This information helps the claims adjuster develop time lines at the time of loss.

Was the business growing at time of loss? How can you prove that sales were escalating? These are some of the questions for which you will be asked to provide information.

How should I use this worksheet if my business has more than one profit center (or location)?

First, identify whether there are any interdependencies between any of your profit centers or locations. For example, you have interdependent locations if two or more locations depend on each other to produce a single product. Or, you have interdependent locations, if employees are trained at one location and do their jobs at another. However, if each of your locations operates independently, then you do not have any interdependent locations. You should use this worksheet/tool to compute the business income and extra expense requirements for each independent profit center or location and for each cluster of interdependent locations or profit centers. The sum of such calculations would be equal to the business income and extra expense needs of the organization if all income generating locations were lost in a single disaster. You may want to buy business income and extra expense limits of insurance for each such location (specific insurance), or you may want to buy a single business income and extra expense limit of insurance that applies across all locations (blanket insurance). Your blanket limit of insurance should represent your worst-case scenario, meaning, the limit should reflect the largest combined loss of business income and extra expense you can envision. If your worst-case scenario includes the possibility of loss of all of your income producing locations, the blanket limit should reflect the sum of the BI and EE limits calculated for each. Your agent will want to see whatever calculations led to your final choice of a combined business income and extra expense limit.

My business is custom software development. Which worksheet/tool option should I use and how does this worksheet/tool work for me?

Use the service option on the worksheet/tool for purposes of insurance. Your annual sales minus any non-continuing service costs are the best representation of your potential 12-month business income loss. This worksheet asks that you start with a 12-month business income duration of loss. There may be many reasons why the duration of loss could be much less.

For example, you may have more than one independent profit center, each of which contributes to total sales. (See multiple profit center organizations.) Or, you may have redundancy in your operation, or both. In the service option on the worksheet/tool, you have the opportunity to develop a business income and extra expense limit that contemplates a speedy recovery (short duration of loss) due to the nature of your operations.

What is the meaning of non-continuing service costs?

It means money/costs you have to pay to have something done that will not continue during the business outage (period of restoration). For example, programming services not under contract, or maintenance services paid on an hourly basis. If these services were under a contract that obligated you to continue to pay the provider while your business was suspended, they would be included under continuing expenses in the Business Income loss settlement. If there is no such contract, nor any obligation to pay during the period of the suspension, the costs will not continue during the period of restoration, and so, the costs can be deducted from gross sales for the purposes of determining the 12-month business income amount.

What if I operate an eBusiness? Are there special issues/exposures?

Like any other business, you provide a product or service. Due to the use of ISPs, contractors or vendor services, your exposures for business income and extra expense may become more contingent than direct. The ISP's exposure to risk can also be yours. If you feel that you need to carry limits of insurance reflective of their downtime exposure, the amounts can be determined by working with the ISP, vendors or contractors to go through the My Business Income Consultation from Chubb. Please discuss these amounts with your agent and insurance provider.

What are Disaster Recovery / Business Continuity Plans? Do I need one?

9/11, Hurricane Katrina, the Southern California Firestorms. Never has there been a more important time to consider what it would take to reconstitute and operate your business in the event of a local or regional disaster.

A Disaster Recovery/Business Continuity plan is your road map to recovery from a major or total loss. It describes the activities and costs, including those you incur to implement the plan (extra expense), to keep your business running and protect your market share.

Does your company have a Disaster Recovery/Business Continuity plan in place? Is it updated and tested regularly? What is the cost to implement such a process/plan?

There are companies that specialize in this field and can help develop a plan. There are also “self-helps” in the form of worksheets and interactive applications that assist you in considering everything necessary.

There could be sizable insurance savings by having a plan. Please, contact your agent to help you get started.

How do I determine extra expense limits before I have a loss?

This is one of the most difficult amounts to determine. While business interruption values are determined using your financial statements, extra expense amounts are determined by your monthly budgets. Extra expense amounts are those expenses over and above your normal operating expenses incurred to attempt to continue some or all of your operations while recovering from a property loss and to reduce your business income loss.

Here are some considerations for extra expense:

- Cost to operate from another location while your primary location is being rebuilt or repaired.
- Cost to rent additional space.
- Cost of additional wages to entice your employees to work from the new location.
- Cost of employees working from home.
- Cost of using subcontractors to produce your goods and services while you recover.

Keep in mind, that while using extra expense dollars, you are also staying in business and protecting your market share. If your company has a Business Continuity plan, extra expense dollars are used to fund this plan.

When is it best to exclude or limit ordinary payroll?

Limiting ordinary payroll can be considered if you anticipate a long duration of loss, your labor force can be acquired or reacquired and quickly trained to perform at an acceptable level. Because of these uncertainties, Chubb recommends including your ordinary payroll without limitation. If you insure your entire payroll or limit it to 30, 60, 90 or 180 days, the option still exists if circumstances dictate, to lay off workers and use the money to pay a business income loss for a longer than expected duration.

If I want to exclude or limit ordinary payroll, can I include some employees in executive payroll even though they would normally be classified as ordinary payroll?

Yes, but you should identify the executives or the executive positions to ensure they are included.

Since I do not derive any profit from my research and development operations, how would business income be handled?

Simply stated, business income losses are determined by adding the amount of net profit or loss, prior to income tax, and continuing expenses you would have incurred had there been no loss. If the business would have operated at a loss, then that amount would be a negative number. Business Income with Extra Expense and Research and Development Income is designed for companies that are solely Research and Development organizations or organizations that have a separate, identifiable, Research and Development operation.

For organizations with separate identifiable R&D operations, the insurance separates R&D operations from revenue generating business activities and in the event of a loss, adjusts each separately subject to the combined limits of insurance.

For R&D operations, no consideration is given to whether there would have been a profit or loss - e.g., continuing expenses from interrupted R&D operations are paid without regard to whether the manufacturing operations are operating at a profit or a loss. In addition, if any grants, endowments or other contributions to further your research activities are lost, they are considered as well.

For revenue generating business activities, the calculation of the business income loss is handled in the traditional manner - e.g., if the business is operating at a loss, the amount of the loss will be deducted from continuing expenses that are incurred during the time the business is recovering. .

What is the difference between a deductible and a waiting period?

A deductible is a dollar amount that is subtracted from the amount of an adjusted loss.

> Ex: A fire causes damage to a building. As a result an insured suffers a $1,000,000 loss of business income. The insurance company agrees to pay $1,000,000 under their policy less a $10,000 deductible. The insured receives a payment of $990,000.

A waiting period is a period of time, normally clock hours, that must elapse before the insurance company starts calculating a business income loss.

> Example: If the waiting period is 24 hours, the company will not consider any business income loss that was incurred in the first 24 hours after the loss.

What does it mean if I insure my business income at 50% coinsurance?

Coinsurance is a penalty clause insurance companies use to protect themselves from situations where the policyholder purchases limits of insurance that do not adequately reflect the property/business income values that are at risk.

The coinsurance formula provides that the company will not pay more of any loss than the amount of insurance purchased bears to the amount of insurance that should have been purchased. The formula is fairly straight forward - How much insurance was purchased divided by how much insurance should have been purchased multiplied by the loss = coinsurance loss payment.

When an insured purchases a limit and a 50% coinsurance clause, they are telling the underwriter that the limit of liability at the time of loss will be at least 50% of a 12 month business income value at risk. If it is not, there will be a penalty.

> To illustrate, an insured purchased a limit of $1,000,000 with 50% coinsurance. Subsequently, there was a loss and the insured claimed $1,000,000. At the time of loss, it was determined that the insured's actual 12 month business income value at risk was $3,000,000. 50% would have been $1,500,000 and that is the amount that should have been purchased. Thus, the actual loss payment would be determined as follows: $1,000,000 (amount purchased) divided by $1,500,000 (amount that should have been purchased multiplied by the loss: = .667 X $1,000,000 = loss payment of $667,000.

Since the baseline starting point for business income pricing is the 12 month business income amount, the underwriter obtains a surcharge in the rate that is applied to the lower limit purchased.

What is contingent business income exposure?

No company operates in isolation. It has suppliers and customers. Damage to either can have devastating effects on your business. Contingent business income insurance indemnifies you for upstream (supply) and downstream (customer) loss that affects the company's profitability.

> Example: You make pens. Several vendors provide integral parts such as ink, clips etc. Your ink supplier suffers a fire and cannot producer ink for your pens, which compromises your ability to complete assembly of your pens and get them to market. Unless you have an alternate supplier that can meet your supply schedule immediately, you will probably suffer a contingent business income loss because of this.

Some companies give an automatic limit for contingent business income, but, automatic limits may not be enough. If you have critical customers and suppliers, or you depend on contract manufacturers or leader type property to draw customers to your business, it would be a good idea to evaluate your contingent business interruption limits needs the same way you have developed your limits for business income insurance for your own premises.

What about business income loss because of a loss at a utility supply company?

Business income insurance is available for business income loss and extra expense caused by or resulting from interruption of services provided to your premises by a power, water, communication or other utility service, caused by or resulting from loss or damage to property by a covered peril at that utility, modest automatic limits are provided, which can be increased for an additional premium charge, subject to underwriting.