



The Impact of Terms and Conditions in Business Interruption Claims

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The lack of clarity in Insurance Terms and Conditions (T&C) can lead to discussions when it comes to a claim, and clarification can be even more onerous when the policy contains Business Interruption (BI) coverage. Discussions around the content of an unclear clause can lead to delays in the claim adjustment process and increase the claim cost substantially.

The main purpose of this white paper is to show how small changes in the content of clauses can have a positive impact at the time of a claim adjustment.

First, it is important to define what T&C means and understand the importance of each single contribution to the entire scenario. In order to make it easier to understand, we can divide T&C into two groups:

1. The Proposal Form
2. The Insurance Policy – General and Special Conditions

Proposal form

Generally, the proposal form refers to the risk questionnaire that is sent to the insured. It is used by the insurer (sometimes also by the reinsurer) to price the coverage of a submitted risk exposure. Some countries, such as the U.S., work with specific BI forms that facilitate not only the insured's process for filling in the questionnaire but also help insurers' and reinsurers' pricing and claims settlement. Unfortunately, this is not a reality in Latin America, where there is no standard BI form and each insurer can create its own questionnaire to send to potential clients in order to evaluate their risk. An essential aspect to be observed is that the answers

Contents

Proposal form	1
Insurance Policy – General and Special Conditions	2
– Is it specified in the policy when exactly the deductible count for BI starts?	2
– Is there any clear limitation for Extra Expenses?	3
– Is the chosen period of indemnity the adequate period for the risk insured?	3
– Is the insured aware of the underinsurance clause and its impact on the indemnity?	3

About This Newsletter

Aimed at property/casualty claims assessors, these articles address various aspects of modern claims assessment – facts and trends relating to the international claims assessment scene, case depictions and information on day-to-day claims assessment practice.

to the questionnaire will be important not only for the risk pricing but might also have a considerable impact on the loss indemnity of the claim.

It is crucial to have definitions and numbers aligned to avoid underinsurance or even lack of coverage – situations that are commonly observed in the daily life of a claims analyst. To avoid this, it is important that the insured completes the questionnaire not only with detailed information but also with a clear understanding of the meaning of each term and its potential implications in case of a future claim. For example, when it comes to a Gross Profit declaration, it is not enough to ask the company accountant responsible for the numbers. For insurance purposes, the accounting gross profit differs from the insurance gross profit; the insured has to declare what the insurance policy covers under the definition of Gross Profit. Insurance Gross Profit should include salaries and fixed expenses while accounting numbers normally exclude those items from the total number. If the insured uses the lower number as basis for its value at risk, it is most probable that an underinsurance situation will occur after a loss.

Insurance Policy – General and Special Conditions

Regarding the insurance policy, it is important to mention that BI is normally included as a consequence of a material damage covered under the policy. Pure BI claims coverage is commonly offered for special conditions, such as loss of attraction, denial of access, contingent business interruption and ingress/egress, among others. When there is a special coverage included in the policy, it is important for the parties to know – to avoid misunderstandings – to what extent there is coverage for those extra perils. A denial of access coverage, for example, only indemnifies the insured while the access to the insured location is restricted. Further losses caused by the loss of attraction of the particular location are covered by this specific coverage. Damages caused by hurricanes to resort locations are a classic example of this situation.

Other questions that normally cause confusion during the claims settlement process and are often underestimated during the risk pricing include:

1) Is it specified in the policy when exactly the deductible count for BI starts?

Waiting periods and time-based deductibles are commonly used in BI coverage but it is not always clear how that waiting period is to be used. We believe that a clearer trigger could not only be better for the insured but also be easier for the insurer to handle and calculate the loss. Five waiting days can be sufficient for some insureds, but for those that do not operate on weekends, specifying “business days” instead of “normal days” can be very useful. Depending on the policy, it can be any one of the following:

- **A trigger for coverage/time based deductible** – A certain amount of time must pass before Business Income and/or Time Element coverage is triggered. The covered loss is then calculated from the moment the loss occurs and the stated deductible applies to the combined property damage and time element loss.
- **An exclusionary period** – Defines or is defined by the Period of Indemnity/Period of Restoration. The covered loss is calculated from the moment the exclusionary period ends and the stated deductible applies to the combined property damage and time element loss.
- **A specified monetary deductible** – Can be either stated as Actual Daily Value or Average Daily Value. If utilized as “Actual Daily Value”, it is 100% BI value of the first “x” hours or days of the Period of Indemnity, even if the operation was fully continued by using Extra Expense. If utilized as “Average Daily Value”, the calculation is based on the average daily BI value over the entire period of interruption.

Regardless of how such a waiting period is utilized, it must also be considered that it should not apply solely to the Business Income coverage, it rather has to be for all time element coverages, including Extra Expense. Failing to do so could result in a BI loss fully averted by using Extra Expense to continue the operation, with no applicable waiting period or deductible.

2) Is there any clear limitation for Extra Expenses?

If an open clause only mentions that the insurer will cover extra expenses in order to speed up repairs, it may not be the best option to delimitate the real intention of extra expenses. Adding two or three words to the existing clause can make the difference and save a considerable amount of money and time when it comes to Extra Expense coverage. Instead of just mentioning speed up repairs, a more complete sentence could be used: *“the need to incur necessary and reasonable extraordinary expenses with the sole purpose to minimize losses and speed up repairs”*. Extra Expense classifications can be wide or more specific; here are three examples:

- **Pure Extra Expenses** are additional expenses incurred to continue operation and avoid or minimize suspension of business. They are not intended for permanent property damage repairs and they do not necessarily need to reduce the loss.
- **Extra Expenses to reduce the loss** have the purpose, for example, of spending up to USD 1.00 to save USD 1.00.
- **Expediting Expenses** are “reasonable” expenses incurred for the sole purpose of expediting property damage repairs; they don’t need to reduce any other loss.

UK policies, for example, provide coverage for additional expenditure necessarily and reasonably incurred for the sole purpose of avoiding or minimizing the reduction in revenue/turnover, but for that expenditure which would have occurred during the maximum indemnity period, subject to the economic limit.

What we observed is that some policies do not specify what is covered by Extra Expenses; they just generally mention the concept. This can lead to discussions around coverage applicability.

3) Is the chosen period of indemnity the adequate period for the risk insured?

When the length of time it takes to repair a loss is under-estimated, the insured can be left without necessary coverage in case of a total loss. Indemnity periods of 12 months may be insufficient if the insured risk is located in the center of a city or in locations where restricted periods apply to construction works.

4) Is the insured aware of the underinsurance clause and its impact on the indemnity?

While insurers may understand the underinsurance clause, insureds often do not. It is important for the insurer to take some time and make sure the insured understands the different aspects of the clause and its implications in a loss scenario. The full understanding of the clause may result in a more accurate evaluation of the risk by the insured.

As regards the reinsurance coverage, insurers must make sure that they have the right structure and conditions that support their insurance product. The main goal should be to avoid discrepancies between insurance policies coverage and coverage in reinsurance contracts.

The subject of T&C is very interesting and can lead to many other topics, but our main recommendation to our clients is to carefully review all the terms and conditions of the insurance in question and make sure the insured and or its representative fully understands the coverage and the impact of its clauses. This alone will avoid several onerous discussions and save considerable amount of money and time during the claims settlement process.

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