



Business Interruption Exposure – An Underwriter’s Guide to Getting It Right

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The significance of business interruption insurance is growing in our modern, globalised world with its increasingly intricate division of labour. Many experts now regard business interruption insurance to be at least as important to companies as property insurance.

According to a claims study,¹ the cost of business interruption claims is often significantly higher than the cost of property damage: The average property business interruption loss is now in the order of more than EUR 3.1 million, i.e. more than one third higher than the average property loss (EUR 2.2 million). Business interruption losses increase more rapidly than property losses and are significantly more volatile. For example, when a business interruption event occurs, company customers search for alternative delivery options and often do not return to the original supplier after the damaged business has been restored.

Another study from the same insurer reveals that for many years business interruption has been regarded by the companies surveyed as the most problematic risk (see Table 1, p. 2).

The Global Risk Management Survey carried out every two years by Aon, in which corporate managers worldwide are asked about the current risk situation, also paints a similar picture (see Table 2, p. 3).² It was reported that in 2019 there was an increase in business interruption losses compared to 2017. Since 2007, it has regularly been recorded as being one of the top 10 risks.

As a result of production trade flow, supply chain globalisation and both macro- and socio-economic trends, the implications of business interruption losses are increasingly far-reaching. The reduction of redundancies and the lack of alternatives in the event of a loss due to the increasing specialisation of companies have contributed greatly, not only to the observed amount of loss, but also to the increase in causes. They range from traditional risks such as fire, machine breakdown, natural

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About This Newsletter

Created for our clients, our Property Matters publication provides an in-depth look at timely and important topics affecting commercial and personal lines of property insurance.

Table 1 – The most critical risks for a company
(1 being the most critical hazard in the respective year)

Risk	2013	2014	2015	2016	2017	2018	2019
Business interruption	1	1	1	1	1	1	1
Cyber risks		8	5	3	3	2	2
Natural catastrophes	2	2	2	4	4	3	3
Market trend	8	5	7	2	2	4	5
Regulation	4	4	4	5	5	5	4
Fire/Explosion	3	3	3	8	7	6	6
New technologies					10	7	7
Reputation/ market value	10	6	6	7	9	8	9
Political risks			9	9	8	9	11
Macroeconomics				6	6	0	13
Climate change/ weather fluctuations						10	8
Shortage of skilled workforce							10

Source: Allianz Risk Barometer, Allianz Global Corporate & Speciality SE, 2018 and earlier

hazards, or supply chain interruptions, to new triggers caused by ongoing digitalisation. The latter don't typically cause material damage but can result in high financial losses. In addition, there are increasing changes in exposure due to new economic/business trends, e.g. customer behaviour, changes in business models, centralisation, outsourcing, patenting, specialisation, production processes, infrastructure in "industrial parks", transport routes, exchange rate fluctuations, and insolvencies of companies in the supply chain.

Overall, it can be said that business interruption insurance for commercial and industrial businesses has evolved from being a cover that used to be neglected to a standard cover that is indispensable.

It is, therefore, necessary for an insurer to consider and assess the business interruption exposure separately from the property loss risk – business interruption carries significantly more weight in underwriting decisions than in the past.

In a previous article I shared my thoughts on possible future developments in business insurance.³ The focus of this article is rather on its components (e.g. concerning capacity, premium and reinsurance placement) which in our opinion are significant for an underwriting decision.

Necessary information

During many site inspections, the risk of business interruption is only casually considered in comparison to the risk of property damage. Often, questions about business interruption are kept general and do not help form a detailed assessment of its possible consequences after an insured property loss.

To make an appropriate underwriting decision that also considers the relevance of business interruption insurance, careful assessment of the facts recorded during a site inspection is required. Other items to consider include the underlying insurance contract, the specific situation of the company to be insured, how its production is organised, and its

financial situation.

The following list contains possible criteria to allow a risk assessment for business interruption insurance to be conducted. Despite its considerable size, it's not an exhaustive list as, depending on the situation, different aspects play a role.

General information

For a general assessment, there are three areas that should be examined:

- Scope of business interruption insurance cover
- Possible interdependency losses
- Possible contingency losses

In order to conduct a proper assessment, it is advisable to consider the following:

- Ownership (e.g. of land, buildings, equipment, and inventories)

- The policyholder’s business areas (e.g. trading, production, provision of services, and possible dependencies between these business areas)
- Gross profit per business segment
- Financial situation of the policyholder (e.g. equity/debt ratio, liquidity, necessary costs for repayment, and interest)
- The market position, presence and development prospects of the company to be insured (past, present, and future in terms of turnover, profit, market)
- Necessary certifications, licenses, approvals, etc.
- Organisational structure of the company, including decision-making, production, and sales structures, interdependencies of these departments and their significance to operating performance (interactions between enterprises/areas of the company)
- Buyer/client structure of the company, including the proportion of the most important buyers/clients as well as alternatives (to assess potential additional damages)
- Supplier structure of the insured company, including information on the proportion of most important suppliers and possible alternatives (to assess potential contingency losses)
- The company’s dependency on the import/export of goods/services and the extent to which seasonal dependencies may exist
- Frequency of internal audits and controlling mechanisms for checking, controlling, and evaluating the (most important) suppliers and buyers
- Willingness of the policyholder to assess risks and implement risk management procedures
- Existing fire protection plan as well as further preventive and protective measures against the risks insured in the insurance contract
- Loss history

Table 2 – The most frequent risks for a company

Exposure/Risk	2007	2009	2011	2015	2017	2019
Reputational damage	4	6	1	4	1	2
Slowdown in economic growth	1	1		1	2	1
Increasing competition				3	3	5
Regulatory/legal changes	2	2	6	2	4	10
Cyber risks					5	6
Lack of innovative strength	6			6	6	
Lack of attractiveness as an employer	7	10	7	5	7	11
Business interruption	5	3	2	7	8	4
Political risks/uncertainty				10	9	15
Liability		9	3		10	

Source: Global Risk Management Survey, Aon Risk Solutions, 2019 and earlier

Information on the underlying insurance contract

- Basis of the current business interruption insurance contract (e.g. standard policy of the insurer or broker form)
- Type of policy (e.g. named risks, all risks policy)
- Covered risks
- Agreed exclusions
- Business interruption compensation based on gross earnings, gross profits, gross revenue, rent insurance, and increased cost of working insurance
- Agreed business interruption insurance sum (Is the reported/agreed insurance sum plausible and realistic?)
- Development of the sum insured in recent years
- Agreed indemnity period (Is the reported insured sum equal to the indemnity period? Is the agreed period of liability sufficient or too short?)
- Agreed extended liability period
- Type and amount of agreed deductibles
- Agreed maximum compensation or limitation of liability
- Underinsurance agreement

- Agreed first risk positions (e.g. additional costs, access restrictions, official reconstruction restrictions, fines/penalties, expert costs, etc.)
- Trade sanctions and other exclusions/inclusions under the insurance contract (e.g. war, terrorism, etc.)
- Inclusion of interdependency losses
- Inclusion of contingency losses (named, unnamed)
- Type and extent of the coverage limit (e.g. layering, specification of the layer limits)

IT, infrastructure as well as the expected financial effects on sales/profit and market share of the business, etc.)

- Number of operating shifts in the course of a year
- Degree of utilization of the plant in the course of a year
- Seasonal fluctuations in the individual product and business segments
- Substitution possibilities for the individual product/business areas as a result of a business interruption (e.g. alternative production, relocation to other plants, contract manufacturing, existing stocks)



Information on the business to be insured

- Address and location information of the business to be insured (e.g. companies in the neighborhood with a possibly higher risk potential, earthquake and flood area, mining area, traffic infrastructure, etc.)
- Business areas, operations and facilities on the premises (main, ancillary, auxiliary), and their respective interdependencies
- Organisation of operations (e.g. operational, structural, administrative, IT, and sales)
- Number of permanent employees vs. percentage of employees with contracts for work vs. services
- Gross profit of the insured per business segment (e.g. trading, production, services) or business interruption insurance sums (necessary indication of the key date of their calculation and expected development within the limits of the insured liability period)
- General description of potential consequential business interruption losses after a possible insured property loss (e.g. related to production facilities and areas, logistics,

- Existing bottleneck areas, machines, plants including commercial and technical IT, energy and telecommunication facilities/supply as well as backup possibilities/emergency plans, etc.
- Indication of the terms for delivery/replacement and installation times required for important machines and plants (series machines vs. custom-made vs. self-built)
- Required reconstruction times for destroyed/damaged buildings including the procurement of the necessary permits as well as any expected reconstruction restrictions due to official requirements
- Time required to regain important operating licences and licences to resume production for operations that require permission from authorities (e.g. in Germany operations subject to the Federal Emission Control Act (BImSchG), biotechnology operations, pharmaceutical operations)
- Susceptibility of the production plant to damage – just-in-time production, automated production, as well as the produced/stored goods (e.g., to fire, heat, smoke, humidity)

- Storage as well as regular duplication of important business documents and data and their protected outsourcing as well as necessary IT data, type of backup, rhythm of backup as well as storage locations (in the company, outside, protected, etc.)
- Stockpiling of important spare parts and reserve systems
- Business Continuity Management (BCM), Risk Management measures (regularly updated and tested)
- Estimated time needed for “technical recovery” and full “commercial recovery” of operations

Supplementary information for companies with multiple locations

- Addresses of the individual insured companies as well as the respective countries (including geocodes, if applicable)
- Natural hazard exposure of the individual locations/ countries (e.g. earthquake, storm, flood)
- Business interruption sum per insured location, alternatively indication of the individual business segments in the respective locations with details of the manufactured products (e.g. number of units, tonnage, metres) or percentage of total sales, consolidated sales analysis, etc.
- Indication and description of existing interdependencies between the various sites
- Indication and description of potential backup possibilities including location (internal or external alternatives) and realistic assessment of alternative capacities specifying the percentage of the turnover

Once this information has been collected, it is possible to make an assessment of the current risk situation with regard to the possible extent and complexity of property damage, its potential consequences, the expected loss of earnings, possible additional costs, and the quality of existing protective measures. This also includes the description and determination of the business interruption Maximum Foreseeable Loss (MFL). This loss is independent of the material loss and its complex analysis, i.e. the largest material loss does not necessarily cause the largest business interruption loss. To this extent, it is essential to determine the combined property and business interruption MFL from the established property and business interruption

maximum loss considerations, including the first risk positions agreed in the insurance contract. This also includes any other existing insurance contracts that may accumulate in the event of a claim. Further, to determine the classic fire MFL, the corresponding maximum loss considerations must also be made with regard to other insured risks in the insurance contract. For example, the combined property/ business interruption fire MFL may be lower than the possible maximum loss from a natural hazard if several of the policyholder’s businesses are affected by the same loss event at the same time.

Conclusion

The business interruption exposure of companies has changed significantly in recent decades. In addition to property insurance, business interruption insurance is now a necessary basic cover, because business interruption can threaten the existence of a company. In this respect, an insurer must take these changes into account when underwriting a proposed risk. This means that the business interruption risk must no longer be seen as an appendage to property insurance but as an independent type of risk that can cause considerable losses for both the policyholder and the insurer.

We believe it will be necessary in the future to consider and assess the business interruption scenario independently of the property loss risk. As a result, the topic of business interruption will become significantly more important in underwriting decisions, e.g. concerning capacity, premium, and reinsurance placement.

The task of underwriting business interruption risks is complex. We would be happy to explore this topic with you and discuss your individual needs to develop an appropriate plan to raise awareness with your underwriters and sales staff.

About the Author



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Additional sources

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Endnotes

- 1 Allianz Global Corporate & Specialty, Allianz Risk Barometer, Top Business Risks for 2019, <https://www.agcs.allianz.com/content/dam/onemarketing/agcs/agcs/reports/Allianz-Risk-Barometer-2019.pdf> et al
- 2 Global Risk Management Survey 2019, Aon plc 2019, www.aon.com/germany/publikationen/risk-solutions/global-risk-management-survey-2019.jsp#.
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