

# Home Counties Insurance Services Ltd



## A Guide to Business Interruption Insurance



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# HCI Guide to Business Interruption Insurance

Business Interruption (BI) insurance covers certain financial losses caused by damage to a business's assets. This is often confused with elements of property insurance that covers physical assets within the business, such as buildings, machinery and stock.

## The two critical elements of BI insurance

There are two items within your policy that are critical to ensuring you have the correct coverage:

1. The indemnity period
2. The sum insured.

### 1) How to set a realistic indemnity period

What's the maximum length of time, within reason, that you think your business could be affected by an insured loss? This is the first step in estimating your indemnity period. For example, factors could include:

- demolishing your building, and site clearance
- building design, planning permission and tendering
- the construction period
- replacing equipment, machinery and stock
- restoring your supply chain and customer base.

You should try to envisage a worst-case scenario to help you set an adequate indemnity period. This will be essential in ensuring your BI policy will provide realistic cover until your business operation recovers to a normal level (i.e. the level you would expect if the loss had not occurred). Don't fall into the trap of underestimating your indemnity period. For example, architects and planning consent could easily take six to eight months before you're able to find a builder and schedule the work.

### 2) How to calculate the sum insured

Different types of business use different methods to calculate their BI sum insured. Most businesses use one of the calculations described below.

**Gross profit:** This method is often used by manufacturers or by organisations carrying a large amount of stock.

Definitions of gross profit can vary. However, the most commonly used calculation is:

$$(annual\ turnover + closing\ stock + work\ in\ progress) - (opening\ stock + work\ in\ progress + uninsured\ working\ expenses) = gross\ profit$$

The precise definition of 'uninsured working expenses' varies between insurers: however, it's often considered to be the costs that vary in proportion to turnover fluctuations. Depending on the insurance policy wording, it could include discounts, bad debts and items described in the policy schedule. Items that are not mentioned will need to be separately insured as appropriate.

Once calculated, current gross profit should be increased to align with anticipated business growth during the term insured and the indemnity period. However, it's important to remember that a loss might occur on the last day of the term insured.

**Gross revenue/gross income/gross fees:** This method often suits organisations that provide services. This insurance calculation will often cover total annual turnover, with few, if any, uninsured working expenses.

**Gross rentals:** This method is for landlords to cover the risk of losing rental income following an uninsured loss.

**Increased cost of working (ICOW):** This does *not* cover loss of income or gross profit. ICOW can be included as an option in the settlement of gross profit and gross revenue loss. It is often described as expenditure necessarily and reasonably incurred for the sole purpose of fully or partially avoiding reductions in turnover following a loss.

An ICOW could comprise:

- renting temporary premises and/or equipment
- the cost of moving equipment
- cleaning costs
- utility costs incurred at a temporary site
- the uninsured cost of equipment purchased
- outsourcing labour, special bonuses and overtime payments
- vehicle rental and additional transport for employees.

Insurers will always be pragmatic. Insurance claims paid will not exceed the amount of income/gross profit that is saved – this is sometimes called the 'economic limit'.

**Additional increased cost of working (AICOW):** This is largely for businesses that exceed the economic limit purely to maintain production. The AICOW sum can be included in addition to the main bases of the BI policy. While this additional cost must be necessarily and reasonably incurred, there might not be a pre-agreed limit.

### **Other extensions**

BI cover can be extended to include customers, contract works extensions and suppliers' extensions.

### **Help is at hand**

The above summaries provide an outline of the cover generally available.

Please contact us if you require further, detailed information or information concerning types of cover not shown here.

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