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Property
Insurance Buyers' News • March/April 2014
Volume 25 • Number 2

# Business Income Coverage: The Survival Plan for Small Business

**At least 30 percent of small businesses in the U.S. have been closed 24 hours or longer in the last three years due to a natural disaster, reports the National Federation of Independent Business (NFIB). FEMA, the Federal Emergency Management Agency, estimates that almost 40 percent of small businesses never reopen their doors following a disaster.**

## What Is Business Income Insurance?

Business income coverage (also known as business interruption coverage) protects your most valuable asset—your business income. It provides the cash you need to survive a shutdown or slowdown due to a covered cause of loss at an insured property. It can cover your payroll, continued operating expenses (such as rent), and lost net profits from the time your business shuts down until physical restoration of the property. Continuing to receive a near-normal income after a disaster helps you retain valued staff and maintain your financial stability during rebuilding.

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## This Just In

**This winter's unusually harsh weather caused an estimated $1.6 billion in insured losses in the U.S. And that was just for January. As this issue went to press, figures for February weren't available yet. "The current winter season in the United States has already become the costliest year for the winter weather peril since 2011," Steve Bowen, senior scientist and meteorologist at London-based Impact Forecasting, said in a statement.**

**The losses stem from property damage and business interruption losses due to higher-than-average snow totals, ice and some of the coldest temperatures in nearly two decades.**

**Business owners can take heart, though. Standard business property policies, including the bundled business owner policy (BOP) cover damage to insured property caused by**

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## The Limitations of Basic Business Income Coverage

Note the key phrases "insured property" and "covered cause of loss" above. To understand why these are important, let's say that heavy snowfall caused your plant's roof to collapse and forced a four-week closure for repairs. If your BOP covers this property, your business income coverage would apply.

Now let's imagine snow damage closed a key supplier's location. Even if you lost business as a result, your coverage would not apply, because the damage did not take place on your "insured premises." Likewise, a shop in a mall would lose income if the mall had to close due to roof damage. If the shop itself (the insured location) didn't have any damage, its business income coverage would not apply.

To cover these and similar situations, businesses can buy "contingent locations" coverage. This essential coverage protects businesses that depend on other businesses for their survival. These could be suppliers, key clients or even a neighboring business that draws customers to the area, such as an anchor store in a mall. If a covered loss closes or slows business at one of these "dependent properties," contingent business interruption coverage will cover your lost income. You can buy this coverage on a named property basis, which would cover you for losses at specific locations, or on a blanket basis.

## The "Time Element" in Time Element Coverage

Some insurance experts call business income coverage a "time element coverage" because it takes time for a loss to develop. Policies usually have a 72-hour waiting period, meaning they will not pay for income lost in the first 72 hours after direct property damage. You can buy additional coverage to reduce or eliminate the waiting period. Your "period of restoration," or time the policy allows for rebuilding, begins after the waiting period. The policy covers your income lost during this time, usually 30 days.

After a major disaster, particularly one that affects a large geographic area, shortages of materials and skilled workers could make repairs drag on much longer than 30 days. To protect themselves from this risk exposure, businesses can buy coverage to extend the period of restoration for up to 360 days.

Most business income policy forms have a coinsurance provision. This requires the insured to buy insurance equaling net income and all operating expenses for a 12-month period, times the coinsurance percentage the insured selects. Coinsurance percentages range from 50 to 125 percent; the higher coinsurance percentage you select, the higher the premium credit your insurer will give.

Coinsurance percentages also affect how much your policy will pay at claim time. If you fail to maintain enough coverage, the insurer will pro-rate any claim payments, using the ratio of the insurance limit to the loss. Let's say your business has an insured property damage loss and no income at all during the period of recovery, losing a total of $250,000 in income over three months. If you have $750,000 in coverage, your policy would pay a maximum of 75 percent of your loss, or $187,500, since you should have had at least $1 million in coverage ($83,334 in income per month times 12 months).

Insurers will waive the coinsurance penalty if your policy has an "agreed value" provision and you submit a business income worksheet to your insurer each year. In this case, your policy limit will be the agreed value, with no deduction for a coinsurance penalty. We'll cover the business income worksheet in more detail in our next issue. For information in the meantime, please contact us.

We can help you evaluate your business income loss exposures, including contingent business exposures, and design an insurance program to help you protect your business income.

*This Just In*

**burst pipes, rain, wind and heavy ice and snow. (In certain high-risk hurricane areas, insurers might exclude coverage for wind damage, but you can buy separate coverage for windstorm damage.)**

**The BOP also provides some coverage for business interruption, or income lost due to insured damage to a covered property. For more information on this important coverage, please see the article on this page.**

# Understanding Your D&O Coverage

**What keeps directors up at night? Many worry about personal liability from their board service. In a 2011 survey, 76 percent of CEOs surveyed said they were not confident for-profit boards had adequate insurance coverage, and 70 percent said the same about nonprofit boards. Only 59 percent of respondents said their board had directors and officers (D&O) liability coverage. (Source: Survey, Chartis and The Chief Executive Group)**

D&O policies will pay legal defense costs and settlements for directors' and officers' personal liability for actual or alleged "wrongful acts" committed in the course of their official duties. Policy definitions vary, but "wrongful acts" usually include actual or alleged acts, errors, omissions, neglect or breaches of duty, misstatements or misleading statements. Even if you have D&O coverage, does it fully protect your directors and officers? Understanding your risk exposures and what your policy covers can help you avoid potentially costly coverage gaps. Some things to look for include:

- Exclusions. Typically, policies exclude: 1) claims for bodily injury, property damage and personal injury, such as libel, slander and emotional distress. Your general liability policy covers these risks, 2) "prior incidents" and "prior litigation," or incidents reported in earlier coverage periods and litigation begun before the policy period, 3) ERISA liability, which results from administering pension and welfare plans, 4) pollution or environmental impairment liability, and 5) coverage for punitive damages. Other exclusions vary more. For example, some policies specifically exclude securities actions; some exclude coverage for fraudulent, dishonest or criminal acts. Publicly traded firms buy D&O coverage, in part, to protect directors and officers from these types of claims. If your policy contains these exclusions, you will want to negotiate with your insurer to have them removed.
- Coverage for regulatory actions. D&O policies can cover costs if a regulatory agency investigates the organization for some types of wrongdoing. However, some policies exclude coverage for spe-

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cific activities, particularly in the financial services field. And some policies might specify coverage for regulatory activities by named agencies. This could imply the policy limits coverage to actions by named agencies only, warned attorney and D&O blogger Joseph Monteleone of Tressler LLP in New York.

- "Preclaim" costs. D&O policies traditionally do not cover costs an organization incurs when investigated as a "party of interest" or in an informal inquiry, as opposed to when it is the target of an investigation. Some insurers now offer coverage for preclaim costs in certain situations, reported *Business Insurance* magazine (8/7/11).
- Securities suits brought outside the U.S. Will your policy cover investigation and defense costs incurred in a foreign jurisdiction, as well as any potential settlements? This coverage could prove important to multinational firms, as other countries beef up their securities regulation.
- Advancement of loss. Whether a policy actually covers a claim can remain undecided until the case is resolved. For example, many claims against directors and officers allege fraud, which many policies exclude. Meanwhile, defense and investigation costs accrue. If your insurer reimburses insureds for legal defense costs before settlement, it might stipulate that the insured reimburse the insurer if the claim turns out to be uncovered.
- Severability. Wrongful acts can void coverage, so you will want your policy to have a severability clause, which clearly states that the wrongful act of one director or officer will not be imputed to any other director or officer.
- Entity vs. insured exclusion. Older D&O policies often have an "insured vs. insured" exclusion, which excludes coverage for claims brought by one insured against another. This could include suits brought by the corporation against insured directors and officers (or ex-directors and officers), if your policy covers the corporate entity. The newer wording specifically eliminates coverage for suits by the corporate entity against its own officers and directors.
- Coverage for bankruptcies. Chapter 11 filings often trigger shareholder suits against the corporation's directors for breach of duty or fraud. When a company goes into receivership, ownership of the D&0 policy and its proceeds can come into question. Entity coverage under the policy can also reduce the limits available to defend directors and officers. Policies can be amended to fix these coverage gaps.

The complexity of claims against directors and officers makes D&O one of the most challenging areas of coverage. Every corporation's situation and policy needs individual analysis. We can help you evaluate your risk exposures and coverage needs. Please contact us for more information.

# Weathering the Storm with Weather Insurance

**If the past few years have proved anything about the weather, it's that you can't control Mother Nature. That's why insurers offer weather insurance.**

Businesses that use weather insurance include farms, special event promoters, filmmakers, contractors and retailers. Weather insurance policies can protect your organization from any type of weather — too much or too little rain, excess heat or cold, wind speed, photographic conditions, tides — that affects your business. Weather insurance might also fill an important gap in your business insurance program. Most standard business policies do not cover business interruption due to weather. You can often tailor a weather insurance policy to cover weather-related loss of earnings, repairs or cleanup.

Weather insurance coverage usually costs from 1 to 10 percent of the amount at risk, depending on the weather perils, location and type of risk. Policyholders can select the benefit trigger to reduce costs — for example, the promoter of an outdoor music festival may opt for a policy that provides cover-

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age if more than ¼" of rain falls only on the festival's weekend days. In addition, since weather insurance underwriters have access to sophisticated weather data, the insurer can help you plan your event or promotion for a time you're most likely to experience favorable weather.

To obtain a quote for weather insurance, you'll need to provide the following information:

- Named insured
- Location of risk
- Covered date or dates, and time of day (if applicable)
- Peril, or type of weather to be insured against
- Weather trigger, or the specific, measurable event that must occur during covered dates for the policy to pay. For example, ½ inch rain, lack of rain (i.e., less than 80% of historical average), one foot of snow.
- Payout amount, or what the insurer will pay if the insured peril and trigger occur at the specified location and time period.

Weather insurers will either use on-site monitoring or data from a local weather station, usually specified in the contract, to verify the insured event occurs.

A weather risk derivatives market also exists, which allows organizations with weather-related risks to enter into contracts with investors willing to take on those risks. Originally used by energy companies to cushion the effects of weather-related fluctuations in demand, weather contracts now represent a $9 billion market annually. Other types of industries now use weather contracts, including contractors and manufacturers. The Chicago Mercantile Exchange now trades contracts related to temperatures, snowfall, frost and hurricanes. Specialized brokers can help businesses place these contracts.

For more information on the uses of weather insurance, please contact our office.

## Five Uses for Weather Insurance

In addition to covering special events, weather insurance has many other uses:

- To supplement federal crop insurance. The federal crop insurance program typically does not pay until a farmer experiences very large yield losses. Weather insurance covers the smaller losses left uncovered by the federal program, but that can make the difference between profitability and loss. It can also cover crops ineligible for the federal program. Getting a claim paid under a weather insurance program is also simpler. Crop policies typically require the insured to notify his/her agent within 72 hours of discovery of crop damage. The insurer inspects the crop and estimate losses; you cannot plow, disk, replant or otherwise damage evidence until the adjuster gives permission. The policy will pay based on your estimated loss. Weather policies require no inspection or estimates. They pay if a specified weather event occurs during a specified time period. For example, an orchardist might insure against freezing weather while blossoms are setting. If weather dips below the specified temperature during the specified period, the orchardist's weather insurance policy will pay the agreed amount.
- To cover filming costs. Filmmaking often requires large crews and casts. If weather is not suitable for filming on scheduled days.
- To cover lost sales. For example, a ski resort has fixed expenses during the season, whether the slopes are crowded or not. Unusually warm or wet weather during a key holiday week means fewer people buying lift tickets, rental packages, lessons and meals. Weather insurance can mean the difference between profitability and loss.
- To cover weather-related promotions. A jeweler might promote engagement rings by offering to pay for the ring if it rains on your wedding day. Weather insurance can offset losses from such promotions.
- To cover snow removal costs. Weather insurance can help offset extra expenses due to an unusually snowy season.

Please contact us to learn more about the many uses of weather insurance.

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