CANTERBURY EMPLOYERS' CHAMBER OF COMMERCE

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FINANCE

INSURANCE

QUICK GUIDE

MATERIAL DAMAGE AND BUSINESS INTERRUPTION POLICY?

At first glance, most Material Damage and Business Interruption insurance policies appear very similar. While policy differences are subtle, they can have a significant impact at claim time. Policy wording negotiated and agreed between insurance brokers and insurers often provide wider cover for policyholders than insurers' standard wordings. Below are some issues to look out for in your existing and future Material Damage and Business Interruption insurance policies.

MATERIAL DAMAGE COVER

- Unless you have a real reason for insuring otherwise, ensure you have **Reinstatement or Replacement** cover. The Canterbury earthquakes have revealed just how endemic under-insurance is.
- Check the replacement valuation for your insured building/plant/equipment policies at least bi-annually. To ensure the sum insured for your building is as accurate as possible, a Quantity Surveyor's report on the cost of reinstatement is a good idea.
- Some policies cap the insurer's liability at the **'Sum Insured'**. Others allow extensions to the sum insured. This is usually expressly noted e.g. the insurer's liability is capped at the sum insured unless expressly noted otherwise. The latter is preferable.
- Ensure you include the cost of replacing all property when setting the sum insured and that the definition of **'Insured Property'** (if there is one) is sufficiently broad.
- **A Constructive Total Loss** clause can be invaluable. They provide that if the insured property is damaged and you are unable to reinstate by virtue of any law, the property is deemed to be destroyed. This increases the dollar value of the policy response to a claim and may give you more options, for example, it should enable, you to reinstate on a different site if necessary (whereas repairs to 'damaged' buildings can only be performed at the insured location).
- Most **Reinstatement Memoranda** allow reinstatement on another site if the property is destroyed. Some extend this to allow reinstatement on another site or sites in any manner reasonably suitable to the insured. The latter gives you more flexibility in your reinstatement.
- If you purchase a new property or undertake any repairs, renovations or extensions of your property (capital additions), tell your insurer. Most policies have a **Capital Additions Cover**, but many are conditional on you informing the insurer of the acquisition or addition.
- Some policies include a **Reinstatement of Sum Insured** clause. The best provide that the sum insured is reinstated from the date of an event or when a claim is payable not from when a claim is paid. However, we'd note that post-quake application of these clauses is highly contentious and they are becoming less common.
- Cover for **Demolition and Removal of Debris** may be included in the sum insured or additional. Either way, make sure that you have sufficient cover as our earthquakes have revealed serious under insurance in this area. It's advantageous for your demolition clause to include the cost of removal and storage and return of unharmed property.

- Insurers are becoming more cautious with their underwriting. Policies are being issued or terms imposed at renewal which include:

    1. An exclusion on the cost of seismic strengthening for any repairs;
    2. An endorsement which reduces the sum insured by the value of outstanding earthquake damage repairs until the repairs are undertaken;
    3. Excesses (for EQ claims) which are a percentage of the site sum insured rather than a percentage of the loss. Some brokers offer buy down cover but it is expensive. If you own a building which is tenanted, you will want to take advice on how site specific excesses are apportioned as they can be extremely significant.

BUSINESS INTERRUPTION INSURANCE

- Ensure your **Indemnity Period** is long enough. Many with 18 month to 2 year indemnity periods have been caught short after the Canterbury earthquakes. What is suitable will depend on the nature of your business.
- The trigger for business interruption cover is usually loss or damage to insured property under a material damage claim. Some policies require that material damage claim to be your own property in which case, having the same insurer for both is important. Others are broader, which is preferable.
- Whatever indemnity period you select, some will start with the event (e.g. the fire or the earthquake) others start with the interruption resulting from the event. The latter is preferable as many businesses are able to continue trading after an event but find their indemnity period may have expired when repairs are to be done. This can be particularly tricky for businesses occupying tenanted premises with no control over when the landlord carries out repairs to the building.
- When setting the **Sum Insured**, if your indemnity period is more than 12 months, the sum insured must be adjusted accordingly; an 18 month indemnity period requires a sum insured equivalent to 150% of the business' annual profit or rental income.
- If your business is growing or profits improving, allowance should be made for this trend not only for the 12 month period of insurance (the policy period) but also the maximum indemnity period on top of that. So, if your turnover is increasing at about 5% per annum, and you have a 2 year indemnity period, you would add 15% to your sum insured.
- An anticipated one off event, for example a machine purchase or a tenant's rent review during the forecasted indemnity period should be allowed for in your sum insured. The policy allows adjustments to the historical business data to ensure the policy pays what the business would actually have achieved during the indemnity period, but this will still be capped by the sum insured.
- If you have **Gross Profit Cover**, take advice from your accountant about what to include in calculating your gross profit. Working costs which are directly variable to turnover are uninsured working costs and if they are not defined in the policy, it can have quite a significant bearing on your gross profit, therefore your rate of gross profit and ultimately your claim payment.
- Take out **Additional Costs Cover**. This is a separate sum insured for costs reasonably incurred to reduce or avoid a reduction in turnover during the indemnity period.
- A broad **CLaims Preparation Costs** clause is advantageous. You want it to have negotiation and justification of claims, not just assessing and preparing claims. This means professional costs incurred to resolve the claim should be covered.

- While business interruption policies are usually triggered by material damage loss, **Optional Covers** are available for business interruption as a result of other things. For example:

  a. Closure by **Civil** or **Public Authorities**;

  b. **Prevention of Access** to your business. Beware of long stand down periods for this cover to kick in, and it is better for the prevention of access to just be *"in the vicinity"* of your business not a specified radius of one kilometre or so;

  c. **Dependency** which means your business interruption claim can be triggered by loss or damage sustained by a supplier or a customer suffering loss or damage.

  These optional covers usually have a sub-limit of 10% of the sum insured available.

This is not intended to be a comprehensive list of issues to consider when taking out or renewing your insurance cover but we hope it is of assistance.

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