



Business Income Fundamentals

What every insurance professional needs to know and share with policyholders

Business income coverage is one of the least understood insurance coverages, but it is also one of the most important. Business income coverage can mean the difference between staying in operation or going out of business. The Independent Insurance Agents & Brokers of America (IIABA) estimates that “43% of businesses suffering a serious loss never reopen, and 23% of those that do close within three years”. While providing business income coverage is vital to insureds, it also serves as a premium income source for insurers.

Business income is defined as the net profit or loss that would have happened if the suspension of business operations had not occurred. In order for business income coverage to kick in, the suspension of operations must be due to a direct covered loss to property at the described premises. Another example is if the premises is made incapable of being occupied by a covered cause of loss. Access to the premises may be prohibited by civil authority. If the reason is a loss to a nearby property, that would have been a covered cause of loss if it happened at the insured’s premises, then there can be a collectible business income loss.

Extra expense coverage is intended to help the business get back in business as soon as possible, thereby avoiding or reducing the business

income loss. Businesses such as restaurants, newspapers and convenience stores must resume operations quickly, or their customers may be gone forever.

No one has a crystal ball. For most types of business, there is no way to know what type of coverage will be needed until the loss occurs, and coverages are not interchangeable. Business income coverage cannot be used to pay for extra expense claims, and vice versa. Companies who offer a combined business income/extra expense limit have a competitive advantage.

There are some common misconceptions about business income coverage. For example, it is seen as “free money” or as not needed by companies that are not making a profit. Neither of these is correct. Business income is not “free money”. Even under policies that offer “unlimited” business income, the burden is still on the insured to prove their loss. Non-continuing expenses are not collectible. In addition, the insured cannot be made better off after the loss than before.

There are time limits on coverage as well as monetary limitations. Business income coverage is available for the reasonable amount

of time it would take to rebuild, replace or relocate the business. Business income coverage does not end when the policy expires or is cancelled. However, even under

policies that offer BOP type “unlimited” or “actual loss sustained” coverage, coverage is usually available for only one year from the date of loss. Getting permits

and contractors takes time. If the repairs take more than twelve months, the insured may be left without coverage. Policies that provide an actual limit of coverage usually do not have the twelve month time limit. Recovery is limited by the amount of coverage purchased.

Does a business that is operating at a loss need business income coverage? Absolutely. Profit is not a requirement for business income coverage. Continuing expenses such as rent and electricity can be paid for. In fact, the coverage may even be more important for businesses that are struggling. It provides money to pay for continuing expenses that the business still has to pay and which would otherwise put them more in the red. The intent of business income coverage is to bring the

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business back to the position they were in prior to the loss. If the non-continuing expenses are less than the net income loss the insured was experiencing prior to the loss, the insured is not due any business income payment.

Picking a coverage limit is difficult. According to IIABA, “95% of business income losses aren’t adequately insured.” This means at the least, an unhappy client, and at worst, loss of the client, either to another carrier or to bankruptcy. The coverage estimate should take into account the anticipated income and expenses going forward at least two years, since the business income loss could occur at any time during the policy period. . Factors to consider include the time it will take to get back in business, the income loss if the shutdown occurred during the insured’s peak period of business, other income sources such as rental income, and estimated operating expenses for a year, as well as any regulatory and construction codes that could delay recovery.

When the loss occurs is also a key factor in the type and amount of coverage needed. A loss at the beginning of the busy season is

probably more critical than one during a slow season.

Determining which expenses will be continuing or non-continuing can also be a challenge. During a short interruption, many businesses may choose to continue to pay their employees, especially in a tight job market or if the employees are highly skilled. There are options to include payroll of “ordinary” workers.

While there is no dollar deductible under business income, there is often a period of time (often 72 hours) from the loss date until coverage kicks in. There is no time deductible for Extra Expense coverage, since, as indicated before, the purpose is to get the business back as soon as possible.

Important optional coverages available with business income coverage include Extended Period of Indemnity and Contingent business income. Even after the damage is repaired and the business has reopened, it takes time for the customers to come back. There is still a business income exposure. The Extended Period of Indemnity is intended to make up lost income

from the time when the business reopens until it is back to the pre-loss profit level.

Contingent business income or business income from Dependent Properties is also important. This addresses losses that occur even when there is no loss to the insured’s premises. Examples include loss to a supplier of parts or goods, or a key customer.

For insurance companies, the goal is to get the insured back in operation as soon as possible, for the least expense. Many businesses that have a business suspension over 30 days never recover. Understanding possible exposures and offering flexible coverage options will help make your company the first choice of agents for their valued clients.

This article originally appeared in the NYIA NY Connection Magazine.

