

Business Interruption Strategies

Companies face multiple risks, not least the chance of loss of income due to unforeseeable events. Business interruption strategies can help a business survive and recover when the unexpected happens.

BY KIRK TURNER

Business interruption and business continuity figures among the top 5 security risks feared by Fortune 1000 professionals in the US according to a 2003 survey by Pinkerton. Considering that an average loss for just 1 month factory downtime can reach millions of euros, depending on contingency or emergency plans, it is not surprising that this fear is second only to workplace violence and ahead of terrorism or identity theft in the Pinkerton survey.

Business interruption (BI) insurance has begun to play a greater role in the property insurance industry in recent years—particularly with the intensification of risks such as terrorism and the growing role of outsourcing and digital systems. Moreover, the main cause of BI claims continues to be fire, followed by natural hazards. BI insurance, which generally covers loss of profits due to disruption, is common for large firms in industrialized economies. Loss of income can have an adverse impact on market positioning, with effects ranging from temporary restriction or cessation of production to loss of market share or even liquidation

BI first became fashionable in 1817 in Hamburg, Germany, primarily as a supplemental coverage to property insurance for fire (see Fig. 1.). BI can include coverage for a wide variety of financial liabilities like loss of profits, workers' salaries and period of restoration. Perhaps the most notable and devastating impact on the property insurance industry, including BI insurance, stemmed from Sept. 11, 2001 which redefined insurability. Prior to that date, terrorism was often automatically covered in property contracts in many countries. The costs and complications arising from Sept. 11 were astounding and although a review of the structure for BI insurance was urged during the late 1980s and 1990s, such a momentous blow to the industry had not been foreseen.





Fig. 1

Key dates in BI insurance

- 1797 First attempts by Minerva Universal, England, to insure consequential costs, such as inability to pay interest. Bookkeeping methods prevented success
- 1817 Hamburger Generalfeuerkasse, a government company, covers loss of rent as a supplement to fire insurance
- 1899 British loss of profits system developed in Glasgow, based on turnover
- 1986 Gross earnings insurance in the US, "Business Income Coverage Form"
- 1990s Contingent BI sums insured surge up to US\$1 billion
- 2001 Sept. 11 terrorist incident results in narrower BI coverage for named perils only

Source: Allianz and Swiss Re publication *Business Interruption Insurance*, 1998

Strategies for BI insurance, also known as Business Income Loss coverage in the US, are still evolving. Many governments, for example Germany, Spain and the UK, have begun to interact more closely with the insurance industry on property insurance issues since 9/11, recognizing the considerable difficulties and costs involved in cases of loss. States and the insurance industry have also funded joint pools in some cases, such as Germany's Extremus AG, to respond to the complication of large risks such as terror attacks, by offering direct financial support or existing as reinsurers of the last resort.

As such, state regulations influence the shape of BI and property insurance, often creating minimum standards for coverage. For example, in the UK, a "material damage proviso" must be included in property insurance coverage to avoid lack of funds adding to business interruption. Terrorism coverage became compulsory in the US with the Terrorism Risk Insurance Act (TRIA) of 2002, which includes BI provisions.

Amid global trade and new production measures, outsourcing and cyber risks, for example, can pose serious threats. Supply from outsourced contractors can break down and potentially endanger production processes—an increasing threat referred to as contingent business interruption. This risk can be covered by supplemental insurance policies such as Service Interruption. The ability to define a company's loss is even more complex when outsourced materials or services contribute to the production chain.

In one example of a contingent BI claim, a fittings factory suffered BI due to a fire at the plant of a supplier. The company assembled patented watertight rings made from synthetic materials onto finished products. The fire started at the plant of the only manufacturer of the rings. This halted deliveries from the contingent firm and therefore the products could not be finished as planned.

Among problems, denial of access coverage is also frequently a part of property insurance, because restrictions to accessing property after a loss commonly hinder the restoration of business capability. Moreover, increasing reliance on digital media also raises the chance of business disruption through cybercrime or system malfunction. For more information about BI risks and coverage options for PC and electronic network systems, see the article starting on page 13.



Fire damage is the No. 1 cause of business interruption

Minimizing losses

In addition to insurance coverage, risk management strategies for BI should include business continuity measures as well as pre- and post-loss consulting. Such activities can help companies cope better after suffering business interruptions, as management is often hampered in their ability to effectively continue their usual duties while addressing the effects of loss.

According to Andreas Shell, head of Client Services at Allianz Global Risks in Munich, the insurance industry trend of large property claims with small BI components has reversed in recent years, with property claims now generally small in comparison. Shell notes that whereas insurers have a lot of experience with property insurance claims, "BI is a different animal altogether." Shell has nearly 15 years of experience in claims handling with the Allianz Group and is the Allianz Group Claims Coordinator, which has included handling of claims related to Sept. 11, 2001.

Allianz Global Risks' Business Interruption Claims Task Force was launched recently in response to increased demand for BI protection solutions and the need for more thorough research and specialization in this area. It can assist clients by providing effective strategic solutions. Members are involved on-site, working in conjunction with, and in addition to, national claims handlers.

Established in May, 2004, the BI Claims Task Force team currently consists of members from Germany, Czech Republic, the UK, US, Mexico and France, nominated and selected for their BI experience and expertise. Headed by Hans Mederer of Allianz Global Risks Germany and Mark Carpenter of Allianz Global Risks Center in Munich, the team is directly involved in the handling of complex and/or large BI losses exceeding €5 million which are insured by Allianz Global Risks. Pre-loss activities can also be arranged with Allianz Risk Consultants. Insureds can ask for the Task Force to get involved at any time and will not be charged for these activities above their regular insurance premiums.

"The BI Task Force is a third party service to help our existing property clients mitigate and prevent BI losses," Carpenter says. "The team interacts with claims handlers, loss adjusters and clients with the aim of ensuring that the right decisions are made to get business back up and running." Claims mitigation measures can be analyzed and implemented. The team also plans to create a knowledge database.

"The Task Force also helps us better manage and cooperate with external service providers to ensure the shortest possible interruption with the least possible financial losses for the client," Carpenter adds. Thus, the costs of BI are increasing, but so are the solutions for dealing with this potentially devastating risk.

CONTACT

Mark Carpenter
Team Leader, BI Claims Task Force
Allianz Global Risks
Munich, Germany
E-mail: mark.carpenter@allianz.de

Hans Mederer
Team Leader, BI Claims Task Force
Allianz Global Risks
Cologne, Germany
E-mail: hans.mederer@allianz.de

www.arc-allianz.com

www.agr.allianz.com