

# BUSINESS INTERRUPTION: INSURANCE AND ADJUSTMENT CHALLENGES

It is generally considered that Business Interruption (BI) insurance is one of the most complex and complicated types of risk assessment insurance products, underwriting, and loss adjustment prospects.

Risk assessment difficulties raise from the following BI insurance particularities:

- (1) The interest insured under BI coverage is formed by the Insured's expectations as opposed to Property Damage (PD) insurance, which is normally relevant to Insured's property on hand;
- (2) There are numerous factors under and beyond the Insured's control that influence business insured during the insurance period and could lead to over- or underinsurance at the moment of loss occurrence. It should be kept in mind particularly when dealing with businesses related to exchange commodities, manufacturing, and trading.

For instance, the LME price for cobalt soared from USD 27,000 in September 2016 up to USD 70,000 in 2017 and up again to USD 90,000 in 2018. Therefore, the insured sum established in September 2016 appeared to be utterly irrelevant to actual BI losses incurred in 2017-2018 and even 20% uplift of the sum insured provided for in the Policy did not help.

- (3) BI Possible Maximum Loss (PML) and Estimated Maximum Loss (EML) do not necessarily coincide with PD PML and EML. For instance, while PD caused by fire can exceed manifold PD due to machinery breakdown (MB), BI losses resulting from a fire can be comparable to BI losses due to MB if it concerns equipment which: (1) forms a bottle neck for the Insured's output process; or (2) cannot be replaced or repaired quickly.

Contingent Business Interruption (CBI) coverage should also be mentioned as it is usually granted with rather high limits but without proper estimation of possible risks. Meanwhile, CBI losses can be comparable with BI losses due to catastrophic incidents at the insured premises. For instance, lack of access to the insured premises due to a bridge collapse or logjam at the only road, as well as fire or structural collapse at a rented warehouse can lead to large CBI losses, especially considering that the

Insured have limited capability of influencing the restoration process, as the damaged property does not belong to them.

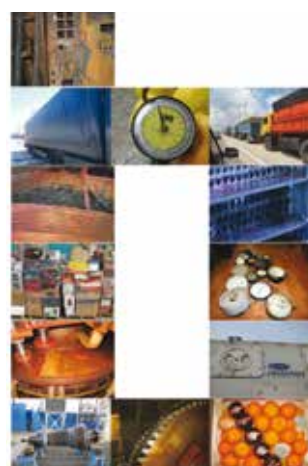
BI underwriting problems specific for Russian, CIS, and other developing markets mainly arise from:

- (1) the lack of generally accepted BI insurance conditions and/or standard insurance forms similar to standard policies and specifications produced by Association of British Insurers (A.B.I) or Insurance Services Office in USA (I.S.O.);
- (2) the lack of mutually agreed terms and definitions used in BI insurance;
- (3) the lack of standard BI extensions and exclusions allowing modularized BI coverage to meet demands of a particular Insured, in a manner that is clear for both the client and for the Insurer and Reinsurance panel.

It is no secret that BI insurance is not so widely spread in Russia and CIS, as in Western Europe or the USA. The main consumers of BI products are transnational companies, with established production and /or trading branches in Russia and CIS, or major domestic companies. The former frequently encounter problems in obtaining adequate fronting of BI coverage in Russia as local policy forms and general insurance conditions have little to do with their master policy wording; the latter need to struggle to work out BI coverage adequate to their business.

When adjusting BI loss one can list all the problems discussed above and some extra, namely:

- (1) BI losses require interdisciplinary review, which means that:
  - a. technical and technological knowledge is necessary to design the fastest means to production process restoration and possible measures to mitigate BI loss;
  - b. clear understanding of business process and logistic schemes is also necessary to evaluate if measures taken by the Insured upon the incident are relevant to the situation and allow maximum possible mitigation, as well as to give adequate recommendations to the Insured;
  - c. knowledge of commodity exchanges operation and marketing strategies is necessary to estimate business results achievable but for the incident;





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- d. forensic accounting knowledge and skills are required to prepare a proper calculation;
  - e. Policy wording review is necessary to figure out a portion of BI loss coverable under BI section.
- (2) A very modest BI insurance statutory regulation, that is not really a problem per se. However, the situation becomes tough due to concurrent lack of a doctrinal approach to BI insurance and consistent court authority.
- (3) A lack of generally accepted methodologies / approaches to BI losses calculation. From a broader point of view it would be possible to refer to more general methodology of lost profits calculation. However, the lost profits calculation methodologies authorized somehow in Russia are not consistent and have limited scope of application.

All the above does not mean that BI insurance is something not worth dealing with. Vice versa, BI insurance is a very effective tool to protect business from different uncertainties. However, this tool should be used properly.

While in Russia and CIS generally accepted rules and principles of BI insurance are not defined and authorized somehow, plain and consistent policy wording seems to be a cornerstone of mutually acceptable, and therefore successful BI insurance and loss settlement. To this end, the LABB team assists clients (both Insurers and Insureds) to design or improve policy wording to make it free of ambiguous provisions, consistent with local legislation and regulation and as close to standard clauses applicable in reinsurance practice as practical.

In the current economic situation, it is very important for Insureds to have a clear understanding of what insurance protection they buy and whether it is really worth spending on. As was mentioned above, nowadays in Russia, BI coverage is requested mainly by large companies or holdings. Such companies normally manage their risks and develop methods of protection preventing their business collapse even in the worst possible

circumstances. BI pre-risk audits allow the revelation of risks and “bottlenecks” which cannot be 100% prevented and avoided through reasonable measures and should therefore be insured. LABB provides assistance in auditing and assessment of BI risks.

LABB deals with the adjustment of BI claims, stemming from incidents in Russia and CIS, as well as in European and African states.

The LABB team has a large experience in handling large BI losses (over USD 30 mil.) and skills for overcoming the tough issues discussed above, including:

- ▶ Arrangement of loss adjustment process involving numerous participants (Insured and their consultants/loss adjusters/forensics, brokers, insurers, reinsurers, experts, etc.);
- ▶ Win-win negotiations in tangled and strained situations;
- ▶ Presentation of BI calculation and overall loss adjustment process at insurance / reinsurance market meetings.

LABB in-house experts in different types of industry carry out a professional review of production processes, production “bottlenecks,” and overall business, business restoration systems and methods of optimization, particularly cooperation during disaster recovery and property restoration for companies aiming at losses mitigation.

LABB financial experts are knowledgeable in BI loss calculation based on IFRS, GAAP, and RAS (Russian accounting standards).

LABB has experience in settling BI losses on a UK and USA basis, as well as on policy wordings used in European civil law countries and BI losses based on Russian, CIS, Ukrainian, and Georgian wordings.

