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BUSINESS INTERRUPTION GROSS PROFIT INSURANCE - GETTING YOUR SUM INSURED CORRECT

WHY IS BUSINESS INTERRUPTION INSURANCE IMPORTANT?

Business Interruption arranged on a Gross Profit basis, replaces your lost income following an insured event. If the insurance is arranged on the wrong basis, your business may fail.

WHAT ARE THE COMMON ERRORS MADE WHEN CALCULATING THE “GROSS PROFIT” SUM INSURED?

The Insurance “Gross Profit” definition differs from that regularly used in business and by accountants. Refer to Insurable Profit, i.e. the profit that you should insure.

Business Interruption insurance on this basis, replaces income until all interruptions from the insured event have ceased. Soon after the event, you may be able to trade on a reduced

basis, however, the Business Interruption will continue to support you and pay the reduction in income until you are operating as if the insured event had never happened.

This is called the Indemnity Period and many businesses underestimate how long it will take them to overcome all the interruptions. A 12-month indemnity period may not be adequate for many businesses and your Business Continuity Plan should help you establish what indemnity period you require.

When calculating the amount to insure for, many businesses do not make allowances for profit trends, basing their calculations on their past trading rather than the future.

If your indemnity period is 24 months and you suffer a loss on the final day of your annual policy, your Insurable Profit claim may not be concluded until 3 years after you originally calculated your sum insured. If trends and inflation have not been allowed for over these 3 years, your sum insured may not be adequate to cover the loss suffered throughout the indemnity period.

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EXAMPLE:

Insurable Profit as calculated overleaf	£1,000,000
Trend of +10% for forthcoming Insurance Period	£1,100,000
Trend of +5% for first year of Indemnity Period	£1,155,000
Trend of +3% for second year of Indemnity Period	£1,189,650

If the business had not allowed for any trends, their business interruption sum insured would have been £2,000,000 (Insurable Profit over 24-month indemnity period), when the Insurable Profit for the indemnity period is £2,344,650 (£1,155,000 + £1,189,650), 17% more than the unadjusted figure.

WHAT WOULD HAPPEN IF MY BUSINESS INTERRUPTION INSURANCE IS WRONG?

Your sum insured is the maximum your insurance policy will pay in the event of a claim. Any loss in excess of your sum insured will be borne by you. Many insurance policies contain an Average clause which, in the event of your loss being greater than your sum insured, allows the insurance company to reduce your claim by the same proportion that you are under-insured.

Your indemnity period is the maximum period over which your policy will replace your lost income. If it is insufficient, your policy will stop supporting you before your business has fully recovered, leaving you to fund any shortfall.

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CALCULATION (B) – INSURABLE PROFIT TREND

1)	Total Insurable Profit for Financial Period	£
2)	Add trend from the end of your Financial Period to the start of your Insurance Period	£
3)	Add trend for forthcoming Insurance Period	£
4)	Add trend for first year of Indemnity Period	£
5)	Add trend for second year of Indemnity Period	£
6)	Add trend for third year of Indemnity Period	£
	Total Insurable Profit	£
	<i>(B4 + B5 if 24M + B6 if 36m)</i>	

* *Financial Period – this is your accounting period most concurrent with the period of insurance.*

* *Uninsured Working Expenses - These are expenses which vary in direct proportion to any variation in Turnover and should be defined in your policy wording. Examples may include Purchases of raw materials, Discounts allowed, Bad Debts, Carriage, and Package & Freight.*

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