Contingent business interruption insurance: Does your company need it?

Contingent business interruption insurance: Does your company need it?

Just a few years ago, many U.S. companies wouldn't have thought that a flood in Australia or a warehouse fire in Germany could impact their business. But most of today's companies rely on suppliers or customers abroad to produce and purchase their products and services. A loss to one of these key partners can have nearly as much impact on an organization's ability to continue operations as if it experienced the loss itself. Complex supply chains and global products sourcing have made it more difficult for businesses and their risk managers to identify loss exposures and put in place the necessary mechanisms to provide adequate financial protection. Many organizations look to contingent business interruption insurance as this mechanism and, increasingly, to newer products like supply chain coverage to provide this necessary protection.

Complex supply chains and global products sourcing have made it more difficult for businesses and their risk managers to identify loss exposures.

What is contingent business interruption insurance?

Contingent Business Interruption (CBI) insurance reimburses a company for lost profits and other possible transferred risks, such as necessary continuing expenses, due to an insurable loss suffered by one or more of its suppliers or customers. Unlike traditional business interruption insurance that compensates the policyholder for a loss resulting from damage to its own property, CBI lets you transfer risk of certain losses to the property of a third party. Also commonly referred to as dependent properties coverage, CBI insurance is triggered if there is:

1. Direct physical loss or damage to a dependent property (supplier or customer);
2. The loss or damage is caused by a covered cause of loss; and
3. The loss results in a suspension of operations at a covered location.

CBI insurance is purchased by a company as an extension to the time element coverages in its property policy when there is no CBI included in the policy. It can be written on a standard industry policy, a company's proprietary policy or a manuscript policy form. Commonly, larger organizations with more complex exposures rely on company or manuscript forms since they are broader and more comprehensive, whereas a standard policy form is typically sufficient for small to mid-sized organizations.

CBI coverage is provided for a covered loss during what is called the "period of restoration." This is what is considered by the insurer to be the reasonable amount of time it should take the dependent property to repair the damage and resume its normal operations. But the CBI coverage is still subject to the applicable deductible stated in your policy.

The concept of contingent business interruption insurance is fairly straightforward, but determining what is a covered cause of loss is rarely black and white. For example, during the earthquake and subsequent tsunami in Japan earlier this year, one challenge was determining the event that caused the loss. Was the loss caused by the earthquake or by flooding as a result of the tsunami? Or should all of the claims be considered earthquake losses due to the fact that the earthquake was the proximate cause of the tsunami? These are valid questions, and the answers can vary depending on the breadth of coverage and how the policy was structured. These issues can be the difference as to whether or not the CBI policy is triggered and coverage is provided.

Who needs CBI insurance?

Global commerce has increased competition, resulting in businesses looking for ways to keep their competitive advantages. In order to sustain growth and boost margins, foreign suppliers and customers have become essential for many companies. This has created new contingent business interruption exposures that didn't exist before. But even if all of a company's suppliers, business partners and customers are local, CBI exposures can still exist.

A solid understanding of your critical third party partners is essential in helping minimize any contingent business interruption loss.

In evaluating whether your company needs CBI, you should start with a thorough understanding of your contingent business interruption exposures in order to determine if insurance coverage is necessary and to what degree. Most manufacturing companies have CBI exposures, but retailers, hospitality companies and even professional services firms also can be exposed to serious financial consequences as the result of the loss of a supplier, a business partner or a key customer. A solid understanding of your critical third party partners is essential in helping minimize any contingent business interruption loss.

You should start by identifying all of your suppliers and customers and determine their impact on your operations. You should ask yourself the following questions:

- If there is a temporary production stoppage by one or more suppliers, can I survive and for how long?
- Do I have alternative suppliers?
- Do I rely on one or a few customers to purchase the bulk of my products?
- Do I rely on a neighboring business to attract customers to me?

Coverage challenges and issues

The breadth of CBI coverage can vary among policy forms, but even with the broadest of coverage forms, there are still causes of loss to suppliers or customers that are not automatically covered. For example, earthquake or flood losses are typically not covered under a CBI policy since these are usually not covered in an underlying property insurance policy. The insured would need to request and purchase this type of coverage separately. You should work closely with your broker to be certain you are purchasing the best coverage for your specific exposures.

...it's important to carefully identify your exposures and evaluate how high of a limit you need.

Identifying other potential coverage restrictions is also important, especially for organizations with complex global supply chains. Two areas that may need to be addressed are "direct" versus "indirect" suppliers or customers, as well as "named" and "unnamed" suppliers or customers. Often policies will only provide coverage for suppliers or customers that the organization has a "direct" relationship with for receiving or selling products. This can create a gap in coverage for companies involved in multi-tiered supply chains. For example, if the supplier or customer of one of your direct suppliers or customers has a loss resulting in an interruption to your direct supplier/customer and this, in turn, causes a business interruption to your business, the coverage could be excluded. If this type of exposure exists, coverage for indirect suppliers or customers can often be added to the policy at the request of the insured.

Identifying every supplier is a challenging task, and sometimes insurance buyers may be unable or unwilling to name every supplier in a multi-tiered supply chain. If this is the case, you can request that the scope of coverage be expanded by endorsing the policy to include the "unnamed" suppliers or customers.

Another issue to consider is that most CBI coverage comes with a specified limit. Therefore, it's important to carefully identify your exposures and evaluate how high of a limit you need.

Finally, the lack of control you have over all of your third-party partners in the event of a contingent business interruption loss can cause many a sleepless night. It can be difficult for you to know whether a loss to a supplier or customer is being handled adequately and effectively. The insured and insurer are often left in the dark about the extent of the damage and what is considered a reasonable "time of restoration." This can lead to an insured being penalized for decisions made by a supplier or customer located halfway around the world. As a way to help mitigate this lack of control, it's a good idea to develop pre-agreed crisis management processes with their suppliers or customers.

In closing

Contingent business interruption insurance, along with up-to-date business continuity planning, is taking on new importance in today's business environment. The disasters of the past decade including the 9/11 terror attacks, Hurricane Katrina and the earthquake/tsunami in Japan have brought CBI to the forefront, due to the many unprepared organizations left in dire financial straits. That's why it's more important than ever to identify your potential for a contingent business interruption loss and work closely with an experienced broker, as well as your underwriter, to assure that the coverage in your policy properly addresses your exposures at an appropriate limit and price.

Zurich

1400 American Lane, Schaumburg, Illinois 60196-1056
800 382 2150 www.zurichna.com

A1-20158-A (08/11) 11-2215