CONTINGENT BUSINESS INTERRUPTION

There is increased demand for Contingent Business Interruption Insurance (CBI), but when a loss occurs it can present some additional and unconventional claims management challenges. Having a named set of experts who can share their experience of managing supply chain losses can improve pre-loss planning, helping firms assess the adequacy of their insurance and set their CBI claims management expectations.

The nature of business operations nowadays means that business structures and supply chains are getting ever more complex and vulnerable. Highly specialised production equipment, lean production processes, just in time practices and increased global interdependencies between suppliers and customers means that a small outage can create a substantial claim. And with the concentration of production and logistics hubs, a disruptive event in certain regions can create a multiplier effect that can spread huge losses to organisations around the world.

Increased demand for CBI

Phil Durrant, Chartered Loss Adjuster with Integra Technical Services suggests that “the Business Interruption proportion of a Property Damage claim now often accounts for the majority of the loss and single risk claims exceeding USD100 million – and in some cases approaching USD1 billion - are not uncommon.” It’s hardly surprising that for the sixth year in a row the Allianz Risk Barometer 2018, a survey of 1,900 risk management experts from 80 countries, cited Business Interruption (including supply chain interconnectivity) as the most important global risk.

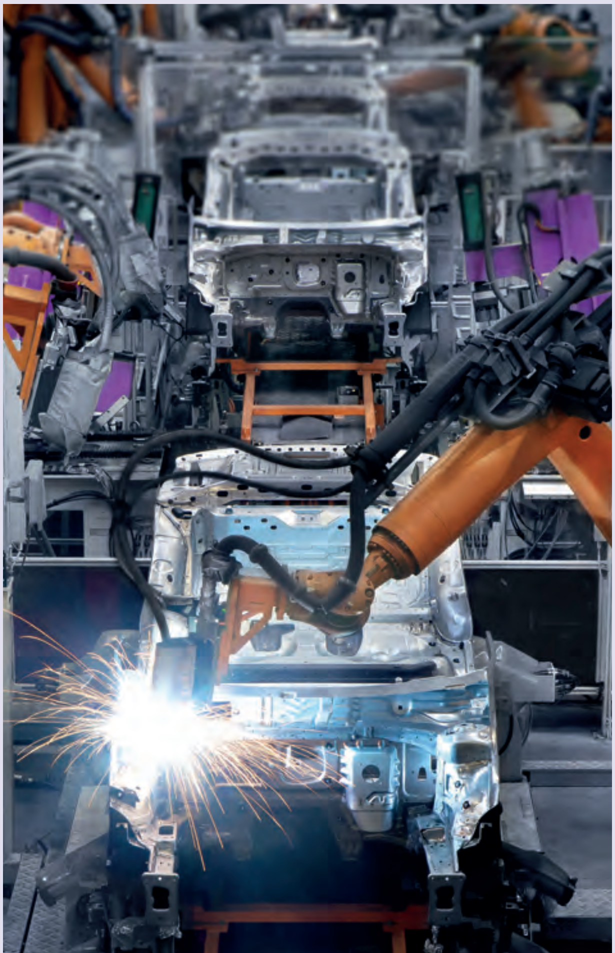
Global supply chains and interconnectivities are fuelling an increased demand for CBI Insurance to pay for loss of revenue or profit arising from an insured event at a supplier’s or customer’s premises. It means that firms in a diverse range of industries that include Energy, Pharmaceutical, Telecommunications, and Manufacturing sectors such as Automotive and Electronics now view CBI Insurance as an important and valuable element of their insurance portfolio.

CBI Insurance is purchased as an extension to a Property Damage and Business Interruption (BI) policy and many of the key issues in CBI claims adjustment overlap with traditional BI, for example adjustments for market trends, wide area damage and temporary price surge. However, the scope and level of CBI Insurance is generally restricted and along with the pure third party aspect of the insurance it can pose additional and unconventional claims adjusting challenges.

Establishing loss causation and quantum

Martin Clark, Global Head of Property & Energy Claims, Zurich Insurance feels that "the most challenging aspect of many CBI claims is the Material Damage Proviso within the CBI policy. This places the onus on the Insured to prove that the policy has been triggered by the loss." That means establishing the proximate cause of the loss; whether it is fire, flood, natural catastrophe, machinery breakdown or, hopefully, some other insured peril. Mark Lewis, Director of international Forensic Accounting firm C Lewis and Company, says "this relies on the customer or supplier to provide access to information and data, not just to help understand whether a claim is admissible but to identify the size of the potential loss, manage the claim and find ways that can reduce the supply chain interruption."

According to Rob Powell Chief Claims Officer – International, Marsh Global Claims Practice "this is not always straightforward even with tier one suppliers, let alone sub-tier. For example, recently one of our Energy clients suffered an interruption to the supply of feedstock but when they approached the tier one supplier for information this was not forthcoming."



Suppliers and customers are often not under any legal obligation to disclose the circumstances of an incident or provide access to information or data. They may be concerned about damage to their reputation, want to protect trade secrets or be wary of other commercial sensitivities. Where the incident involves a close supplier relationship it may be possible to gain their support, but this could require agreed Non-Disclosure Agreements (NDAs) and these are notorious for being onerous and delaying the claims handling process, due to the time necessary to negotiate a workable draft.

Martin feels that "some industries are very good at managing transparency within the customer and supplier relationships." Others would probably prefer the removal of the Material Damage Proviso especially as the proof can be almost impossible to gather when the loss involves sub-tier suppliers and customers with whom the Insured has little or no relationship.

Ewan Cresswell, Chairman of Integra Technical Services suggests that "claims handling protocols and communication channels should be discussed and agreed at the outset of the policy. This can provide an opportunity to introduce agreements that impose a requirement on customers and suppliers to provide sales and production data, especially for those key and close relationships."

When a loss occurs having already agreed response protocols that extend to key suppliers and customers it provides the ability to assess the mitigation options. This was evident when a supplier to a large manufacturer suffered a major fire. The manufacturer was able to gain access to the damaged property and rescue partly damaged production moulds. These were able to be repaired and delivered to an alternative supplier in a matter of days, limiting the CBI loss and supply chain interruption.

Inner limits

When a loss occurs the Loss Adjuster and Forensic Accountant will want to see the Insured's Business Continuity Plan to understand the supplier/customer independency network and potential mitigation options. Mark feels that "transparency and cooperation at this early stage of the claim is vital and can be so important to the claims service experience. By working with the Insured, the Loss Adjuster, Forensic Accountant and other experts can help to mitigate the claim."

A strong understanding of the Insured's network of supplier flows, revenue streams, internal and external dependencies is equally key to sourcing the right level of cover. This can prove to be difficult for many organisations as they may have limited visibility beyond their tier one suppliers. Some tier one suppliers might consider the sub-tier suppliers to be a key part of their value proposition and resist sharing information.

Many larger firms will focus on their top products or product lines and choose to secure the right level of cover for their critical suppliers. Unnamed suppliers may then be subject to lower sub limits and cover is frequently restricted to tier one suppliers or at most tiers one and two suppliers.

The subjectivities and assumptions built into the Business Continuity Plan can be so important to securing the right level of cover. Rob suggests that "it is not uncommon for CBI sub limits to be inadequate in the event of a loss, with claims far exceeding the amount insured." There are a vast range of reasons for this and some will undoubtedly be outside the control of the Insured. Mark suggests that "in his experience, firms often underestimate the interconnectivity within industries and regions. This was evident from the Thailand floods when many firm's plans B and C were undermined by the widespread damage." Phil believes "a named Loss Adjuster, Forensic Accountant and Business & Market Analyst who are familiar with the Insured and their industry can contribute to this pre-loss planning, using their experience with similar losses to help the Insured analyse loss scenarios and develop more robust loss mitigation options."

Policy wordings

Occasionally, poorly constructed wordings can create division and difference of opinion about the policy coverage. Rob suggests "that this can happen in two key areas, stacking limits and Interdependency Clauses."

It's already been mentioned that CBI policies have inner limits, some applying to specific circumstances such as unnamed supplier losses and others restricting the total amount payable for a CBI loss. Many London market policies will include a Stacking Clause NMA 5130 that prevents these individual sub limits from being added together to create a higher cover limit. When this type of clause is missing it can create disagreement with Insurers arguing that the stacking of policy limits was not intended.

Many firms count joint ventures and associated companies as part of their customer and supplier chain. When firms have two or more interdependent sites their policy should have an Interdependency Clause. Otherwise when a company's main premises suffers damage they will not have cover for group interdependencies and may be unable to recover end-to-end margins.

BI and CBI claims are by their very nature complicated and they can be a source of frustration for the Insured when the cover that has been purchased does not function in the way that had been expected. Involving named Loss Adjusters, Forensic Accountants and other experts at the outset of the policy coverage can help firms understand some of the nuances of the cover and be better prepared to address some of the potential contentious cover issues before a claim occurs.