

## **The Money Trap: Protecting Your Income Before the Loss**

**By Dan Weedin, CIC**

What is the most important asset you insure for your business?

Your property? Your fleet of autos? Your computer system?

Yes, these are all important, and in my experience I've found that most business owners consider these coverages first when programming their insurance. The problem is that without money, these may end up being irrelevant because you are out of business.

You are in business to make money. With that income, you are able to:

- Pay employees so they can provide for their families
- Pay business expenses like rent, mortgage, insurance, advertising, taxes, etc.
- Donate money to your community
- Grow your business and...
- Provide your family income

You must consider Business Income like a disability policy for your business. If your operations are suspended because of a calamity like fire, water damage, or hurricane, you must be able to get back into business quickly or jeopardize your ability to survive. According to Gartner Research, 78% of businesses that suffer a catastrophic loss are out of business within 2 years. You can bet that most of those were improperly insured for Business Income.

So how do you make sure this doesn't happen to you? It's as easy as 1-2-3. It takes:

1. Proper planning
2. Knowledge, and
3. Implementation

<b>Proper Planning</b>
------------------------

When was the last time you spent more than about 10 minutes discussing loss of income coverage with your insurance agent? Time to dust off your insurance policy and financial statement and get to work.

Business Income is a commercial property form that insures for loss of income, continuing expenses, payroll, and extra expenses associated with quick recovery from a claim. Here are 5 questions that your insurance agent should have asked you by now:

1. How do you make money?
2. How quickly do you have to have income?
3. How long will it take you to recover from a total loss?
4. What do you need immediately to get back to work and how will you get it?
5. At what rate is your business growing?

With those answers, and the help of your financial statements, you can create a plan that meets your needs. You must be prepared to replace your income in all your operations in a time frame that will cause you the least harm. You also need to have enough money to last the entire time. And, a popular “miss,” you need to take into account the trend of your business. If your company is growing, you must account for that extra income.

Don't get caught in the trap of using your gross revenue as a barometer in setting a limit on your policy. There are too many other factors that need to be considered.

### Knowledge

You don't need to be an insurance professional to properly program your Business Income, but you should understand the definition and terminology.

Business Income is triggered when your business sustains a ***covered property loss***. Take note of the italicized words. There is no Business Income loss on a liability or auto claim. If you don't insure for earthquake or flood, you have no protection for loss of income. It can only be a covered cause of loss like fire, windstorm, and water damage.

The loss must occur ***on your premises*** and cause a ***suspension of operation***. In other words, if a horrific windstorm knocks out power to your utility and you are out of business for a week, there is no coverage for business income (unless you purchased that endorsement). If you have a small fire, but are able to keep the doors open, then you will have coverage for new property but not for loss of income.

You must suffer a ***financial loss***. The insurance company won't pay to reimburse you if there isn't anything to reimburse!

Finally, be prepared for a ***period of restoration***. In English, that means a deductible. Most policies require a 72-hour period where you've been unable to open as a time deductible for payments. The one exception is Extra Expense, where there is no period of restoration.

***Extra Expense*** is designed to reimburse you for necessary and immediate expenses used to get you operating again. Examples include rent deposits, expediting expenses, and communication hookups.

### Implementation

There are 4 ways to cover Business Income. This is where it can really get tricky.

1. **Coinsurance** – The most common coinsurance percentage is 50%. This means that your limit of insurance must be at least 50% of the actual value or else you will be penalized and become a “coinsurer” of your claim. This can be a nightmare when you consider all the variables that go into determining “actual value.” You must diligently work with your agent to make sure that you are not underinsured because the penalty is onerous. On the positive side, coinsurance has no time limitation. I've seen claims go into second years and this is a huge advantage for those high-valued and complex claims.

2. **Maximum Period of Indemnity** – This option waives coinsurance. That’s pretty much the only positive. With Maximum Period of Indemnity, you must choose a limit and you have 120 days in which to use it. So what’s the big deal with that? What if your claim extends past 120 days? You’re on your own! This is a dangerous option from that standpoint. I can’t imagine a scenario where this option would be chosen over the others. Even minor property claims are difficult to gauge how long they will take to settle, much less how long you will need income. I recommend steering clear of this one. If you see that you already have it, contact your agent.
3. **Monthly Limit of Indemnity** – This option also waives coinsurance and is a better alternative than Maximum Period of Indemnity. In this case, you still choose a limit, but instead of total number of days, you choose a monthly limit using fractions. The available options are 1/3, 1/4, and 1/6.

Here’s an illustration – You have a limit of \$120,000. After a claim, this limit will be divided into monthly increments based on the fraction you chose.

At 1/3, you receive a maximum of \$40,000 per month. At 1/4, you receive a maximum of \$30,000. At 1/6, you receive a maximum of \$20,000. The negative is that you are limited per month and might need more, especially in the beginning. The good news is that you have NO TIME LIMIT. The policy will continue to pay until your limit is exhausted. That is why I favor this option over the previous. I recommend taking the highest fraction – 1/3 – so you can get the highest monthly payback. Make sure you have an adequate limit.

4. **Agreed Value** – This option waives coinsurance, too. It’s pretty simple. You and the insurer agree on a limit of coverage and that’s what they pay until the limit is exhausted. They will, of course, require reviewing your financial statement to make sure the correct limit is chosen. This is an excellent option if you can properly determine your exposure and your insurer agrees to it.

Some of you will notice that your Business Income is provided on an **actual loss sustained** basis. That means that more than likely your policy is on a Businessowners policy (BOP). This means that the company will pay you what your actual loss is without dollar limitation. The time limitation is 12 months. Many companies are offering this option for non-BOP accounts in an effort to be more competitive. This is an excellent option if you can get it, but do remember that coverage ceases at 12 months. If you are concerned about claims extending past that time, this may not be for you. Talk with your agent about your situation.

Here’s the bottom line for your bottom line – Talk about Business Income **first instead of last** with your agent. If you follow these three steps to determining your exposure, make educated decisions, and properly implement, then you’ve gone a long way in making sure that your business will survive a disaster.

*Dan Weedin, CIC is President and Founder of Toro Consulting, Inc. He has been in the insurance industry since 1987 in various capacities including company underwriting, sales, risk management, and consulting. His company is committed to helping business owners reduce their total cost of insurance through a strategized risk management process.*