Factors to consider in choosing an amount of Business Interruption Insurance

We recognise that each business is unique and may have special factors to consider. We are providing the following as guidelines only, and we are available to assist companies in performing the necessary calculations.

Standard Profits Form

Under a profits form, in order to collect the full amount of any loss incurred, a company must have insurance in place equivalent to 100% of the projected annual defined gross profit. A co-insurance penalty will arise if sufficient insurance was not purchased.

For example, if the amount insured is $90,000 and the projected annual defined gross profit is $100,000, the company would only be covered for 90% of any loss.

To avoid a co-insurance penalty, when reviewing a company's insurance coverage the projected annual defined gross profit should be calculated as follows:

i) Obtain a copy of the company's most recent financial statements.

ii) Identify the net profit and the expenses that can be considered to be standing charges. Standing charges are those costs which remain relatively unchanged for a wide range of sales. Examples include rent and the fixed portion of utility charges (see Worksheet).

iii) Decide which standing charges to insure. If the standing charges are not individually identified on the endorsement form then all standing charges are automatically included in the calculation of the projected annual defined gross profit.

iv) Estimate the net profit and the standing charges for the 24 month period following the start date of the policy.

v) Identify the 12 month period, within your 24 month estimate, during which the highest net profit and standing charges occurs.

vi) Insure 100% of the amount determined in step v).

Gross Earnings Form

Under a gross earnings form in order to collect the full amount of any loss incurred, a company must have purchased insurance equivalent to 50% or 80% ("the co-insurance percentage") of the annual defined gross earnings. A co-insurance penalty will arise if sufficient insurance was not purchased.

The co-insurance percentage may be chosen as follows:

i) Determine the amount of time required to replace the insured property if the worst case scenario occurred (see below).

ii) Estimate the maximum loss of sales during this down time - $M (see below).

iii) Determine the sales during the last financial year - $F.

iv) Choose a co-insurance percentage consistent with the ratio $M / $F.

For example if there are no sales for more than six months under the worst case scenario, then the 80% co-insurance percentage should be chosen.

The amount of insurance is then estimated as follows:

i) Determine the gross earnings percentage (defined gross earnings / sales) for the most recent financial year based on the latest financial statements (see Worksheet).

ii) Estimate the sales for the 2 year period from the start date of the policy. For example if the policy period begins on January 1, 2008, you will have to estimate the sales during the period January 1, 2008 to December 31, 2009.

iii) Identify the 12 month period within your 24 month estimate, during which the highest sales occurs.

iv) Estimate the highest annual defined gross earnings in the 2 year period from the start of your policy using the highest sales determined in iii) and the gross earnings percentage determined in i).

v) Apply the co-insurance percentage calculated above.

The calculation assumes that the amount of insurance includes ordinary payroll.

<u>Maximum Probable Sales Loss</u>

Worst Case Scenario

The worst case scenario should be developed

i) Determine the event.

ii) Describe property damage and which assets are affected.

iii) Determine the time of the outage (time of repair).

Calculation

The maximum probable sales loss may be developed as follows:

i) Estimate what the sales would have been but for the loss

ii) Estimate what the sales will be under the worst case scenario

iii) The maximum probable sales loss is the difference between i) and ii)

Contact Kieran at (416) 230-0584 or Glenn at (416) 230-8840 for more information.