Understanding Business Income (BI) Coverage

What is BI coverage?

BI covers the reduction in an organization's income when operations are interrupted by damage to property caused by a covered peril. Because the severity of a business income loss is directly related to the length of time required to restore the property, BI coverage is considered a "time element" coverage.[1]

Why do I need BI coverage?

Unlike typical property insurance, which covers the costs to repair or replace your equipment and buildings, BI coverage specifically covers the loss of income and extra expenses incurred during the interruption. In the event of a disaster, your property insurance can help you recover the physical assets of your business, but it won't cover the income you lose while your operations are halted. This is where BI coverage becomes essential, ensuring that you can maintain financial stability during recovery.

How much BI coverage do I need?

BI coverage is determined by calculating your net income (net income = revenue – expenses) plus continuing normal operating expenses, plus loss of rent if applicable. Continuing normal operating expenses include things like taxes, insurance, rent, licenses, payroll of key employees, interest, debt, and more. Continuing expenses are expenses that the business incurs whether the business is operating or not.

Additionally, anticipated growth and seasonal fluctuations in business may be important considerations. Please refer to page 3 to review and complete ICAT's business income worksheet, which will assist you in determining the amount of coverage you need.

Revenue vs. Net Income

Understanding revenue vs. income is important when calculating how much BI coverage you need. Net income is the difference between revenue (such as money received for goods or services) and expenses (such as money paid for merchandise, payroll, rent or mortgage, tax payments, utilities, loans, and more). It can be expressed by the formula:

Revenue – Expenses = Net income[1]

Example of inaccurate BI value

In the example below, a small business owner forgot to account for expected growth and miscalculated certain expenses when obtaining coverage. This impacted his out-of-pocket expenses when his business had to close for repairs after a storm.

ANNUAL BI VALUE:	× INACCURATE	✓ACCURATE
Net Income Past 12 Months *(Revenue – Expenses = Net Income)*	$400,000	$400,000
Continuing Normal Operating Expenses Including Payroll	+$100,000	+$200,000
Expected Annual Growth	n/a	10%
BI Total	$500,000	$660,000

Does BI coverage include Extra Expense coverage?

Yes. The necessary expenses you incur during the "period of restoration" that you would not have incurred if there had been no direct physical loss or damage to property caused by or resulting from a Covered Cause of Loss are also covered. For example, after sustaining wind damage to its warehouse, a distribution company rents a similar

icat
a VICTOR company

[1] Business Income Insurance, 5th edition; The Institutes Knowledge Group

building and continues operations within three weeks, instead of shutting down entirely for several months. This rent would be considered a necessary extra expense.

What is Monthly Limit of Indemnity and how does it work?

The Monthly Limit of Indemnity (MLOI) is the most we will pay for loss in each period of 30 consecutive days. This amount is determined by multiplying the business income limit of insurance and the MLOI percentage. If the amount of loss in a 30 day period is more than the MLOI, we will only pay the maximum MLOI, not the full amount of loss in that period. The difference between the amount of loss and MLOI does not get rolled over and paid in the next 30 days. This is why it's very important to select an MLOI that appropriately matches your exposure. Full details can be found in the underwriting guidelines.

Seasonality and MLOI

Seasonality refers to predictable fluctuations in demand and revenue that occur around the same time each year. For example, a restaurant on the Jersey Shore likely does a significant portion of their annual business during the summer. As such, they would require a higher MLOI than an apartment complex where earnings, as well as expenses, are spread evenly throughout the year.

Example of MLOI:

A commercial building experienced a fire and had to stop doing business while under repair. The MLOI is 50% (½) and the BI Limit of Insurance for the client is $120,000. The most ICAT will pay for loss in each period of 30 consecutive days is $60,000 (120,000 x 1/2).

The example in Figure 1 shows the importance of selecting an appropriate MLOI for your exposure as well as how the payments are calculated and distributed based on the 30 day periods.

FIGURE 1

$60,000 is the MLOI limit

$30,000 is the MLOI limit

DAY	ACTUAL AMOUNT OF LOSS	AMOUNT TO BE PAID AT 50% MLOI	AMOUNT TO BE PAID AT 25% MLOI
1-30	$70,000	$60,000	$30,000
31-60	$20,000	$20,000	$20,000
61-90	$60,000	$40,000	$30,000
Total	$150,000	$120,000	$80,000

BI limit reached

Unpaid difference from previous period does not roll over into the next period.

Please note this illustration does not account for waiting periods or deductible payments.

Loss Scenario: Business Income coverage after a storm

In this hypothetical scenario, a retail store was hit by a severe storm. The storm's wind and rain caused significant damage to the store's physical structure, including the roof. As a result, the retail store was forced to close for 30 days for repairs. The store typically earns about $162,000 per month in revenue and incurs $42,000 per month in expenses.

Calculation of Business Income Loss:

Expected Revenue (monthly revenue):	$162,000
Expected Expenses:	($42,000)
Expected Income:	$120,000
Actual Revenue:	$0
Actual Reduced Expenses:	($30,000)
Actual Income:	($30,000)

Total Loss to Claim = Lost Income of $120,000 + Actual Expenses of $30,000 = **$150,000.*** In addition, they incurred $10,000 in extra expenses that helped them recover more quickly. Extra expenses are not subject to MLOI.

This insured accurately calculated their BI value and had $660,000 of annual BI limit of insurance. Their MLOI is 25% (1/4), so the maximum ICAT will pay for the loss in each period 30 consecutive days is $165,000, which covers the total loss.

** Disregarding any applicable waiting period and deductible.*