

## Financial Protection from Natural Calamities

Earthquakes across the world have been having a crippling effects on the assets and operations of business enterprises. **The latest earthquake in Nepal is a grim reminder.** Losses caused by natural disasters have a severe financial impact on businesses and therefore it becomes important for business to be adequately covered.

We want to remind managers to assess their:

- Adequacy of the sum insured
- Need for Business Interruption insurance



### How to get my Sum insured right ?

**Sum insured** represents the maximum liability of the insurers in the event of the claim.

A common question which puzzles the managers / owners is **“What would be the right value for which we should get the insurance for ?”** It may not be always possible to get the sum insured 100% accurate, but the attempt should be to reach as close as possible to the actual value of the assets .



The insurance of assets ( Building, plant and machinery , furniture, fixture and fittings) are mainly done on either of the following basis; **“Reinstatement Value Basis ( RIV)”** or **“Market Value Basis”**. The option lies with the client to choose any of these

Insurance on reinstatement basis would mean that the sum insured should represent the “new replacement cost” of the assets , whereas the market value would mean insuring the assets on “depreciated basis “. The sum insured would definitely be higher in the former and consequently the premium outgo will be higher , but in case of a loss the insured gets enough reimbursement to buy a new asset to replace the lost / damaged asset. If the assets are insured on depreciated value basis the insured will get a fraction of the actual

expenses done to rebuild or reinstate the damaged assets.

Few common mistakes which need to be avoided are :

- Insure on book value / capitalised cost
- Depreciate the capitalised cost

- RIV clause incorporated under the policy, but the sum insured is on depreciated basis .

Please keep in mind that stocks should always be insured on market value basis .

### **Do we need to have Business Interruption (Loss of Profit) insurance?**

The effects of natural catastrophe do not end with the damages to the assets. Large scale damage can result in shutdown of operations. Loss of revenue due to such a shutdown is often much larger than the material damage losses. Such losses put a financial strain on the company, which can lead to insolvency of the enterprise .

Therefore it is important for a business to have a Business Interruption (Loss of Profit) policy also. The policy commonly called Fire loss of profit policy( FLOP) covers the reduction in turnover/ output due to shutdown of operations following a loss. The sum insured under the policy represents the anticipated gross profit during the year , which for the purpose this insurance should be the sum of “Net profit” and “Fixed Cost”. The loss is computed based on the reduction of turnover/ output during the interruption period (shutdown period) X rate of gross profit .



An important consideration for the BI policy is arriving at the correct “indemnity period”...this represents the insured’s guesstimate of the maximum period of interruption which can happen following a loss. Natural catastrophes like earthquake can result in devastating damages which may require long period to rebuild and restart the facility. Thus while arriving at the indemnity period , few things one needs to keep in mind are; the maximum period which might be required to reconstruct the building ( including time to be taken to get the necessary clearance ), lead procurement time for machinery , installation time for machinery (it would take more time to procure machines, if they are imported ) and lead time for repair/ procurement of critical spares.

**Insuring the assets adequately and having a suitable business interruption cover goes a long way to protect an organisation in times of disaster**

**For any query or comments, write to us on [info@optima.co.in](mailto:info@optima.co.in)**