

C40 BUSINESS INTERRUPTION INSURANCE

IMPORTANT

The time allowed for this exam is 3 hours.

Total marks: 200

You must hand in this paper and any paper used for rough work to the supervisor when you leave the examination room. Failure to do so may result in disqualification.

Section A: Multiple-Choice Questions

Question 1. For the following multiple-choice questions, fill in the circle of the letter that identifies the most correct answer.

Example: (A) (B) ● (D)

<p>DO NOT MARK THE ANSWERS ON THESE PAGES.</p> <hr/> <p>USE THE FIRST PAGE OF YOUR ANSWER BOOK.</p>

1. Management salaries, and business and realty taxes, are common examples of
- (A) fixed expenses.
 - (B) semi-fixed expenses.
 - (C) semi-variable expenses.
 - (D) variable expenses.

2. When a business is shutdown due to a direct loss it may be concerned that its highly technical and knowledgeable employees will find employment elsewhere, perhaps with a competitor. To avoid this situation, a company may continue to pay the employee's wages until the business resumes operation. This is one example of a(n)
- (A) variable expense.
 - (B) fixed expense.
 - (C) semi-variable expense.
 - (D) unavoidable expense.
3. Which of the following is a FALSE statement? Business interruption losses
- (A) are sometimes settled on a per diem basis.
 - (B) are the most common type of indirect loss.
 - (C) arise from the direct loss or damage to property.
 - (D) must first be recovered under the underlying direct-damage contract.
4. The standard Business Income Form roughly corresponds to the older
- (A) Extra Expense Form.
 - (B) Gross Earnings Form.
 - (C) Profits Form.
 - (D) Rental Income Form.
5. **Semi-variable expenses** are defined as expenses that
- (A) are incurred in supplying goods to be sold.
 - (B) cannot be forecast in advance to cease or vary should the business be interrupted.
 - (C) cease if the operation ceases completely.
 - (D) vary in direct proportion to the amount of business or production.
6. In the Business Income forms, **Business Income** is determined by subtracting from the revenue, and closing stock and work in progress, the
- (A) gross profit before taxes.
 - (B) net profit after taxes.
 - (C) amount of the opening stock and work in progress and Variable Operating Expenses.
 - (D) fixed, variable and semi-variable expenses.
7. In the standard Business Income forms, the money paid or payable to the insured for its sold and delivered goods after allowing for returns and discounts during the twelve months immediately before the date of the damage is defined as
- (A) Annual Revenue.
 - (B) Business Income.
 - (C) Expected Revenue.
 - (D) Revenue Shortfall.

8. In the Business Income policies, payroll
- (A) generally provides coverage for a period of 180 consecutive days from the date of damage.
 - (B) applies only when an amount is shown on the Declarations Page for Ordinary Payroll.
 - (C) cannot be covered by the policy.
 - (D) is subject to the coinsurance clause for the entire policy.
9. Which of the following is true of the Interruption by Civil Authority Clause?
- (A) The clause does not provide coverage for the resulting business interruption.
 - (B) The damage to neighbouring premises that gives rise to the denial-of-access must be caused by a peril excluded by the insured's policy.
 - (C) The denial-of-access order must have been given by the military.
 - (D) The indemnity period under the clause is limited to two weeks.
10. In the Business Income forms, **business income** includes
- (A) fixed expenses.
 - (B) the amount of closing stock without adjustment for opening stock.
 - (C) a provision for depreciation when calculating the amounts of opening and closing stock and work-in-progress.
 - (D) the opening work-in-progress without adjustment for closing work-in-stock.
11. One way of differentiating between the standard and Extended Income forms is that the
- (A) standard forms are written on a named perils basis and the extended forms on an all risks without exclusions basis.
 - (B) standard forms are endorsements and the extended forms are stand alone policies.
 - (C) standard forms use the American approach and the extended forms the British approach to the indemnity period.
 - (D) standard forms use normal accountancy methods and the extended forms require special accounting practices.
12. The coinsurance clause present in the Business Income Extended forms
- (A) requires the amount of insurance to be 100% of the product of the Annual Revenue or its multiple and the Business Income Percentage.
 - (B) requires the amount of insurance to be 80% of the product of the Annual Revenue and the Business Income Percentage.
 - (C) reflects the mandatory twelve month Indemnity Period clause.
 - (D) is subject to the due diligence proviso.

13. Both the Business Income standard and Extended forms exclude loss due to
- (A) fines or damages for breach of contract.
 - (B) the operation of a by-law.
 - (C) the suspension or cancellation of a lease or contract.
 - (D) the presence of strikers.
14. The insured's common law duty to minimize a loss can be found in the provisions of the
- (A) due diligence clause.
 - (B) permissions clause.
 - (C) reinstatement clause.
 - (D) accountant's fee clause.
15. In the Extended Named Perils Business form, the absence of an exclusion on losses arising from labour disturbances
- (A) increases the amount of insurance.
 - (B) extends the Indemnity Period.
 - (C) broadens the coverage by not penalizing the insured for circumstances beyond his control.
 - (D) restricts policy coverage directly attributable to the shutdown.
16. What minimum amount of business income insurance should an insured purchase, if a business is insured by a standard Business Income form, has a steady business income of \$1million per year and the insured expects the income level will grow at a level of 10% over each of the next three years? (Ignore the coinsurance percentage.)
- (A) \$1 million
 - (B) \$1.1 million
 - (C) \$1.21 million
 - (D) \$1.33 million
17. When insuring under an Extended Business Income form, one of the two **most** important determinations an insured must use when calculating the amount of insurance required is the
- (A) maximum loss of business income.
 - (B) sales recovery time after a loss.
 - (C) maximum loss of sales that the insured may suffer after a direct damage claim.
 - (D) trend of future business results.

18. The insured is presently covered by an Extended Business Income form, has total sales of \$1,000,000, and a business income percentage of 60%. The maximum loss of business income the insured could anticipate if his sales increased to \$2,000,000 is
- (A) \$ 600,000.
 - (B) \$ 1,200,000.
 - (C) \$ 1,800,000.
 - (D) \$ 2,000,000.
19. In the extended Business Income forms, the multiple for Annual Revenue required by the Coinsurance clause when the Indemnity Period exceeds 12 months is
- (A) mechanically derived.
 - (B) applied to the actual Indemnity required after a loss.
 - (C) applied to the minimum Indemnity Period allowed under the policy.
 - (D) 1.10.
20. One disadvantage of a stated amount coinsurance clause is
- (A) that a coinsurance penalty will apply if the loss occurs during a year when sales exceed expectations.
 - (B) the insurer will pay only a partial amount of the loss if the insured has at least the amount agreed between the insured and insurer.
 - (C) the insurer will not pay the full amount of the loss if the insured has a loss during a bad business year.
 - (D) the insurer may delete the Premium Adjustment clause as a condition to granting the stated amount coinsurance clause and consequently, the insured may pay more premium in a bad business year than it would have otherwise.
21. The Gross Earnings Form (Manufacturing)
- (A) assumes that a manufacturer's profit is earned when a finished product is sold.
 - (B) assumes that a manufacturer's profit is earned when the raw stock starts to be processed.
 - (C) assumes that a manufacturer's profit is earned when a product is finished.
 - (D) includes coverage for finished stock.
22. Which of the following business interruption policies will pay for an insured's loss of income for as long as the business results are affected by the loss, subject to a time limit?
- (A) Leaseholder Interest Form
 - (B) Gross Earnings Form
 - (C) Extra Expense Form
 - (D) Profits Form

23. Under the Profits Form, the depreciation of stock is considered
- (A) insurable in addition to the normal standing charges.
 - (B) an inventory shortage and therefore a business loss.
 - (C) a standing charge and therefore must be insured.
 - (D) uninsurable since insuring it would violate the principle of indemnity.
24. Under the Profits Form, what are elsewhere referred to as fixed and semi-variable expenses are called
- (A) average daily value.
 - (B) daily indemnity.
 - (C) sunk costs.
 - (D) standing charges.
25. In the Profits form, the money paid or payable to the insured for goods sold or services rendered in the course of business at the insured's premises during the twelve months immediately before the date of the loss is the definition of
- (A) Annual Turnover.
 - (B) Gross Profit.
 - (C) Standard Turnover.
 - (D) Annual Sales.
26. **Rental income** includes the income
- (A) that could be generated from leasing out the portion of any building occupied by the insured.
 - (B) derived from the sale of merchandise manufactured in the building rented by the insured.
 - (C) received or receivable for equipment or product rentals.
 - (D) from the rendering of property management professional services.
27. The 80% Coinsurance Clause is a requirement in the
- (A) Broad forms only.
 - (B) Extended Rental Income forms (both Named Perils and Broad).
 - (C) Named Perils forms only.
 - (D) Standard Rental Income forms (both Named Perils and Broad).
28. The clause found in Rental Income forms that addresses the principle of indemnity is the
- (A) Breach of Conditions clause.
 - (B) Permission clause.
 - (C) Reinstatement clause.
 - (D) Alternate Accommodations clause.

29. Under a rental income form, when an insured files a premium adjustment form at the end of a year for which it overestimated rental income by more than 80% of its actual income, the insured would receive
- (A) a premium adjustment not exceeding 50% of the advance paid premium for that year.
 - (B) a premium adjustment not exceeding 70% of the advance paid premium for that year.
 - (C) a premium adjustment not exceeding 30% of the advance paid premium for that year.
 - (D) no premium adjustment.
30. In the standard Rental Income (Broad Form),
- (A) perils insured are identical to a fire and extended coverage direct-damage form.
 - (B) perils excluded are identical to a fire and extended coverage direct-damage form.
 - (C) fines due to lapse or non-completion of a contract are covered unlike the standard Business Income (Broad Form).
 - (D) exclusions are identical to the exclusions found in the standard Business Income (Broad Form).
31. Extra Expense insurance is purchased to
- (A) insure the loss suffered by a business when it is affected by a property loss of another business upon which the first business depends.
 - (B) replace lost income until a business is able to reopen.
 - (C) restore lost profits until the business is no longer affected by a business interruption.
 - (D) allow the insured to continue operations even if the cost of doing so exceeds the savings.
32. A client asks what kind of business interruption insurance he needs. If he has a serious loss, his business could be shut down for several months. He would lose customers and it would probably take a year to build up his clientele to the original level. This time could be reduced if he can find suitable rental premises. Which of the following would be the best recommendation?
- (A) Contingency Form
 - (B) Earnings No Coinsurance Form
 - (C) Profits Form and Earnings Form
 - (D) Profits Form and Extra Expense Form
33. Which of the following forms do NOT insure loss of income or profit after an interruption of business?
- (A) Extra Expense forms
 - (B) Gross Earnings (Manufacturing) forms
 - (C) Gross Earnings (Mercantile) forms
 - (D) Rental Income forms

34. It has been two months since the insured suffered a fire loss. The insured has claimed 60% of the amount insured under the Extra Expense Insurance policy. It will be another three months before he can resume normal operations. What percentage of coverage is still available under the policy?
- (A) 40%
 - (B) 30%
 - (C) 10%
 - (D) 0%
35. A renter has signed a lease for new premises because of a growth in the business. Because of a shortage of labour, the contractor is unable to complete the tenant's improvements for ten days beyond the contracted occupancy date. As a result, the renter will incur additional costs including temporary telephones - \$1,000, staff overtime - \$500, and additional office rental costs - \$1,500. How much will the insured collect from his Extra Expense (Broad Form) policy?
- (A) \$3,000
 - (B) \$1,500
 - (C) \$500
 - (D) \$0
36. Which of the following is a FALSE statement? The Contingent Business Income Extension Endorsement is sometimes necessary because
- (A) a manufacturer may sell a large part of its production to one single customer.
 - (B) a manufacturer often depends on external supplies of raw materials or accessories.
 - (C) the insured's business may be interrupted by a direct-damage loss to property at premises other than those of the insured.
 - (D) the insured's business may influence the results of another business due to its proximity.
37. The coverage that can be added to a Business Income form to eliminate the Economic Limit Test is the
- (A) Additional Increase in Cost of Operations Endorsement.
 - (B) Start-Up Delay Extension.
 - (C) Auditor's Fees clause.
 - (D) Contingent Liability From Enforcement of Building By-laws clause.
38. Which of the following would NOT be defined as **Contingent Premises**?
- (A) Customers' premises
 - (B) Insured's premises
 - (C) Leader properties
 - (D) Suppliers' premises

39. Which of the following is FALSE of Tuition Fees Insurance on private schools?
- (A) Salaries of school teachers and employees represent a fixed expense for the school year.
 - (B) School students may be forced by a shutdown to enrol at another school.
 - (C) Coverage expires on the date of the completion of the repairs regardless of the school year.
 - (D) This type of insurance is governed by a due diligence proviso.
40. The clause added to a Profits form to cover the costs of certifying the financial details of the insured's business for settlement of a claim under the business interruption policy is known as
- (A) Economic Limit.
 - (B) Verification of Amount.
 - (C) Auditor's Fees.
 - (D) Extra Expense.

(2 marks each = 80 marks)

Section B: Narrative Questions

- Question 2. (a) Why should a business include business interruption insurance in its insurance portfolio? In your answer, include sound reasons that would make good business sense to the average businessperson. (16 marks)
- (b) How have the differences between the British and American approaches to business interruption hindered sales of that type of coverage? (4 marks)
- Question 3. (a) Identify and explain the FOUR (4) exclusions found in the standard Business Income (Named Perils) Form that have been derived from the earlier business interruption forms. (10 marks)
- (b) Explain fully the Alternate Trading Clause found in the Business Income forms, and provide an example. (10 marks)
- Question 4. (a) The Extended Business Income Form (Named Perils) differs from the standard Business Income Form (Named Perils). Identify FOUR (4) advantages and TWO (2) disadvantages of the Extended form. (10 marks)
- (b) With respect to the Extended Business Income forms, identify and describe the THREE (3) factors that will affect the length of a shutdown. (10 marks)

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- Question 5. Contrast the Gross Earnings and Profits forms under each of the following headings:
- (a) Indemnity period (4 marks)
 - (b) Limitation of indemnity period (4 marks)
 - (c) Exclusions (4 marks)
 - (d) Coinsurance (4 marks)
 - (e) Due diligence and dispatch (4 marks)
- Question 6. (a) Describe the need for Leasehold Interest Insurance. (10 marks)
- (b) What is the purpose of and the coverage provided by Tuition Fees Insurance? (10 marks)

Section C: Application Question

- Question 7. (a) A fire destroys the building next to the insured's premises with no damage to the insured's property. A single wall is left standing that threatens to fall onto the insured's building. For the few days it takes to get the demolition under way, the municipality cordons off the entire neighbourhood. Explain whether the loss to the insured from this interruption of business would be a valid claim under the Extended Business Income forms. (5 marks)
- (b) You are an insurance broker. One of your client's companies has a problem in that it is dependent on a specific supplier for raw materials, and it sells a large part of its production to a single customer. What extension coverage should the company add to its existing business interruption insurance coverage? Why? How would you describe to your client the key features of this additional coverage? (5 marks)
- (c) You are an insurance broker. Your office has been damaged by fire and this prevents access to your premises for several weeks. What steps would you need to take immediately to continue servicing your clients and what type of business interruption insurance would you have arranged for your operation? (10 marks)

