



Webcast: Business Interruption in a Low Commodity Price Environment



Tuesday, June 23, 2020

Business Interruption in a Low Commodity Price Environment

Our Speakers



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Business Interruption In A Low Commodity Price Environment

Just how low are we talking about? Very low.

Crude Oil WTI (NYM \$/bbl) Front Month

ADD TO WATCHLIST

☀ OPEN
\$27.66
 ▲ 0.10 0.36%

Last Updated: May 14, 2020 7:10 p.m. EDT
 - Delayed quote



SETTLEMENT PRICE 05/14/20

\$27.56

0.181% VS AVG.

VOLUME: 1K

↑ 65 Day Avg. - 564K

OPEN: 27.64

LAST: 27.66

DAY RANGE

27.47

DAY LOW/HIGH

27.79

-40.32

52 WEEK LOW/HIGH

65.65

OVERVIEW

CHARTS

HISTORICAL QUOTES

KEY DATA

OPEN

\$27.64

52 WEEK RANGE

-40.32 - 65.65

RECENT CONTRACTS

	LAST	CHG	OPEN	HIGH	LOW	DATETIME
<u>Crude Oil Jun 2020</u>	27.66	0.10	27.64	27.79	27.47	May 14, 2020 7:10 p.m.

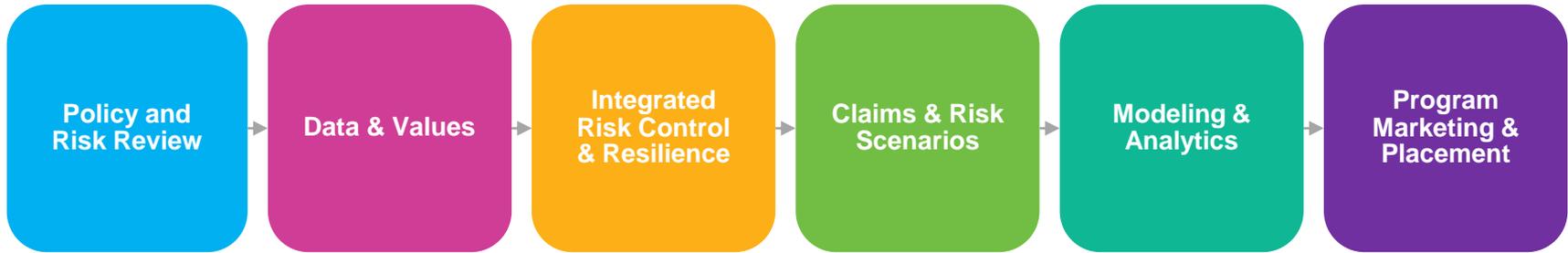
Source: West Texas Intermediate

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 Canadian Blends	Last	Change	%Change	Last Update
Central Alberta	20.68	-0.65	-3.05%	(17 Hours Delay)
Light Sour Blend	21.18	-0.65	-2.98%	(17 Hours Delay)
Peace Sour	20.68	-0.65	-3.05%	(17 Hours Delay)
Syncrude Sweet Premium	25.68	-0.65	-2.47%	(17 Hours Delay)
Sweet Crude	25.68	-0.65	-2.47%	(17 Hours Delay)
US High Sweet Clearbook	28.43	-0.65	-2.24%	(17 Hours Delay)
Midale	19.18	-0.65	-3.28%	(17 Hours Delay)
Albian Heavy Synthetic	23.68	-0.65	-2.67%	(17 Hours Delay)

Business Interruption Basics

Knowing BI Exposures Supports a More Informed Strategy and Better Outcomes And How It Fits into the Property / BI Risk Management Continuum



Provides focus on important coverage elements

Ensures appropriate values are in the process – including inputs to underwriting submissions, business impact analysis, and risk financing optimization

Supports more targeted risk control and business continuity

Allows for a deeper understanding of what actually can happen – including contingent events – validating limits and building knowledge for any potential claims

More accurate exposure information leads to more accurate modeling

Better outcomes
Premium Structure Limits
Risk mitigation

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Time Element: Business Interruption and Extra Expense



The purpose of time element coverage is to put the policyholder back in the same financial position they would have been in had the loss not occurred.

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Refresher of Revenue Breakdown



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BI Definition and Approach



Top-Down Approach

Revenue Subject to Risk	Operating Profit
-	+
Variable Costs and Expenses	Fixed Costs and Expenses
Ordinary Payroll*	Insured Payroll
=	=
Business Interruption Value	Business Interruption Value
Subtractive Methodology	Additive Methodology



Bottom-Up Approach

Business interruption indemnifies an insured for the operating profit lost and the necessary continuing costs and expenses incurred over the period that the business is being restored.

*Subject to the days of Ordinary Payroll Coverage selected by policyholder

Both approaches to calculating business interruption values will yield the same results.

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BI Loss Example for Total Shutdown Using Both Methods of Calculation

	Projected	Actual	Loss
Revenue	\$10,000,000	\$0	\$10,000,000
Cost of Sales	(\$7,000,000)	\$0	(\$7,000,000)
Gross Earnings	\$3,000,000	\$0	\$3,000,000
Operating Expenses			
Variable	\$1,000,000	\$0	\$1,000,000
Fixed	\$1,500,000	\$1,500,000	\$0
Total Operating Expense	\$2,500,000	\$1,500,000	\$1,000,000
Net Income	\$500,000	(\$1,500,000)	\$2,000,000

Gross Earnings (\$3,000,000)
less N/C Exp (\$1,000,000) =
\$2,000,000

NI + Continuing \$500,000 plus
\$1,500,000 = \$2,000,000

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BI Loss Example for Partial Shutdown Using Both Methods of Calculation

Loss of 400 Units	Standard Cost Per Unit	Projected	Actual	Difference
Quantity Produced		1,000	600	400
Selling Price (Sales)	\$2.20	\$2,200.00	\$1,320.00	\$880.00
Materials	\$1.00	1,000.00	650.00	350.00
Direct Labor	\$0.25	250.00	225.00	25.00
Variable Overhead (OH)	\$0.15	150.00	125.00	25.00
Cost of Goods Sold	\$1.40	1,400.00	1,000.00	400.00
Gross Profit		800.00	320.00	480.00
Fixed Overhead		500.00	500.00	–
Selling and Administrative		500.00	500.00	–
Sub-total		1,000.00	1,000.00	–
Operating Profit		(\$200.00)	(\$680.00)	\$480.00
Operating Profit		(\$200.00)		
Continuing OH & Expense		1,000.00		
Less Actual Gross Profit		(320.00)		
Loss		\$480.00		

Note: Clients may suffer a BI loss even if the projected profit of the business is negative



Effects & Solutions for the Low Commodity Pricing

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Stratifying the Client Base



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BI Loss Example with Negative Gross Profit

Loss of 400 Units	Standard Cost Per Unit	Projected	Actual	Difference
Quantity Produced		1,000	600	400
Selling Price (Sales)	\$28.00	\$28,000	\$16,800	\$11,200
Variable Costs	\$43.00	43,000	25,800	17,200
Gross Profit (Insurance Rate)	(\$15.00)	(15,000)	(9,000)	(6,000)
Negative gross profit = losing money per unit sold				
Fixed Costs		3,000	3,000	–
Selling and Administrative		2,000	2,000	–
Sub-total		5,000	5,000	
Operating Profit		(\$20,000)	(\$14,000)	(\$6,000)
Operating Profit		(\$20,000)		
Continuing OH & Expense		5,000		
Less Actual Gross Profit		9,000		
Loss		(\$6,000)		

Insured results improved by \$6,000 after losing unit sales with a negative gross profit!

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Best Practices for Reporting Using Traditional BI Coverage



Estimate commodity sales volumes based upon potential future price range



Calculate multiple BI value scenarios using matrix of potential volumes and price



Report BI values with highest probability or confidence of occurring.



Secure policy limit that provides some protection to the upside should commodity prices rebound suddenly

Business Interruption In A Low Commodity Price Environment Negative Gross Profit – Potential Solutions



Fixed cost and expense coverage

- Covered loss would pay the fixed costs and expenses of a business (no profits), including interest payments.



BI volatility clause

- Provides a capped BI payment based upon a percentage of declared values for impacted location.



BI valuation derivative to commodity price

- Valuation of BI loss is determined by the underlying commodity price at the time of loss.

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Example of Fixed Costs and Expense Coverage

Loss of 400 Units	Standard Cost Per Unit	Projected	Actual	Difference
Quantity Produced		1,000	600	400
Selling Price (Sales)	\$28.00	\$28,000	\$16,800	\$11,200
Variable Costs	\$43.00	43,000	25,800	17,200
Gross Profit (Insurance Rate)	(\$15.00)	(15,000)	(9,000)	(6,000)
Negative gross profit = losing money per unit sold				
Fixed Costs		3,000	3,000	
Selling and Administrative		2,000	2,000	
Sub-total		5,000	5,000	
Operating Profit		(\$20,000)	(\$14,000)	(\$6,000)
Operating Profit		(\$20,000)		
Continuing OH & Expense		5,000		
Less Actual Gross Profit		9,000		
Loss		(\$6,000)		

Client would recover fixed costs and expenses (standing charges) even if application of the normal BI formula would result in no loss.



Insured results improved by \$6,000 after losing unit sales with a negative gross profit!

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Example of BI Volatility Clause

LMA5383 – The most common template for a BI volatility clause:

1. Subject to the other terms, conditions, and limitations of this (Re)Insurance:
 - 1.1 the Annual Cap for business interruption indemnity shall be ____% of the declared annual business interruption value of the Location(s) suffering Damage; and
 - 1.2 the Monthly Cap for business interruption indemnity shall be ____% of the declared monthly business interruption values of the Location(s) suffering Damage. In the absence of declared monthly business interruption values, monthly business interruption values used to calculate the Monthly-Cap shall equal the declared annual business interruption value of the Location(s) suffering Damage divided by twelve; and
2. If the values are declared for a period which is more, or less, than one year, then the annual value shall be calculated on a pro-rata basis.

- An additional set of sub-limits (monthly and annual) for onshore BI.
- A defined uplift factor for values pro-rated from the declared BI values.
- Greater emphasis on accuracy/fidelity of BI values being declared.
- Consider what uplift factor would be appropriate for the business.



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Example of BI Valuation Derivative to Commodity Price

Commodity Price:	≤ \$20	\$30	\$40	\$50	\$60	\$70	\$80	\$90	\$100 ≤
Profitability:	Negative GP	Negative GP	Positive GP Negative OP	Positive GP Negative OP	Positive OP	Positive OP	Positive OP	Positive OP	Positive OP
BI Valuation Method:	Fixed Costs Only	Fixed Costs Only	Normal BI Valuation	Normal BI Valuation	Normal BI Valuation	Normal BI Valuation	Normal BI Valuation	BI Calculated using \$80 Price	BI Calculated using \$80 Price

GP = Gross Profit OP = Operating Profit

Valuation of a covered loss would change based upon commodity price at the time of loss.

Practical Claims Considerations

Current and Future Impact

Non-COVID Claims Triggered Pre-COVID

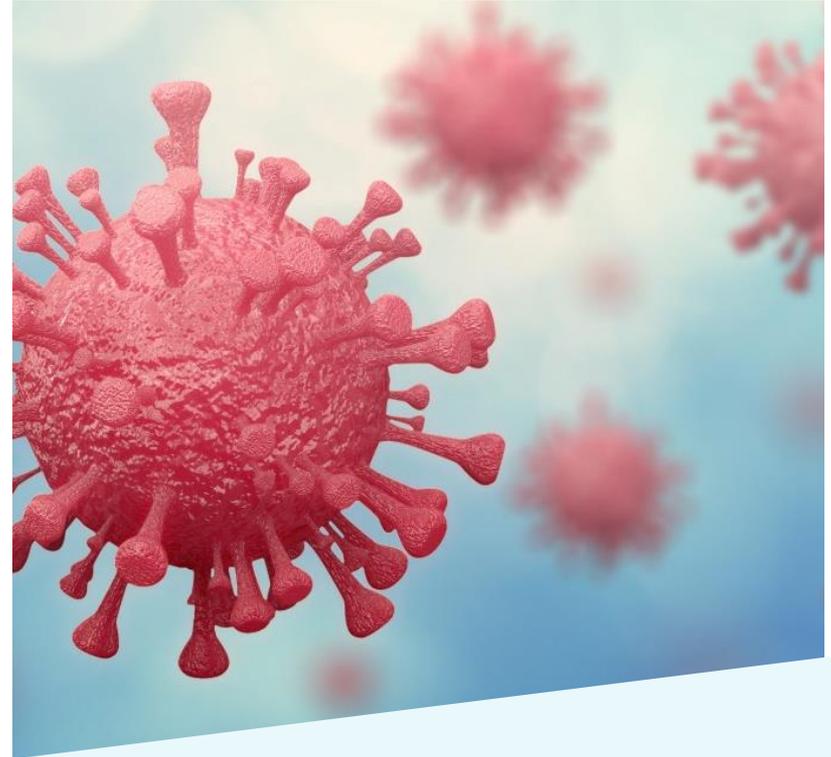
- Delayed repairs or start up
- “But for” COVID considerations
- Returning to work impacts and increased costs

Non-COVID Claims Triggered Post/during COVID

- Forecasts need to reflect Post COVID economic factors
- Phased re-entry considerations
- Long term tail considerations: commodity pricing fluctuations

COVID Claims

- Underwriters will scrutinize forecast adjustments
- Continuing to monitor government programs and subsidies
- Presenting a claim to the Insurer
- Limitation awareness
- Preserving the right to claim



Business Interruption In A Low Commodity Price Environment

COVID Claims



Challenges

- Uncertainty regarding coverage trigger.
- Need to preserve rights under the policy.
- Legal process may take years to resolve.



Solution

- Preserve data today.
- Prepare claim today.
- Submit initial claim.
- Claim prep fees charged and paid at discounted rates.



If Coverage Is:

- **Affirmed** – go through normal claim process at normal rates.
- **Denied** – claim prep at discounted rates.

Questions?



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How an organization prepares for and manages financial issues prior to or after a business-impacting event can often mean the difference between remaining successful and being left behind. FAS provides expert assistance in the quantification and measurement of values, damages, economic claims, and losses.