BUSINESS INCOME
THE ISSUE OF PAYROLL

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Liberty Mutual
INSURANCE
BUSINESS INCOME:
The Issue of Payroll

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This material has been designed for use in training programs for insurance industry personnel. It is not intended to be used as a complete reference resource on the programs and coverages outlined herein.

The programs use “standard” policy forms and endorsements for the purposes of discussing the exposures to loss that may exist, some of the coverage options available to treat them, and to provide a framework for discussions with carriers you represent concerning the programs they have available.

Coverages, rules and materials presented during this program may differ from those used by individual insurance companies. Contact individual carriers for details about interpretations of their eligibility requirements, particular insurance contracts and rates.
A. COVERAGE

1. Business Income

Business Income means the:

a. Net Income (Net Profit or Loss before income taxes) that would have been earned or incurred; and

b. Continuing normal operating expenses incurred, including payroll.

For manufacturing risks, Net Income includes the net sales value of production.

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Coverage is provided as described and limited below for one or more of the following options for which a Limit of Insurance is shown in the Declarations:

(1) Business Income including “Rental Value.”
(2) Business Income other than “Rental Value.”
(3) “Rental Value.”

If option (1) above is selected, the term Business Income will include “Rental Value.” If option (3) above is selected, the term Business Income will mean “Rental Value” only.

If Limits of Insurance are shown under more than one of the above options, the provisions of this Coverage Part apply separately to each.

We will pay for the actual loss of Business Income you sustain due to the necessary “suspension” of your “operations” during the “period of restoration.” The “suspension” must be caused by direct physical loss of or damage to property at premises which are described in the Declarations and for which a Business Income Limit of Insurance is shown in the Declarations. The loss or damage must be caused by or result from a Covered Cause of Loss. With respect to loss of or damage to personal property in the open or personal property in a vehicle, the described premises include the area within 100 feet of such premises.

With respect to the requirements set forth in the preceding paragraph, if you occupy only part of a building, your premises mean: (a) The portion of the building which you rent, lease or occupy; (b) The area within 100 feet of the building or within 100 feet of the premises described in the Declarations, whichever distance is greater (with respect to loss of or damage to personal property in the open or personal property in a vehicle); and (c) Any area within the building or at the described premises, if that area services, or is used to gain access to, the portion of the building which you rent, lease or occupy.
3. Loss Determination

a. The amount of Business Income loss will be determined based on:
   (1) The Net Income of the business before the direct physical loss or damage occurred;

   (2) The likely Net Income of the business if no loss or damage had occurred, but not including any Net Income that would likely have been earned as a result of an increase in the volume of business due to favorable business conditions caused by the impact of the Covered Cause of Loss on customers or on other businesses.

   (3) The operating expenses, including payroll expenses, necessary to resume “operations” with the same quality of service that existed just before the direct physical loss or damage; and

   (4) Other relevant sources of information, including:
       (a) Your financial records and accounting procedures;
       (b) Bills, invoices and other vouchers; and
       (c) Deeds, liens or contracts.

- Payroll is included as a continuing normal expense

- **Payroll:**
  - Contrary to popular beliefs, there is no definition of the word “payroll” under the ISO Business Income forms
  - The undefined word then takes on a common meaning

**PAYROLL:**
1. a paymaster's or employer's list of those entitled to pay and of the amounts due to each
2. the sum necessary for distribution to those on a payroll
3. the money to be distributed
BUT, the necessary payroll will be paid **ONLY IF the payroll is necessary to resume operations with the same quality of service the existed just before the loss or damage**

- **Insureds and carriers may differ** as to what payroll would fall into this category

- Also, **insureds may want to include payroll of certain employees** that may not qualify as necessary to the resumption of operations
DISCRETIONARY PAYROLL EXPENSE ENDORSMENT (CP 15 04)

This endorsement option was introduced in 2007. When attached to the policy, the payroll for employees or job classifications shown is covered regardless of whether the payroll expense is necessary for the resumption of operations at the same level of service as existed prior to the loss or damage.

CP 15 04 06 07 DISCRETIONARY PAYROLL EXPENSE

This endorsement modifies insurance provided under the following:

BUSINESS INCOME (AND EXTRA EXPENSE) COVERAGE FORM
BUSINESS INCOME (WITHOUT EXTRA EXPENSE) COVERAGE FORM

SCHEDULE

<table>
<thead>
<tr>
<th>Job Classifications Or Employees</th>
<th>Maximum Number Of Days For Discretionary Payroll Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
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<td></td>
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</tbody>
</table>

Information required to complete this Schedule, if not shown above, will be shown in the Declarations.

A. Payroll expenses for the Job Classifications and/or Employees identified in the Schedule will be included as continuing normal operating expenses in determining the amount of Business Income loss, provided that you pay such expenses and regardless of whether such expenses are necessary to resume “operations”.

Payroll expenses include: 1. Payroll; 2. Employee benefits, if directly related to payroll; 3. FICA payments you pay; 4. Union dues you pay; and 5. Workers' compensation premiums.

B. With respect to Job Classifications and/or Employees identified in the Schedule, payroll expenses are included in the Business Income loss for the entire “period of restoration” and any extension of the “period of restoration” if an extension is provided under this policy, unless the Schedule indicates otherwise. With respect to a Job Classification(s) or Employee(s) for which the Schedule shows a maximum number of days, Business Income loss includes payroll expenses for not more than the stated number of days. The number of days need not be consecutive but must fall within the “period of restoration” or extension (if any) of the “period of restoration”.

C. This endorsement does not affect coverage of payroll expenses for job classifications and employees not identified in the Schedule.
Some insured’s would not want to continue to pay for their “ordinary payroll” expenses during the suspension of their operations following a covered loss or damage.

The business income forms, which unless endorsed, are a coinsurance basis and require that the limit includes all operating expenses that encompasses all of the payroll expenses.

The business income coverage forms DO NOT define or distinguish between “payroll” and “ordinary payroll”.

If a business does not plan to retain all of their employees if they suffered a lengthy shut down, ISO offers a solution.

The “Ordinary Payroll Limitation or Exclusion Endorsement” can be used when a business wants to either limit or exclude the payroll expense of:

- Employees that would not be needed during the recovery period, or
- Employees whose service can easily or readily be replaced

ADVANTAGES:

- Reduces or eliminates “ordinary payroll”
- Reduces the limit necessary to meet coinsurance requirements
This endorsement modifies insurance provided under the following:
BUSINESS INCOME (AND EXTRA EXPENSE) COVERAGE FORM
BUSINESS INCOME (WITHOUT EXTRA EXPENSE) COVERAGE FORM

SCHEDULE

<table>
<thead>
<tr>
<th>Number Of Days (if Ordinary Payroll Coverage is provided):</th>
</tr>
</thead>
<tbody>
<tr>
<td>Additional Exemptions – Job Classification(s) Or Employee(s):</td>
</tr>
</tbody>
</table>

Information required to complete this Schedule, if not shown above, will be shown in the Declarations.

A. Business Income includes "ordinary payroll expenses" only for the number of days shown in the Schedule. The number of days need not be consecutive but must fall within the “period of restoration” or extension of the “period of restoration” if an extension is provided under this policy. If the schedule does not indicate a number of days, then "ordinary payroll expenses" are excluded.

B. In determining the operating expenses for the policy year for Coinsurance purposes, payroll expenses will not include "ordinary payroll expenses," except for "ordinary payroll expenses" incurred during the number of days shown in the Schedule, or in the Declarations. If the "ordinary payroll expenses" for the policy year vary during the year, the period of greatest "ordinary payroll expenses" will be used.

C. "Ordinary payroll expenses" means payroll expenses for all your employees except:
1. Officers;
2. Executives;
3. Department managers;
4. Employees under contract; and
5. Additional Exemptions, shown in the Schedule or in the Declarations as:
   a. Job Classifications; or
   b. Employees.

"Ordinary payroll expenses" include:
(1) Payroll;
(2) Employee benefits, if directly related to payroll;
(3) FICA payments you pay;
(4) Union dues you pay; and
(5) Workers compensation premiums.
THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

PAYROLL LIMITATION OR EXCLUSION

This endorsement modifies insurance provided under the following:

BUSINESS INCOME (AND EXTRA EXPENSE) COVERAGE FORM
BUSINESS INCOME (WITHOUT EXTRA EXPENSE) COVERAGE FORM
SCHEDULE

<table>
<thead>
<tr>
<th>Premises Number:</th>
<th>Building Number:</th>
</tr>
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</table>

- Payroll Expense Limitation – Number Of Days:

- Payroll Expense Exclusion

The following are subject to the provisions of this endorsement if so indicated in this Schedule:

- All employees and job classifications including officers, executives, management personnel and contract employees

- All employees and job classifications other than officers, executives, management personnel and contract employees

- All employees and job classifications (including officers, executives, management personnel and contract employees), except:

- Only the following job classifications and/or employees:

The following are subject to the provisions of this endorsement if so indicated in this
THE ISO BUSINESSOWNER POLICY (BOP)

ADDITIONAL COVERAGES:

- Business Income—Loss of business income is included under the BOP policy as one of the Additional Coverages

- There is no dollar amount or coinsurance percentage on the business income coverage – loss is based on “actual loss sustained”

- There is a 12 month maximum for the insured’s loss recovery, including coverage for payroll

- A 60-day maximum applies to coverage for ordinary payroll expenses unless a greater number of days is shown in the declarations.

  - The BOP does not have any endorsement option to extend the payment of ordinary payroll, but does include the ability to increase the number of days by entering an amount on the Dec page
  - ISO allows up to 360 days to be entered
  - Check with your carriers for their specific underwriting guidelines on ordinary payroll for any carrier specific forms
ISO BOP ADDITIONAL COVERAGES

Business Income Means:
- Net Income (*Net Profit or Loss before income taxes*)
  that would have been earned or incurred if no physical
  loss or damage had occurred . . .
- Continuing normal operating expenses incurred,
  including payroll.

Ordinary Payroll Means:
- Mean payroll expenses for all your employees **except:**
  - Officers;
  - Executives;
  - Department Managers;
  - Employees under contract; and
  - Additional Exemptions shown in the Declarations as:
    - Job Classifications; or
    - Employees

Ordinary payroll expenses **include:**
- Payroll;
- Employee benefits, if directly related to payroll;
- FICA payments you pay;
- Union dues you pay; and WC premiums
In 2010 ISO added the following BOP endorsement:

Discretionary Payroll Expense Endorsement (BP 14 30)

- Provides flexibility with respect to the payroll expense
- Allows payroll coverage (without the need to prove that it is necessary) to be provided for the entire period of restoration or limited to a specified maximum number of days