

# **INSURANCE – A LAYPERSON’S GUIDE**

As a business owner, navigating the range of insurance options available to you can be daunting at times. However, insurance is a way to protect against a variety of risks as well as increase the value of your business. It also protects your partners and investors. It is therefore a vital component in the success of your venture.

To help you find your way, the Insurance Services Group of the IFC has put together the following sample of typical insurance policies that businesses may need in the course of their operations, and explains some common insurance terms.

**Disclaimer:**

These insurance definitions are presented herein for informative purposes only. Actual insurance coverage will depend on the specific terms and conditions of a policy, including any exclusions. It is the responsibility of each individual business to understand such terms, conditions and exclusions, and is not the focus of these definitions. The user understands that no claims, implicit or explicit, are made with respect to these definitions and that any conclusions or inferences drawn from them are wholly the responsibility of the user. These definitions have been adapted from a number of sources by the Insurance Services Group of the Environment and Social Development Department of IFC, and we welcome feedback on its content and applicability. Judgments expressed herein do not necessarily reflect the views of IFC’s Board of Directors or the governments

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## **Construction All Risks (“CAR”)**

This type of policy covers the civil works from commencement of construction to final handover (including testing/commissioning and extended maintenance – normally 12 months). The policy also normally includes a section covering claims arising from third parties (**Third Party Liability**) who are injured, or whose property is damaged, during the construction period.

It is recommended that this policy be procured by the principal (i.e. the project owner), making it an ‘owner-controlled’ insurance policy, as opposed to a contractor-controlled policy. There are a number of reasons for this, including the following:

- Contractors commonly include the cost of insurance in their contract price. When asked for a breakdown of the contract, it is often discovered that the owner can buy the insurance at a lower cost.
- The owner can maintain control over the extent of coverage - ensuring all necessary perils are included and the policy remains valid at all times.
- The owner retains control of the policy at the critical time of transition from the construction to the operational phase to ensure there is no gap in coverage.
- It avoids 'finger-pointing' when a loss occurs and contractors or sub-contractors blame each other for the loss, often resulting in a delayed response from insurers.
- Contractors and sub-contractors are named as “additional insureds” under the policy, so that all claims by third parties arising from the construction are covered, regardless of who is to blame.
- It enables the owner to place associated coverages, such as **Advance Loss of Profits** insurance for delays in project completion due to losses suffered during construction.

## **Erection All Risks (“EAR”)**

This type of policy insures equipment during installation and testing/commissioning, up to the point where the equipment is operational (when it then is transferred to the **Fire, Property All Risks, and/or Machinery Breakdown** insurance policy). This policy also contains coverage for an extended maintenance period (typically 12 months) and includes a section for **Third Party Liability**.

Arguments for owner-controlled policy (as under **Construction All Risks**) similarly apply to this policy.

## **Marine All Risks**

This policy insures items such as plant and equipment, finished goods, and raw materials – among other things, during transportation. Despite its name, the policy is not restricted to marine (ocean transit) risks, but also covers transportation by air, road and rail. In addition to “transportation”, this policy is generally extended to cover temporary storage.

A 50/50 clause is important when Marine All Risks is taken in conjunction with a **Construction All Risks/Erection All Risks** policy. This clause will feature in both policies with the effect that in case of ambiguity between the cause of loss being construction/erection or transportation of cargo, each policy will pay 50% of the loss amount.

## **Advanced Loss of Profits (“ALOP”)**

This policy is particularly important for large greenfield projects where delay in project completion could have a substantial impact on the expected revenue of the Company, potentially impacting the sponsors’ ability to service debt and other fixed expenses.

The policy pays for Anticipated Net Profit plus Standing Charges during the period of delay, from the scheduled date of commencement of commercial operation up to the actual date of commencement of commercial operation, subject to a time excess and the **Indemnity Period**. The delay must have occurred due to a loss during construction, and payable under the Construction/Erection All Risks policy. Particular attention needs to be paid to the **Indemnity Period**, which must anticipate the maximum time to rebuild, re-erect and retest any part of the project if damaged.

Many sponsors choose to insure Standing Charges only, as this keeps costs down. This policy does not cover normal project schedule slippages, and insurers require close monitoring of project activity and coordination with the underlying Construction/Erection All Risk insurance. As such, it is recommended that both insurances are placed via the same insurance company to ensure efficient handling of losses.

## **Marine Delay in Start Up (“MDSU”)**

This policy is particularly important for large greenfield projects where delay in project completion due to an event insured under the **Marine All Risks** policy could have a substantial impact on the expected revenue of the Company, potentially impacting the sponsors’ ability to service debt.

The policy covers loss of Anticipated Net Profit and Standing Charges (including debt service) incurred as a result of delay in project completion because of loss during marine transit. Most sponsors choose to insure Standing Charges only, as this keeps the costs down. Particular attention needs to be paid to the **Indemnity Period** selected, which should anticipate time to reorder, deliver and install materials enabling completion of the project to its original specifications.

## **Fire**

A basic **Fire** policy insures damage to tangible property due to fire, lightning, explosion and aircraft impact, but is normally extended to include storm (e.g. hurricane, typhoon, cyclone), water damage (including flood), earthquake (and where relevant tsunami or volcanic eruption), strike riot and civil commotion and vehicle impact as causes of loss. It should be noted that a **Fire** policy only insures those perils specified in the policy.

Assets should be insured for Replacement Value, not Book/Depreciated or Market Value. Assume say a building is insured for a depreciated value of \$800,000, but to replace it would cost \$1,000,000. Should that building be damaged/destroyed by an insured peril, the company would be penalized for underinsurance, and receive only 8/10 of their claim (application of average). This also applies to other assets, including plant and machinery. Insuring for anything less than replacement diminishes the value of the insurance to the project.

War on land is a standard exclusion under any policies insuring property damage. Sabotage and Terrorism cover is normally an exclusion since 9/11, however it can be procured either as an extension to the basic Fire policy (e.g. in India or Turkey) or as a standalone policy.

## **Property All Risks**

This policy offers broader cover than that available in a basic Fire policy. It will respond to all perils except those specifically excluded in the policy, such as war, radioactive/nuclear contamination, willful acts, defective design, etc.

## **Business Interruption (also known as Loss of Profits)**

This is as important, if not more important, than **Fire** or **Property All Risks** cover on assets, as loss of revenue can have a serious effect on a project company.

The Business Interruption policy can insure the project company for loss of Net Profit and Standing Charges until such time as normal production or commercial operation is resumed. The **Indemnity Period** typically ranges from 3 to 36 months depending on the nature of the operations. Insured perils follow the **Fire** or **Property All Risks** policy, and there has to have been an accepted property damage claim for the associated business interruption claim to be valid.

Extensions are available to the policy, such as damage at the premises of key suppliers and/or customers, which results in interruption to the insured's business. The covered causes of loss are the same as those under the insured's **Fire** or **Property All Risks** policy. This extension is of importance where the project relies heavily on a limited number of suppliers or customers. Other extensions include utilities expense, and denial of access by order of civil authority.

To keep costs down, a company can elect to insure Fixed Expenses only and also to carry time deductibles. Alternatively, if production can be continued, but only at increased cost, the company can elect to insure only Increased Cost of Working/Extra Expenses. Overall business loss indemnity and recovery should be given priority over minimizing premium cost in all situations.

Business Continuity/Disaster Recovery plans are important when assessing the level of this cover.

## **Indemnity Period**

The Indemnity Period is a limit under a **Business Interruption** policy relating to the maximum period over which the insurer will pay for loss of profit. The limit normally reflects the anticipated time to restore operations to their normal pre-loss levels.

## **Machinery Breakdown and Business Interruption following Machinery Breakdown**

This policy covers mechanical and electrical breakdown of plant and machinery, and the ensuing loss of production (cover which is often excluded from **Fire** and **Property All Risks** policies). Policies can also cover loss to surrounding property damaged by breakdown, such as in the case of explosion of boiler machinery. The cover is important for critical items of plant where limited back-up or standby facilities exist or where sophisticated and expensive equipment is in place. Companies should consider maintaining adequate back-ups, and holding spares of critical components.

## **Electronic Equipment**

The policy covers losses resulting from sudden and unexpected physical loss or damage to electronic equipment (e.g. computers) by any cause (other than the exclusions specified in the policy), in a manner necessitating repair or replacement. The policy can often also be extended to cover expenses incurred in reconstruction of data, and the cost to rent substitute equipment.

## **Sabotage & Terrorism**

This policy responds to physical damage (and, if elected, Business Interruption) caused by acts of Sabotage or Terrorism. A standalone Sabotage & Terrorism policy is usually sought if insurers exclude or limit coverage via standard **Fire** or **Property All Risks** policies.

## **Third Party Liability (also known as General Liability or Public Liability)**

This policy protects the policyholder in respect of legal liability to third parties (not employees) for both bodily injury and for any loss of or damage to their property.

All businesses have a legal liability to their customers, suppliers and the general public. If a third party suffers bodily injury or damage to their property arising out of the company's business activities, maintenance of business premises and the actions of its employees, it may be held liable. A court can award significant compensation against the company, the affect of which may be compounded by the impact on the company's time, reputation, and defense costs. Public Liability insurance will indemnify for compensation awarded in court and the associated costs for investigation and defense of claims.

The policy does not cover injury to employees, which is covered under Workers Compensation (often compulsory insurance). Third Party Liability insurance is not expensive and is readily available in all countries, though full extent of coverage granted by individual policies may vary.

## **Product Liability**

This policy covers the company's legal liabilities to third parties for bodily injury or loss of or damage to property caused by the company's products or goods.

Product Liability insurance indemnifies the insured for compensation awarded in court or compensation agreed with insurer's consent out-of-court, as well as costs associated with defending claims, both of which may be substantial.

Product Liability is imposed under several different legal theories, including negligence, breach of contract and strict liability in tort.

Legal proceedings are generally subject to the jurisdiction of the country in which the product was purchased. The 'geographical scope' under Product Liability policies insuring exports therefore needs to include all relevant countries and the 'jurisdiction' should also extend to all of those countries (ideally stated as "worldwide". Not only will the manufacturing come under scrutiny, but labeling, packaging, instructions, installation, service and other elements of the product can all be attributed blame. Consequently, liability is a concern to all parties 'within the stream of commerce'.

When a product causes damage, the right to take action is certainly not a right limited to citizens of the USA or other litigation-conscious countries. With growing awareness and enforcement of consumer rights around the world, affected parties can and increasingly do take action against manufacturing firms, including importers or distributors they believe have been negligent.

### **Medical Professional Liability (also known as Medical Malpractice)**

Medical Professional Liability is important for medical service providers, such as hospitals as companies, or individual doctors/medical staff who may be deemed liable for professional errors (e.g. injury to a patient, failure to diagnose) or administrative errors or omissions. This coverage is commonly triggered in claims alleging injury or death as a result of action (or inaction) by a doctor/nurse/hospital. The policy also covers legal costs associated with defending a claim.

### **Professional Indemnity or Errors and Omissions (PI/E&O)**

Professional Indemnity insurance is designed to cover businesses in the event that they are pursued by third parties who claim that they have suffered a loss as a result of the company's professional negligence. Cover is normally taken by professionals such as accountants, fund managers, lawyers, architects or any professional services providers.

General Liability and Product Liability policies generally exclude professional liability losses. Therefore, stand-alone insurance is needed outside of these contracts for companies that have a significant, not incidental, exposure to liability loss.

### **Directors' & Officers' Liability (D&O)**

This policy provides protection in respect of claims from shareholders, creditors, customers, employees and others, who can sue directors as individuals, for their negligence in the running of, and behavior of, the Company. The policy may be in two parts:-

- a) cover for individual directors/officers serving in an outside directorship for loss where they are not indemnified by the insured organization, and where the director/officer becomes legally obligated to pay on account of any claim made against him, individually or otherwise, during the policy period;
- b) cover for an insured organization for i) losses they pay as indemnification to a director/officer who serves in an outside directorship; ii) where the director/officer is not indemnified by the outside entity; and iii) where the director/officer has become legally obligated to pay a claim made against him, individually or otherwise, during the policy period.

The policy also pays for any damages and for defence costs in relation to claims.

The policy can be extended to cover Observers in some jurisdictions.

## **Environmental Impairment Liability (EIL)**

This insurance provides cover against unexpected (and in some cases anticipated) losses from sudden or gradual pollution conditions. Claims from third parties for resulting bodily injury or damage to their property, associated clean-up costs, and legal defense costs, fines and penalties allowable by law, and contractual liability are generally insurable under EIL policies.

Some categories of EIL insurance include:-

- First-party onsite clean-up, which covers the cost to remediate pollution on the insured's own premises.
- Contractors pollution liability, which insures contractors against liability for bodily injury and property damage arising out of environmental clean-up operations.
- Environmental professional liability, which provides professional liability insurance for engineers, consultants, or other providers of services or advice involving pollution.
- Remediation cost cap, which covers cost overruns when environmental remediation projects exceed projected costs.

## **Marine Hull and Machinery (H&M)**

This policy provides coverage following damage to the hull, machinery, and equipment of a watercraft or ship/vessel. The sum insured is typically based on Agreed Value.

## **Protection and Indemnity (P&I)**

This policy provides liability protection if a ship owner or operator is sued for claims from third parties for bodily injury or damage to their property arising out of the negligent operation of a vessel. Claims can arise, for example, from damage to bridges, piers, wharfs or like structures along waterways, injury to passengers, crew on board the vessel itself, or on other vessels if collision liability is covered.

## **Mortgagees Interest Insurance (MII)**

This policy covers the lender's interest in the mortgaged vessel. This insurance cover is secondary to the primary insurance on the vessel, such as Hull & Machinery, P&I insurance, etc., and a claim is valid only when the primary insurance cover does not respond.

## **Aviation Hull**

This coverage provides payment to the owner of the aircraft for physical loss of or damage to the aircraft. Coverage excludes losses arising from war, hijacking, terrorism, riot, strike, sabotage, etc. but these risks can be insured separately under a **Hull War Risks** policy. The sum insured is based on Agreed Value.

## **Hull War Risks**

This insures aircraft hull damage losses excluded under the **Hull All Risks** policy by virtue of the war exclusion.

## **Aviation Liability**

This type of policy is designed to cover the insured's legal liability to third parties (including passengers) for bodily injury and property damage resulting from the ownership, maintenance or use of an aircraft while on the ground or in flight. These policies include coverage for the defense of any suit brought against the insured.

An extension covers the insured's legal liability to passengers for bodily injury and property damage resulting from war and terrorism acts, such as aircraft confiscation, sabotage, hijacking, unlawful seizure and civil commotion.

Companies that may charter aircraft frequently are also advised to carry insurance suitable to their exposure.

## **Aviation Liability – War Risks**

This policy covers the insured's legal liability to others for bodily injury and property damage resulting from war and terrorism acts, such as aircraft confiscation, sabotage, hijacking, unlawful seizure and civil commotion.

## **Oil & Gas – Energy Package**

This policy is specifically designed for the risks associated with the oil and gas sectors, and can cover on- and off-shore risks. Coverage typically includes property damage, control of well/operator's extra expenses, and liability risks (including sudden and accidental pollution).

## **Key Man Insurance**

This is a life insurance product procured by a company, designating itself (or a financial institution) as a beneficiary, to compensate it for financial losses resulting from the death and/or disability of a key member. This insurance is important where the presence of one key individual is deemed critical to the success of a project, particularly in small, privately held organizations or family-owned businesses.

The policy sum insured can be selected to cover the amount of the loan (or in the case of equity, the amount that would be required to hire a replacement immediately, assuming one can be found). Proper succession planning may mitigate the need for Key Man Insurance.

## **Crop Insurance**

There are various types of crop insurance depending on the country offering the cover, but generally, it may provide coverage for yield-loss due to natural causes, including: drought, excessive rain, hail, flood, frost, snow, wind, lightning, hurricane, tornado, accidental fire, damage caused by wildlife, waterfowl, insects and/or plant disease.

## **Livestock Insurance**

There are various types of livestock insurance depending on the country offering the cover, but generally it may provide coverage for loss of livestock by death due to accident and certain diseases.

## **Bankers Blanket Bond (Financial Institution Bond)**

This is a policy which provides broad protection to Financial Institutions. The policy covers a number of guarantees relevant to the sector, and may include the following elements:-

Fidelity Guarantee: coverage in respect of losses sustained due to the dishonest or fraudulent acts of the Insured's employees, which are committed with the intention of a) causing the assured to sustain such loss and/or; b) to obtain, and which result in, improper personal financial gain for said employee.

Losses sustained under this category of coverage should not distinguish between any particular position, level, or territory, as losses are often a result of collusion between various levels. Losses due to such acts by employees can account for a large proportion of an institution's losses, and in some extreme cases, can result in the institution's liquidation.

Cash on Premises: covers loss of financial instruments of the insured while on the premises (counters, safes, vaults), through events such as burglary, hold-up, robbery, damage, destruction, misplacement. The sum insured is normally not the full value of all financial instruments at all times; it is based on the maximum which could potentially be lost in any one incident.

Cash in Transit covers loss of financial instruments during transit by the company's own employees, or by a company hired for the purpose. The sum insured is normally not the full value of all financial instruments at all times, it is based on the maximum which could potentially be lost in any one incident.

Electronic and Computer Crime: covers losses arising from fraudulent input of electronic data or computer instructions to the insured's computer, by unauthorized access to a terminal or an institution's communication lines by a third party (e.g. by hackers).

Forgery: cover against a financial loss which results from having acted in good faith upon "written instruments" or "payment instructions", if these prove to be forged, or fraudulently altered, lost or stolen, or forged as to signature.

Counterfeit Currency: covers the institution for losses sustained as a result of its acting upon any counterfeit currency, for example the encashment of counterfeit currency handled during the normal course of business.

These coverage elements are in most cases also available on a stand-alone basis.