

## **General BI Subjects**

### **Dual Wages Insurance**

#### **Introduction**

Dual Wages is a flexible means of insuring less than 100% of Wages. It was very common but appears to be less frequently used in recent years, which may be a cost-benefit issue.

The General Description, which follows, will probably be adequate for most readers but those who want more of the mechanics and theory can continue to “Dual Wages in Detail”, at page 2.

#### **General Description**

I remember my first experience of Dual Wages as a very young adjuster (probably 150 years ago). I saw this strange Wages Item in a policy without really understanding it, immediately before attending a crisis meeting following a major fire. There were ten or twelve people, including the insurer and broker plus senior executives of the insured. Fortunately none asked me at that meeting, about the policy's coverage of Wages or my credibility would have been seriously eroded. By the time we got to the final settlement calculations and negotiations I knew the Item inside out.

The difficulty with Dual Wages is that it uses words to describe a potentially complex calculation and if I try to explain it in detail I will merely be using different words for the same end result. I will therefore provide a few words under “General Description” and then use numbers to show how the Item works, under “Dual Wages in Detail”.

The Dual Wages Item covers 100% of Wages during an initial period, say, 8 weeks, but only a lesser percentage, say, 40%, of Wages for the remainder of the Indemnity Period (say, weeks 9 to 52). If there are savings in Wages during the initial 8-week period these can be carried over to increase the available cover for the remainder period (i.e. additional to the 40%).

At the option of the insured, which can be exercised at any time, the initial period of 100% cover can be extended (say to 26 weeks) but the available claim in the remainder period (27<sup>th</sup> to 52<sup>nd</sup> weeks) is then limited to just the savings achieved during the initial 26 weeks.

If you want to know the mechanics of the Item, read on. Otherwise go to “How to select the Periods and Percentages”.

### Dual Wages in Detail

The loss in respect of Wages in any period is calculated by the following formula.

**Table 1**

Reduction in Turnover	x	Rate of Wages
Less Savings in Wages		

(If this appears a bit strange I suggest that you review Module 9: The Insurance of Wages before continuing.)

For example, the loss during the first, say, 8 weeks of an Indemnity Period, is calculated as follows:

**Table 2**

Reduction in Turnover (during the first 8 weeks)	x	Rate of Wages		
\$220,000	x	32%	=	\$70,400
less Savings in Wages (during the first 8 weeks)				(\$22,240)
Net Loss in the first 8 weeks				\$48,160

The Dual Wages Item uses this formula to define a claim during an initial period, say 8 weeks. The period is selected when the policy is taken out and recorded in the Schedule. This provides total cover for the initial 8 weeks (or whatever initial period is specified).

For the remainder of the Indemnity Period after the initial 8 weeks, the loss is again calculated by the formula:

**Table 3**

Reduction in Turnover (during the remainder period)	x	Rate of Wages
Less Savings in Wages (during the remainder period)		

For example:

**Table 4**

Reduction in Turnover (during the remainder period)	x	Rate of Wages	=	
\$850,000		32%		\$272,000
less Savings in Wages (during the remainder period)				(\$120,000)
Net Loss during Remainder Period				<u>\$152,000</u>

This is **the loss** during the remainder period but there is a limit on how much of it can be claimed. The claim is limited by a two-stage formula. The first is:

**Table 5**

Reduction in Turnover (during the remainder period)	x	Rate of Wages	x	"Remainder Percentage"
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The remainder percentage is also selected in advance and recorded in the policy Schedule (say, 25% or 40%). I will use a limit of 40% in the example.

**Table 6**

Reduction in Turnover (during the remainder period)	x	Rate of Wages	x	Remainder Percentage	=	Initial Limit
\$850,000	x	32%	x	40%	=	\$108,800

In this example the loss in Table 4 was \$152,000 but the claim limit in Table 6 was \$108,000. The good news is that this limit during the remainder period is increased by the value of savings in Wages during the initial period. The calculation for the initial period in Table 2 was reduced by savings of \$22,240 and so the limit in the remainder period is increased by this figure, as follows:

**Table 7**

Reduction in Turnover (during the remainder period)	x	Rate of Wages	x	Remainder Percentage	=	Initial Limit
\$850,000	x	32%	x	40%	=	\$108,800
Plus Savings in Wages during the Initial Period						\$22,240
Final Limit during Remainder Period						<u>\$131,040</u>

And to bring the loss and the claim limit together:

**Table 8**

Reduction in Turnover (during the remainder period)	x	Rate of Wages		
\$850,000		32%	=	\$272,000
less Savings in Wages (during the remainder period)				(\$120,000)
Net Loss during Remainder Period				<u>\$152,000</u>
Limit during Remainder Period (see Table 7)				<u>\$131,040</u>

The limit is not quite adequate to cover the total loss in the remainder period because the savings in Wages during both initial and remainder periods were not sufficient. The key to the Dual Wages Item is in the savings in Wages.

I will complete this section by quoting the first part of the Dual Wages Item but inserting the optional factors. I will also simplify the words a little because the original specification of Dual Wages used rather ponderous language.

*“The insurance under this Item is limited to the loss in respect of Wages and the amount payable as indemnity shall be:*

*(a) In respect of reduction in turnover*

*(i) During the initial period beginning with the occurrence of Damage and ending not later than 8 weeks thereafter the sum produced by applying the Rate of Wages to the Shortage of Turnover during this initial period less any saving in Wages during the initial period in consequence of the Damage,*

*(ii) during the remainder of the Indemnity Period the sum produced by applying the Rate of Wages to the Shortage of Turnover during the remainder of the Indemnity Period*

*less any saving in Wages during the remainder of the Indemnity Period in consequence of the Damage*

*but not exceeding the sum produced by applying 40% of the Rate of Wages to the Shortage of Turnover during the remainder of the Indemnity Period increased by the savings in Wages deducted in terms of clause (i)"*

### **The Option to Consolidate**

I described this briefly in the general introduction on page 1, as follows:

"At the option of the insured, which can be exercised at any time, the initial period of 100% cover can be extended (say to 26 weeks) but the available claim in the remainder period (27<sup>th</sup> to 52<sup>nd</sup> weeks) is then limited to just the savings during the initial 26 weeks."

This converts the cover of 100% for 8 weeks plus a 40% limit thereafter (increased by the saving in the first 8 weeks) to a cover of 100% for 26 weeks plus a limit thereafter of only the savings in the first 26 weeks. The calculations are all the same but where we had 8 weeks we now substitute 26 weeks and where we had 40% we substitute zero.

The policy uses the following words, again very slightly simplified by me:

*"Note: At the option of the Insured the number of weeks referred to as the initial period in clause (a)(i) may be increased to 26 provided that the amount calculated under clause (a)(ii) shall not exceed the savings in Wages deducted under clause (a)(i)."*

In practice any claim that results from a shortage of turnover that is no longer than the option to consolidate period (26 weeks in the example) will be calculated in terms of the option because it simply gives total 100% cover during that period. If the shortage of turnover exceeds 26 weeks the claim will be calculated under both options (8 weeks plus 40% or 26 weeks) and the higher amount will prevail.

### **Increased Costs under Dual Wages**

Increased costs are automatically payable under a Gross Profit Item if they result in a reduction in the amount of the shortage of turnover on which the claim under that Item is based. For the same reason increased costs in excess of what is payable under the Gross Profit Item can be claimed under a Dual Wages Item because by reducing the loss of sales they also reduce the claim under clause (a) of the Dual Wages Item.

For completeness I quote Clause (b) of the Dual Wages Item:

*"(b) In respect of increase in cost of working*

*so much of the additional expenditure described under Clause (b) of the Gross Profit Item as exceeds the amount payable under that Clause but*

*not more than the additional amount that would have been payable in respect of Reduction in Turnover under Clauses (a)(i) and (a)(ii) of this Item had such expenditure not been incurred.”*

### **How to Select the Periods and Percentages for Dual Wages**

Three loss scenarios need to be considered when choosing the period and percentages:

- 1 The longest period for which the insured will choose to retain all staff during a major disruption to the business and loss of turnover. This period should be selected as the “option to consolidate period”.
- 2 The percentage of payroll that would be required throughout the Indemnity Period if faced with a major and long-term interruption. This is the “remainder percentage” and is typically based on the key Wages staff.
- 3 In the event of a major, long-term interruption, (longer than the period for which the insured would retain all staff, as in 1, above) how many weeks Wages would be required to cover the consultative period (required for a redundancy situation) plus Wages in lieu of notice and redundancy Wages? This is the “initial period”.

Most people choose the initial period and the remainder percentage, which then determine the option to consolidate period. However I suggest that it is more important to choose the option to consolidate and the remainder percentage and let that combination determine the initial period. If the initial period is then too short, simply extend the option to consolidate or the remainder percentage.

### **Average in Dual Wages**

When the Dual Wages Item includes an average proviso it is –

*“Provided that if the sum insured by this Item is less than the sum produced by applying the Rate of Wages to .....\* the Annual Turnover the amount payable under this Item shall be proportionately reduced.*

*\* Here insert the appropriate multiple if the Indemnity Period exceeds 12 months.”*

The sum produced by applying the Rate of Wages to the Annual Turnover is simply the Annual Wages and so the adequacy of cover is determined by comparing the sum insured with Annual Wages. Both the Rate and the Annual Turnover are subject to the Adjustments Clause and it is therefore Annual Wages that would have been paid, but for the Damage, during the 12 months after the Damage (or a multiple thereof if the maximum Indemnity Period exceeds 12 months), that are used to calculate average.

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