Reviewing insured values: How to maximize return on capital

Statements of values are not just a mechanism for calculating insurance premiums. Here a WTW expert shows how they can drive optimal business, insurance, and risk management decisions for mining companies.

Introduction

Supply chain disruption is inflating insured values and lengthening restoration periods due to specialized equipment requiring lead times often exceeding a year or more. It's also significantly increasing the cost of materials and labor, thereby driving up the values that mining companies should report at renewal.

If a mining company faces a business interruption event, it will want to avoid further pain in its recovery. Today, this means ensuring that policy terms and conditions reflect longer times frames and increased costs. And when insurers are regularly suggesting buyers increase their stated property values for building and equipment values by 15%-20% (compared to the typical 1%-5% year-over-year increases the sector has experienced historically) the hunt is on for better value.

But in the pursuit of the precise cover required at an appropriate price, mining companies can also uncover further strategic advantages and ways of upping their return on capital. In this insight, we look at how to assess insured values to identify optimization opportunities in the current market conditions.

Avoiding over or understated values

Avoiding overstated values means mining companies won't pay increased insurance premiums and deploy business resources inefficiently. To achieve this, they will want to avoid some common mistakes, such as starting the values worksheet completed as part of the renewal process based on gross sales versus net sales. Net sales accounts for any discounts, freight and royalty expenses that would be considered variable in nature when presenting business interruption values. This means that a company's values will be overstated if it is not properly accounting for the saved selling expenses, and so the overstated values may result in an increased insurance expense.

On the flipside, if a mining company reports understated values, it could encounter significant issues following a loss, resulting in uncovered losses for amounts exceeding stated limits. Furthermore, insurers often include average or co-insurance clauses when lacking confidence in the reported values. A common mistake here that results in understated values is where policyholders report gross profit as per the profit and loss statement. Policyholders cost of sales may include continuing expenses or fixed expenses such as labor and depreciation, which should be included to ensure the accuracy of the value and protect the business properly in the event of a claim. The financial impact of under-reporting a company's values can be devastating if a catastrophic loss occurs and the recovery is limited to the reported value.

Understand the assets' context

Insured values are the starting point in the property insurance purchasing process, meaning that accurately measuring and presenting these values is key.

During the renewal process it's critical to understand the mining company's locations, the nature of operations at these locations, construction, plant/equipment types, and the location where the plant/equipment is originating from. Increases in construction cost inflation rates vary widely between countries and regions.

Presenting the specifics of a mining company's business and articulating its operations and the risk mitigation and controls in place is the first step to seeking improved value.

Analyzing values comprehensively

Historically, from our experience many mining companies may not have spent significant time and resources on the valuation process, perhaps only inputting the basic information into an insurer's or broker's statement of values worksheets at renewal.

However, the current economic conditions mean that it is crucial that a more comprehensive analysis of values is performed. This should consider all the key factors that can impact the company's business, including the current market trends for infrastructure/buildings/equipment repair, replacement costs and timelines, which could all leave the business facing significant shortfalls in reported values if not handled appropriately.

For example, suppose a mining company has total reported values on property, plant and equipment at US$900m in 2020 and this was increased by the traditional 1-2% in subsequent years; the values are therefore up by US$18m to US$918m in 2021, then up by US$18.36m to US$936.36m in 2022. Let's also say that the company increases total reported values this year by 2% to US$955m in 2023. Given the current conditions and an inflation rate of roughly 12%, a more accurate total reported value might be US$1,055m so the company's property plant and equipment values could be understated by around US$100m.

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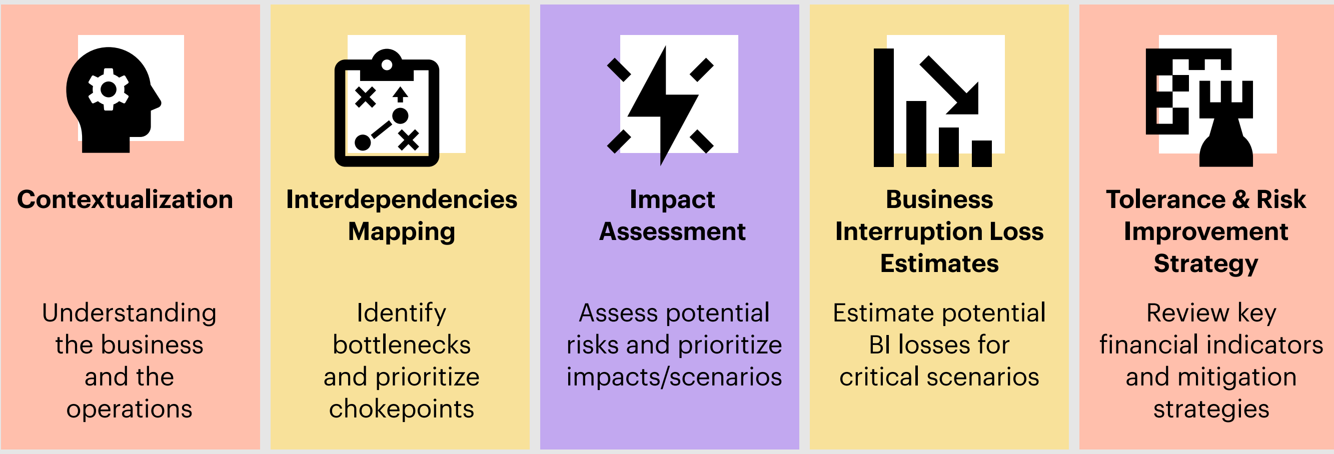
Other factors to analyze at renewals

Assessing the following will also help mining companies build up a more accurate picture at renewals and therefore prevent their business from either facing deficiencies in the event of a claim or paying too much for cover:

- Replacement cost versus actual cost value in the policy terms and conditions
- Historical results versus current plans for projected volume, grade, and yield
- Capacity at key production stages and any production bottlenecks
- Contractual price obligations and future spot market or commodity pricing, including potential currency fluctuation impacts
- Matching ordinary payroll coverage to labor agreements/union contracts
- Scheduled major maintenance outages that would impact operating income
- Any planned equipment upgrades impacting production levels
- Worse case lead time scenario planning for key equipment
- Potential mitigating expenses:
  - Meeting contractual obligations
  - Increased labor/overtime
  - Increased travel including room and board) expenses

Figure 1: **mapping interdependencies**



Source: WTW

Interdependencies mapping

The process of generating accurate insured values can lead mining companies into exploring their broader vulnerabilities and where resources can be deployed most efficiently. In preparation for renewal, mining companies need to produce answers to the following questions:

- Does the company have a deep understanding of the interdependencies that would impact operations and its ability to recover in the event of severe disruption?
- Where are the chokepoints?
- Is the company prioritizing the resiliencies around its chokepoints?
- Can the company present how it mitigates the risk of severe disruption more compellingly?

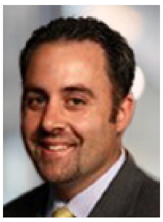
After understanding the interdependencies, the next step is to undertake impact assessments around the potential risks and impact scenarios, then estimate the potential business interruption losses under critical scenarios.

These exercises will not only mean the company enters into renewals with accurate information, but could have broader, strategic advantages. The insight could lead the company to review the required policy limits and indemnity periods as well as key financial indicators and mitigation strategies. All of this may mean the company can re-set their risk tolerance approach/appetite and risk improvement strategy.

Why specialists for reliable assessments may be needed

Accurately reflecting insured values and seeking broader optimization opportunities is not always straightforward. Mining companies may need to call on experts to ensure that the pre-loss valuation process is a fully comprehensive, accurate, and reliable assessment of loss exposures and values, such as:

- Engineers and appraisers, to assist with building and equipment replacement cost or actual cash values measurement
- Forensic accountants, who are able to quantity business interruption values and values at risk precisely
- Risk engineering, to perform risk assessments, present mitigation strategies and quantify maximum foreseeable loss (MFL) scenarios



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