With the Cost of Rebuilding Rising, are You Underinsured?

Insurance brokers, when arranging material damage insurances (buildings, plant, fittings, stock and consequential loss) will, in your interest, select a sound insurer, suitable policy conditions and a competetive premium but what they can't do is to set the values, the "sums insured" that will ensure that in the event of a loss you will be properly indemnified for that loss.

Universally and invariably these policies are subject to what is known as the "average" or "co-insurance" clause and if you are underinsured you will only be paid a proportion of your claim.

A simple example: you insure your building on replacement conditions for $400,000, a fire ensues and the cost of reinstatement is $100,000. Experts retained by the insurer determine that the rebuilding cost of the entire building was in fact $600,000 with the result that you are insured for only two thirds of the correct sum insured. Applying the average clause this means that you will only be paid two thirds of your loss, i.e. $66,000.

Unfair? Not really if you took at it logically. By not having the correct sum insured you have - (unwittingly) opted to be a self insurer for one third of any loss - the insurer will pay its proportion and you carry your proportion. Following this logic, if the building is a total loss the insurer will pay the full $400,000 sum insured as obviously you will bear the $200,000 "self insurance".

Best Practice in Setting Sums For Insured: Buildings

If you own the building, get a local builder or a quantity surveyor familiar with buildings of this size and occupation to give you a written "replacement and reinstatement cost for insurance purposes" asking that any changes that would be required by Council Regulations be taken into account.

At each renewal adjust the figure in line with inflation. Depending on the economic climate in the building trades one should expect that after five years the exercise should be repeated. Lodge a copy of the cost valuation with your broker (the surveyor or builder might not be around in a few years and your copy might well be detroyed).

Insured Stock

Settlement of a stock claim is based on the replacement cost to you of the stock at the date of the loss. Note that this is "cost" at the time and does not include any overhead or profit margins. In larger stores there is a very real cost in the physical restocking of the shelves and prudence dictates that a separate sum insured be allocated to this cost and you no doubt are in a position to assess what this cost would be.

Importantly the stock sum insured should not reflect the value of stock on the day the policy incepts, nor the figure in the last balance sheet, but rather the maximum stock that you might carry in peak season.

Insured Plant, Fixtures and so on.

In assessing the sums insured for these items remember to allow sufficient for installation costs, not just the purchase price. Again if these items are insured on a replacement basis, i.e. "new for old" even if your fixtures, cash registers etc are considerably aged, you must allow for NEW costs.

If you don't own the building it is quite possible that you have expended capital on leasehold improvements and if this is so you should ask the broker to specify that leasehold improvements are included in the sum insured, otherwise there might be difficulty in settlement.

If you own the building and have a cool room or similar determine with your broker what is attributed to the building policy and what to plant etc and have it noted on the police .

Consequential Loss

This cover is the most common risk that is underinsured. Make sure that your broker is given access to your accountants to confer on this risk.

They of course can only operate on historical accounts but it is the insured who must determine if last year's figures actually reflect what business will be in 18 months time. Last year might have been a poor year, or business is expanding. If such matters are not taken into account you will have a disappointing settlement to your claim.

I say "in 18 months time" simply because many stores will have a 12 months indemnity period (the period during which the insurer will indemnify you). If a fire occurs in the last week of the policy term, your indemnity period runs for12 months from then, which clearly finishes two years after you effected the cover and selected your sum insured.

Note that experience dictates that 12 months is a minimum indemnity period that" should be bought. There are circumstances where this in fact is insufficient and you should discuss with your broker circumstances that might require a greater period. Remember that after a fire where your business has been shut for six months whilst rebuilding is taking place your customers will not necessarily flock back to you. Their habits have altered and it migh take a further year before turnover is back to pre-fire levels!

Article Courtesy of FIS Insurance