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Risk Management Advice Sheet – Under Insurance, The Adequacy of Your Covers and Sums Insured:

When arranging insurance, the task of selecting the correct sum insured for your house, building, shop, business or other property is very important.

As insurance brokers, we are not valuers, accountants or book keepers. We do not provide advice as to the amount of sum insured you choose; nor do we provide advice as to the adequacy of any sum insured you have chosen, as it relates to the possible risk you may have in the future. You as the client, remain at all times, including at the inception of the policy, during the course of the policy year, and on renewal of the policy, solely and fully responsible to ensure that the levels of sum insured you choose are adequate for your needs.

Under-insurance:
Under-insurance is the situation that arises when your sum insured is less than the total assessed replacement or rebuilding cost of property that was damaged or lost. Under insurance affects buildings, contents, stock, plant and equipment, tools of trade and loss of gross profit, which occurs as a result of a fire, storm or the like. Most business and home policies will penalise you by reducing your claims settlement if you have taken out insufficient sum insured.

What happens if I under-insure:
If you are under-insured, you might be in for an unpleasant surprise if you ever need to make a claim. Even in situations of partial claim or loss, it is likely that you will be deemed to be carrying a percentage of risk and you will not receive a complete pay out. Business and home policies have one of the highest incidences of under-insurance and it is estimated that over 70% of policies have some form of under insurance.

To show the impact of under-insurance, we include the following example based on a policy with 80% co-insurance:
Adjusted Loss = (Declared / Value) x Loss
If insured for $500,000 and the value at risk was $1,000,000 with a loss of $200,000, the claim would be adjusted as follows.
Adjusted Loss = ($500,000 / $800,000) x $200,000 =
Adjusted Loss = $125,000 - In this example, the uninsured loss would result in a $75,000 reduction in the claims payout.

Under-Insurance and Business Interruption Insurance:
Under-insurance must also be considered when determining a sum insured for loss of profits / business interruption insurance. Remember, accounting gross profit is not the same as insurable gross profit just as the replacement value of your assets is completely different from the written down book value. To ensure you get it right, you should consult your accountant who can advise you on how much gross profit cover you need and also assist with calculating extra costs you may incur during a claim, such as cost to relocate temporarily, costs to advise your customers of your change in address, hiring of temporary replacement machinery, additional rent or staffing costs etc.