## UNDERSTANDING **UNDERINSURANCE**

# UNDER INSURANCE EXPLAINED

Underinsurance, also known as co-insurance or the policy *average clause*, occurs when assets are insured for less than their actual replacement cost.

Underinsurance applies to any commerical insurance policy that insurers an assest or income.  Ie: Building, Contents, Fitout, Stock, Buisness Interruption and in some cases - Machinery Breakdown.

## HOW UNDERINSURANCE **WORKS?**

### Reduced Claim Value:

Insurers can reduce your claim payment based on the percentage of underinsurance. For example, if a building is insured for $1,000,000 but has a replacement cost of $1,500,000, the insurer can reduce the claim by 33%.

### Policyholder Pays the Difference:

In this example, if a $300,000 claim arises, the insurer would pay only $200,000, leaving the policyholder to cover the remaining $100,000.  If the building was completely destroyed by a fire (total loss), the policy holder could only claim the $1,000,000, leaving a significant short fall to rebuild the property.

**HINT** One of the most common mistakes businesses make is underinsuring their assets. This can lead to significant financial losses that can be difficult to recover from.  Underinsurance tops the list of the biggest pitfall to be aware of, when putting an effective insurance program in place.

## ENSURING **ADEQUATE COVER**

### Regular Assessments:

*Periodic Reviews:*
Conduct regular assessments of your assets to ensure your coverage remains accurate.

*Update Your Policy Sums Insured*:
Account for changes like expansions, new equipment, or increased inventory and update your policy sums insured

*Keep An Asset Register:*
this should reflect the purchase price and therefore the replacement value of items, equipment and fit out, rather than the depreciated value.

### Accurate **Valuations**:

*Professional Appraisals:*
For high-value items, consider professional appraisals to determine their replacement cost.

**HINT** Some insurer will waive the Underinsurance clause on a policy if building valuations have been conducted regularly* by an insurance valuation professional / service and you sum insured reflects the report's values and suggested indexing.
(*Regularly mean every 3 years)

### Understand **Coverage**:

*Policy Review:*
Carefully review your insurance policy to understand the types of coverage and any limitations. E.g.: Do you need to list specified items that might be valued at more than a policy sublimit?

### Avoid Lowballing **Premiums**:

*Quality Over Cost:*
Prioritize coverage that meets your needs, even if it means slightly higher premiums.

*Take a Long-Term Perspective*:
Consider the potential financial consequences of underinsurance compared to the premium savings.

## Consider **Inflation**:

*Adjust for Rising Costs:*
Factor in inflation when determining replacement costs to ensure adequate coverage over time.

**HINT** Thanks for inflation and supply chain issues it is estimated that building costs have risen by **30% in the past 12-18 months to date** (2024), and building timeframes and delays have increased exponentially as well.

## Adjusting **Business Interruption Coverage**:

To ensure adequate protection, your Business Interruption coverage should reflect your clinic's full gross income before **any** taxes and expenses.

*Indemnity Period:*
A minimum 12-month indemnity period is recommended, but given current building timelines in Australia, 18-24 months might be more suitable, especially for larger facilities.

*Trending*:
Account for income growth during both the policy period and the indemnity period. This adjustment, known as "trending," ensures your coverage keeps pace with your business's financial performance.

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