

Are You Underinsured?

An insight into how a claim could be affected when insuring your business



What is underinsurance?

Underinsurance is a preventable but often devastating consequence of not insuring your businesses assets or income for the full replacement value if an **Insured Event** were to occur.

There are many ways you can be underinsured, but a few which can be more common are:

01.

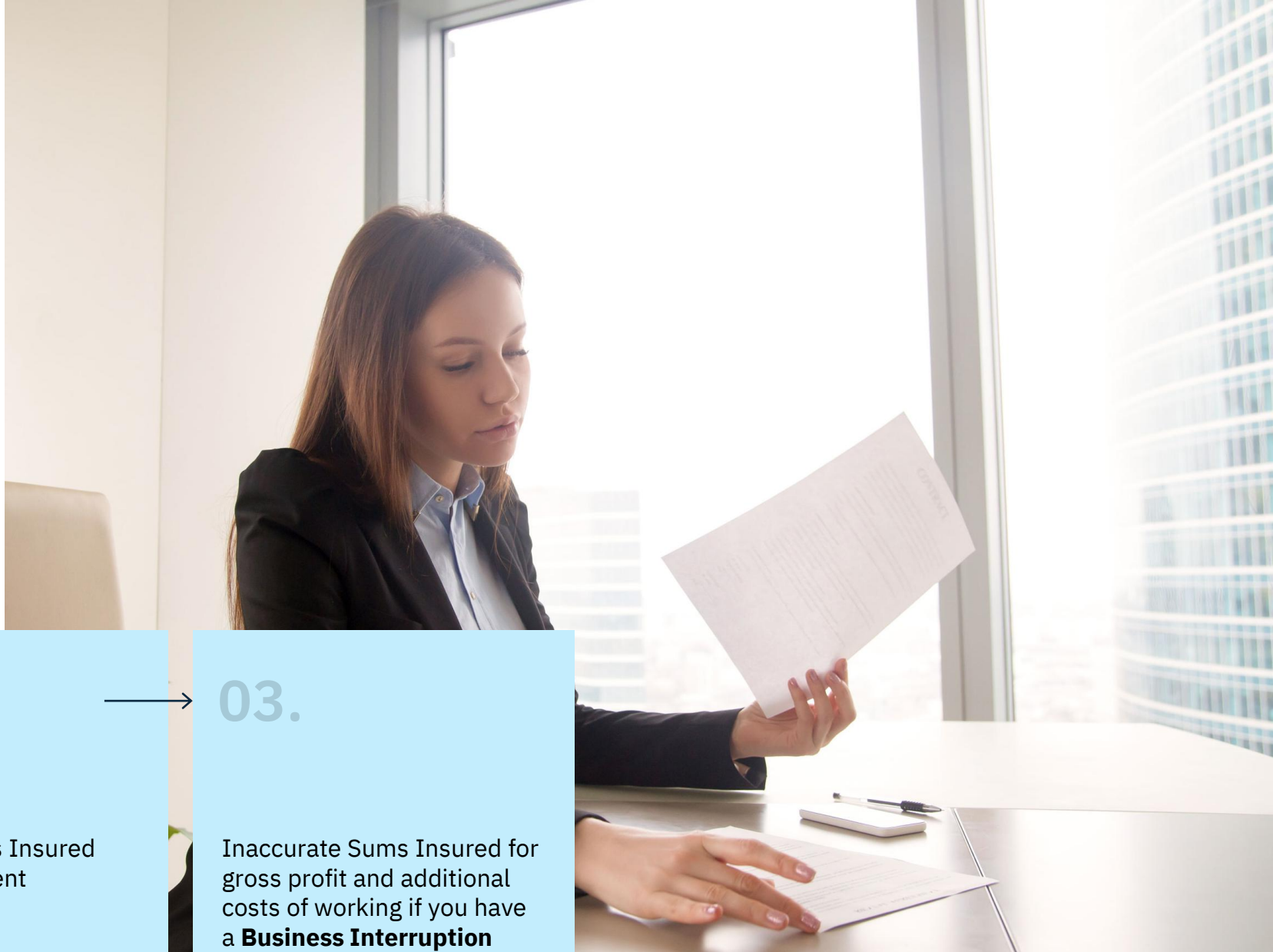
Inaccurate Sums Insured for property, including building, stock and contents as well as removal of debris after an Insured Event.

02.

Inaccurate Sums Insured for your equipment and machinery.

03.

Inaccurate Sums Insured for gross profit and additional costs of working if you have a **Business Interruption Insurance** policy.



What is underinsurance?

While it's easy to assume your business' insurance policies will cover the full cost to rectify any damage to assets or lost income, rising inflation, high replacement costs or business growth may mean either the sums insured declared in your policy/ies may not cover the full cost to bring your assets back to their original condition or replace your lost income at the time an Insured Event occurs.



Underinsurance is a growing problem in an environment where building costs are escalating. At the same time, rising day-to-day expenses are putting pressure on your business to control costs.

You may be underinsured if ...

The rule of thumb when identifying whether you are underinsured is when the **Sum Insured** in your policy will only cover

80–90%

of the cost of replacement of your business' assets.

“

Rolling over your Sum Insured at renewal is one of the most common causes of underinsurance for Australian businesses. A midyear check in with your insurance broker who has the tools and knowledge to accurately assess your replacement values and sums insured is a great way to help ensure your business is properly protected”

Graham Cassidy

Head of Broker Network (Steadfast Group Limited)

Here is a checklist to help you identify ways you may be underinsured:

- ✓ Do you understand how to calculate the replacement value of your business premises or equipment and machinery?
- ✓ In the past year, has your policy been updated to reflect the rising cost to replace or rebuild your property as construction materials like wood, steel and cement have risen?
- ✓ Have there been bushfires or floods in your area that have impacted the cost to rebuild your business premises as building standards may have changed?
- ✓ Have you accounted for the cost to remove debris after a loss?
- ✓ If your business has experienced recent growth, are your financial statements up to date? Is this reflected in your Business Interruption Insurance policy?
- ✓ Have you let the Sum Insured amount in your insurance policy carry over without a review?
- ✓ How long is the **Indemnity Period** in your policy? And is it long enough to sustain your business? Staff shortages, extended council approval lead times and logistical delays from domestic and international suppliers are common factors contributing to this issue.



Scenario →

Commercial Property

A shopping centre, with a range of specialty stores and supermarkets took out a policy a number of years ago with a Sum Insured of \$1,500,000. Over a number of years, the Sum Insured of the shopping centre was not adjusted.

When the property suffered significant fire damage the insurer calculated the current value of the shopping centre to be \$2,000,000. This meant the business was underinsured by a total of \$500,000.

The actual loss caused by the fire was calculated by the insurer to be \$500,000.

When the insurer applied the Co-insurance formula, the claim payout was a total of \$468,750.

This resulted in a shortfall of \$31,250 leaving the insured to pay the balance to restore their business.



Co-insurance formula

Insured Value ÷ 80% of replacement cost × Amount of loss = Amount payable by insurer

Let’s assume the Sum Insured for a building is declared by the insured at:	\$1,500,000
But the actual total replacement cost for the building is actually:	\$2,000,000
For the purpose of the Co-insurance calculation, 80% (of \$2m) equates to:	\$1,600,000
The building suffers a partial fire damage for:	\$500,000

Insurer will pay out:	\$468,750
Leaving the insured to pay:	\$31,250

At claim time, insurers use a **Co-insurance formula** to calculate the total claim amount you will receive.

Note:
80% is a common percentage but is negotiable.

Scenario →

Business Interruption

A large commercial catering business operating in a suburban town centre took out a Business Interruption Insurance policy with a Sum Insured for gross profit worth \$20,000. The disclosed annual turnover of the business was \$1,200,000.

When the insured suffered significant damage to their premises, they couldn't operate for 3 months.

As a result of the damage, the business' loss of gross profit during that period was \$200,000.

When the insurer applied the Co-insurance formula, the claim payout was a total of \$4,166.

This resulted in a shortfall of \$195,834 leaving the insured to pay the balance of loss incurred during the closure period.



Co-insurance formula

Insured Value ÷ 80% of replacement cost **×** Amount of loss **=** Amount payable by insurer

Let's assume the Sum Insured for gross profit is:	\$20,000
But the actual disclosed annual turnover of the business is:	\$1,200,000
For the purpose of the Co-insurance calculation, 80% (of \$1.2m) equates to:	\$960,000
Loss of gross profit during the period:	\$200,000

Insurer will pay out:	\$4,166
Leaving the insured to pay:	\$195,834

At claim time, insurers use a **Co-insurance formula** to calculate the total claim amount you will receive.

Note:
80% is a common percentage but is negotiable.

How we can help

Working with an experienced insurance broker is one of the best ways for businesses to reduce the risk of underinsurance.

We understand insurance can be complex, and it can be devastating if you get it wrong.

As an insurance broker, we have the knowledge, experience and tools to help accurately assess your sums insured.

We can help



Navigate valuation process

Guide your business through the valuation process to help make sure your sums insured are accurate.



Insurance policy updates

Regularly conduct check-ins to help ensure your policy is up to date with current values.



Use tools for accurate sums insured

Access advice and unique tools to check sums insured accurately reflect your property values and the replacement value of stock, equipment, machinery, business essentials and gross profit.



Expert advice on extras

Provide expert advice on important policy extras such as trade credit insurance, machinery breakdown or cyber insurance that may not be included in your standard business pack.

Contact us today at
→

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Glossary of terms



Business Interruption Insurance ⁽¹⁾

Business interruption insurance can cover the loss of any sales you would have made while your business is out of action – plus any extra costs you incur to stay open.

Co-insurance ⁽²⁾

Co-insurance is a clause used in insurance contracts. This clause helps ensure policyholders insure their assets to an appropriate value and that the insurer receives a fair premium for the risk. Co-insurance is usually expressed as a percentage.

Insured Event ⁽³⁾

An event, loss or damage for which the insured is entitled to benefits under the Policy.

Indemnity Period ⁽⁴⁾

The period of indemnity is the length of time the insurance company is obligated to make payments to cover the losses insured under the policy. Typically an Indemnity Period will have a time limit stated within the policy, such as 12, 24 or 36 months.

Sum Insured ⁽⁵⁾

The maximum amount you can claim for any one Insured Event.

¹ <https://www.steadfast.com.au/insurance-types/business-insurance/business-interruption-insurance>

² <https://www.investopedia.com/terms/c/coinsurance-formula.asp#:~:text=Coinsurance%20is%20a%20clause%20used,usually%20expressed%20as%20a%20percentage>

³ <https://www.lawinsider.com/dictionary/insurable-event#:~:text=Insurable%20Event%20means%20an%20event,benefit%20Fs%20under%20the%20Policy>

⁴ <https://www.investopedia.com/terms/p/period-of-indemnity.asp>

⁵ <https://www.gio.com.au/know-more/insuring-your-home/how-much-should-to-insure-house-for.html#:~:text=The%20'sum%20insured'%20for%20your,what%20its%20market%20value%20is>

Important note

ABN

41 825 622 933

AFSL number

238979



This general information does not take into account your specific objectives, financial situation or needs. Deductibles, exclusions and limits apply. Insurance is issued by various insurers and can differ.