

VÉZINA FLASH

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THE CO-INSURANCE CLAUSE ... THE HIDDEN DANGER!

You own a quality property, built with the most solid and least flammable materials. It can be tempting to reduce operating costs (premium) by declaring an insurable value that is less than its replacement cost since, in the event of a loss, the building is less likely to sustain major damage or be declared a total loss. Sounds logical, right? Not from the insurer's perspective! If this practice were widespread, insurers would have a serious problem because premiums paid would be insufficient to cover their loss exposure.

In order to circumvent this, insurers responded by inserting the Co-Insurance Clause into policies. It creates the obligation to maintain minimum insurance values according to the percentage set by the insurer. The Co-Insurance Clause applies to property insurance, including stock and equipment, as well as to business interruption insurance (loss of revenue or profits). If the insurable values declared in the contract do not satisfy the Co-Insurance Clause imposed and defined by the insurer, you will have to bear a proportion of the claim should a loss occur! A Co-Insurance Clause generally has a percentage of 80%, 90% or 100%. It is preferable that the insured values that you provide comply with the percentage set by the insurer to avoid being penalized in the event of a partial loss. The following is an example of how you can be stung by the Co-Insurance Clause.

When an insurance policy contains a Co-Insurance provision, the indemnity to which the insured is entitled is calculated by applying the following formula:

$$\frac{\text{(Amount of Insurance in Force)}}{\text{(Amount of Insurance Required)}} \times \text{Amount of Loss} = \text{Indemnity Payable to the Insured}$$

Example:

Value of Insured Property:	\$250,000
Amount of Loss:	\$40,000
Amount of Insurance in Force:	\$150,000
Co-Insurance:	80%
<u>\$150,000</u>	X \$40,000 = \$30,000 (Payable to Insured)
\$200,000 (80% of \$250,000)	

In the example, to respect the Co-Insurance Clause of 80% in the policy and avoid being penalized, the insured should have had an insurable value of \$200,000. Consequently, he must bear the loss of \$10,000 because he is under-insured. This is the concept of Co-Insurance. By failing to respect the Co-Insurance Clause stipulated in the contract, the Insured becomes proportionally responsible for the underinsurance and bears a partial cost of the loss. This calculation would not have been necessary in the case of a total loss. Nonetheless, the insured would still have been penalized as the paid indemnity would have been limited to the insurable value of the property declared in the contract, \$150,000.

The purpose of insurance is to bring you back to the same financial footing as before the loss; no more, no less. To avoid these types of situations, it is essential to accurately determine the correct insurable values for both property and business interruption coverage. To certify the value of property, we strongly recommend using the services of a professional who is a specialist in the field. Their evaluation could then be used as a basis for insurance, justifying the insurable value declared and thereby avoiding putting your financial assets at risk. Thereafter, the evaluation should be indexed annually and reviewed periodically to take into account inflation and other possible factors. As for business interruption insurance, it is also important to use the services or counsel of a professional to establish the insurable values.

For more information concerning this specific product or for any other questions you may have relating to your insurance or risk management requirements, we encourage you to contact your account executive at Vézina, whose knowledge enables them to offer you unsurpassed guidance for the choice of coverage that best meets your company's situation thereby protecting what counts most to you — the future of your company!

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