



ALEXANDER BONHILL

Underinsurance

Even the best run businesses may, at some point have to make a claim, and if you are underinsured this may have a negative impact on your organisation's recovery. It could result in you not receiving enough funds to help your business recover, because if you are underinsured you are insufficiently covered.

Knowing more about underinsurance, and its implications for your policy, therefore becomes vital for the business.

WHAT IS UNDERINSURANCE?

As the name suggests, underinsurance is when there is inadequate insurance cover to meet your organisation's requirements. In the event of a claim, the claim amount could exceed the maximum limit that will be paid out by the insurance company and lead to a subsequent financial loss to your business.

THE IMPLICATIONS IF THIS HAPPENS

As already mentioned, if your policy does not adequately cover your needs, this will become apparent during the claims management process. It can then result in your business not getting back on its feet, as there will be a shortfall in proceeds. There are also wider implications to this. Under the Insurance Act 2015, policyholders have a 'duty of fair presentation of risk'. In plain English this requires you to be open and honest with your insurer because, if they consider your underinsurance to be a deliberate and reckless breach of this duty, they are within their legal rights to void the policy, culminating in no return of premium. It could, in some cases, also lead to prosecution.



WHAT LEADS TO BEING UNDERINSURED?

Although most businesses would not wish to be underinsured, we do see incidents where this happens. But why? Often it is because valuations are out of date, incorrectly calculated or roughly estimated. Property is one main area where this happens. Here are some (but not all) reasons for underinsurance:

OUT OF DATE VALUATIONS

We suggest that your properties are professionally valued every 3 years by a qualified surveyor, irrespective of whether the property has been altered or improved. If the property has been altered, extended or its use has changed, then contact your account manager straight away, rather than waiting for your policy to renew.

REINSTATEMENT COST VALUATIONS

We recommend that the **Building Reinstatement Value (BRV)** is increased, inline with the percentage (index linking) laid out by the Royal Institution of Chartered Surveys (RICS) to ensure that this figure remains accurate and reflects its true worth. It is prudent that this valuation is also carried out by a surveyor that is regulated by the RICS.

RISE IN COST AND DELAYS TO KEY BUILDING MATERIAL

The costs of rebuilding your properties have risen significantly in the last 18 months and are predicted to continue with merchants giving advance notice of increases of 6.5% in 2022. Roof/wall tiles for example have a reported lead-in time of 26 weeks and an increase cost of 32%. These increases need to be reflected in the sum insured value.

MARKET VALUE VERSUS REINSTATEMENT COSTS

A misguided belief is often to think that the market value and the sum insured are the same thing, and hence to insure for the market value, rather than the sum insured. This is not true. The rebuild cost should be the sum insured as the market value can fluctuate and is not a true representation of the actual cost of the rebuild. It's worth noting that the sum insured should also reflect the cost of materials, site clearance, labour, architect fees, planning fees and legal costs.

COVID-19

The pandemic has meant many workplace adaptations to comply with Covid-19 risk assessments, for example through changing the layout of the workspace or social distancing measures. These should be reported back to your advisor, so that they can ensure that your policy covers these changes.





AVERAGE CLAUSE: HOW IT AFFECTS YOUR CLAIM IF YOU ARE UNDERINSURED

When a property is underinsured, insurers are entitled to reduce the value of a claim in proportion to the property's underinsurance. This means that the insurer can reduce the claim settlement by the same percentage that the asset is underinsured. This is called an **Average Clause**.

As an example, this means:

A property with a rebuild value of £5,000,000 but insured for only £3,000,000 is 40% underinsured. If the property is damaged, typically by fire, flood, storm and the cost of repairs is £600,000, insurers could reduce the claim by 40%. This means the Insured only receives £360,000 from Insurers, leaving a shortfall of £240,000 should the client under insure the property then the insurer could apply the average clause.

It has serious repercussions when you are making a claim, as you may find that you do not receive the financial amount that you calculated.

A SPECIAL CONDITION OF AVERAGE

Occasionally, some insurers will apply a Special Condition of Average. This means that the average clause will only be applied if the sum insured falls below a certain percentage.

BUSINESS INTERRUPTION & BUSINESS CONTINUITY

When business is not 'business as usual' and your organisation is adversely affected by an event, there can be considerable financial loss. As already mentioned, the issue of underinsurance of a property comes to the fore when you need to make a claim, but so too does business interruption Insurance and a **Business Continuity Plan (BCP)**. It is not just the rebuilding of a property, but the consequential business interruption, and how you manage this, that needs to be considered so that costs to the business are minimised.

How long before your clients go elsewhere, and your systems and processes are back up and running?

THE DIFFERENCE BETWEEN BUSINESS INTERRUPTION INSURANCE AND BUSINESS CONTINUITY

Business Interruption Insurance covers you for loss of income during periods when you cannot carry out business as usual due to an insured event. Business Continuity enables a business to continue supplying its products and services no matter what events/ disruptions it experiences.

WHY HAVE A BUSINESS CONTINUITY PLAN (BCP) TO HELP YOUR BUSINESS RECOVER?

A BCP creates resilience in a business. Through the implementation of planned systems and rehearsed response mechanisms, it is designed to minimise the likelihood of loss and offers protection, when disaster strikes.

Establishing risk management procedures prevents extended interruptions to services and re-establishes full function to the organisation as quickly as possible. It should be fit for purpose and form part of your audit of underinsurance to make sure all 'bases are covered'.

MISREPORTING BUSINESS TURNOVER

If the turnover of the business is not reported correctly, this will impact the amount that your insurer pays out on your business interruption claim. The consequences could be far reaching.

The Chartered Institute of Loss Adjusters (CILA) recently reported that 43% of business interruption schemes demonstrated underinsurance. Does this include you?

HOW TO PREVENT UNDERINSURANCE

To help eradicate aspects of underinsurance, here's some suggestions to follow:

- **Valuation:** Get a professional valuation to ensure that your assets have been valued correctly
- **Recovery:** Check that you have considered all the aspects and timeframes, within your Business Interruption insurance, to give you enough time to get back on your feet and that you have a robust BCP.
- **Sum Insured:** Your sum insured should reflect the anticipated business growth and not just past performance. Check that this is also index-linked to inflation
- **Review:** Conduct a review, ideally yearly, to ensure that your policy reflects your business needs regardless of whether your circumstances change.
- **Inflation:** As inflation continues to rise, confirm that your Building Reinstatement Value is index linked to reflect the true value of your assets.

HOW CAN ALEXANDER BONHILL HELP?

We are specialists in the management of risk and would be happy to help with any questions or enquiries regarding the topics discussed in this briefing. If we already work with us on your risk needs, and if you have any concerns from the information raised above, speak to your broker to ensure that your policy is not underinsured.

Please do not hesitate to contact us for more information or guidance.

