

# Top 10 Tips – For underinsurance

Supplied by: Heather Coupland, Associate Director Bluefin Insurance Services, Milton Key



## Top 10 Tips for underinsurance

### The pitfalls of underinsurance and tips to avoid risking your business.

Running a business can be a challenge at the best of times. Keeping up with the competition, dealing with day-to-day tasks and not losing sight of the company's goals can be difficult for even the most seasoned of business professionals. So it is easy to understand why insurance is not at the top of everyone's priority list.

A failure to ensure the correct level of cover can cost a business dearly. Each day businesses are risking their future by not fully reviewing the policies they hold and ensuring they have adequate cover in place.

#### What motivates a business to risk it all?

There are numerous reasons why businesses are underinsured. For many it is simply a case of not providing the correct sum to be covered: not taking into account fluctuating stock prices, change in circumstances or even increase in market value of their property. However for some it is economics - trying to save money on their premiums, taking a gamble that a major loss event will never happen to them.

Buildings cover, business interruption (BI), stock, machinery and plant values are all commonly under estimated by businesses. If the sums insured are only a percentage of what they should be, the insurer can apply this figure to any relevant claim, by the application of the "Average" clause. When this happens the business will be faced with a shortfall in their insurance pay-out. For some this can mean the difference between bouncing back from a loss to financial hardship or even ruin.

#### What is the cost of being underinsured?

Below are real-life examples of businesses who were underinsured when their business faced a major loss event.

##### **Motor trade fire – property undervalued.**

Take for example a motor trader who suffered a £38,000 fire. The sum insured was £400,000, with no professional valuation for years, if ever. The rebuilding value was costed at £675,000 therefore with the application of Average) the insurance pay-out was only £22,500.

Had the motor trader had regular valuations, and updated their policy accordingly, they would have had the correct level of cover, and not faced a *shortfall of nearly £15,500.*

##### **Golf course vandalism- business interruption underestimated.**

A golf club assessed its BI sum insured at £600,000 with a 12 month indemnity period. After a malicious attack, a number of greens needed to be reconstructed and reseeded. Members moved to a nearby golf club, which saw the

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opportunity and offered very attractive 2/3 year membership deals. The client was able to claim for loss of revenue for 12 months following the attack, but the *affect to the business stretched for 2 years and beyond*.

The golf club had seriously underestimated the length of time of their indemnity period. If only they had spoken to insurance specialists and truly assessed the length of time to recover, BI could have been arranged for 24 months or more.

## **Factory theft – stock value shortfall.**

Intruders broke into a factory and damaged the alarm system, then left. The alarm monitoring company detected the activation and dispatched employees to the scene. Because of the damage to the system, the alarm could not be reset, but as there were no sign of the intruders, the premises were secured, and the alarm company employees left. Predicting this, the intruders then returned and removed stock to the value of £80,000. Unfortunately the sum insured on the whole of the stock was £250,000 exactly half its true value. With an excess of £15,000 the factory owner can expect a payment of £25,000 against the total £80,000 loss, *leaving a shortfall of £55,000*.

This example shows the importance of fully understanding the implications of a policy. Had the factory owner regularly reviewed the value of their stock, and their excess requirements they may not have faced such a major shortfall.

## **How to avoid the pitfalls of underinsurance?**

There are simple steps businesses can take to help remove the risk of being underinsured:

- Understand the implications/ramification of underinsurance – if you are unsure, speak with an insurance broker. It's their job to advise you on this.
- Thoroughly assess the risks to the business, work with an insurance broker to discuss what cover is needed.
- Make sure the cover arranged is sufficient to:
  - Rebuild the premises: Be mindful of the definition of 'Buildings', allow for the total cost of rebuilding, not just the market value or purchase price of the building.
    - There is no substitute for a professional rebuilding valuation.
  - Replace as new all machinery/plant/office equipment/contents
    - keep an inventory of all equipment and regularly update
  - Purchase all stock at current prices
    - the value of stock may fluctuate dramatically and if necessary amendments mid-term might be appropriate
- Calculate gross profit in accordance with the policy definition.
  - Many accountants have a different definition
  - As a general rule – use the sum of sales, less purchases of stock/consumables and you won't go far wrong
- Once you have achieved the above, assess the likely indemnity period. If a building is so badly damaged it needs to be demolished and rebuilt, be mindful that even straightforward planning permission will take a minimum of 3 months to obtain.
- Lastly, so that business can continue to operate following a loss make sure you have an up to date disaster recovery plan that is familiar and accessible to relevant personnel.

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Whilst we all hope that there is never the need to claim, many businesses will not realise they are underinsured until a major loss occurs. By following the simple steps above, dealing with professionals where appropriate and regularly reviewing sums insured and policy cover, businesses can be proactive at making sure their cover is up-to-date and covered for the true cost of recovery.

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