THE DOLLARS AND SENSE BEHIND INSURANCE TO VALUE

Insurance to value is insurance written in an amount approximating the value of the insured subject or that meets co-insurance requirements. Although this is a common term in the insurance industry, many insured companies—including recycling companies—might not fully understand why it's important.

One misconception is that the term means simply making sure the insurance you buy is enough to pay for a partial or total loss of income—or of your buildings or business personal property—when you insure them on a replacement-cost value. That is important, but most insurance policies also have a co-insurance provision that obligates you to keep a specific amount of insurance on the insured property or face penalties in the event of a loss. When people purchase property insurance for their businesses, they often overlook or fail to fully consider the co-insurance provision that is part of the insurance-to-value definition.

You might be wondering, "If my building is underinsured and it's a total loss, isn't that better for the insurance company?" In reality, it's not good for your business, and it's not good for the insurance company. If you don't have the funds to rebuild or restore your business, your company could experience longer downtime and lose customers as well as income. Also, odds are your business will suffer a partial loss rather than a total loss. With inadequate insurance to value, your firm could face unexpected costs due to uninsured losses in addition to your deductible.

CO-INSURANCE REQUIREMENTS ARE KEY

The best way to understand the potential costs of having inadequate insurance to value is to examine a hypothetical loss. Let's say your building has a replacement cost value of $5 million, and your building insurance has an 80-percent co-insurance requirement and a $2,500 deductible. That means you should maintain a minimum of $4 million in co-insurance (80 percent of the $5 million replacement cost). What happens if your building has a fire and sustains damage assessed at $1 million? If you have maintained the recommended co-insurance amount, all you would deduct from the $1 million loss is the $2,500 deductible, yielding a final recoverable total of $997,500.

Now let's assume you insured your building for a replacement cost of only $3.5 million. The inadequate coverage will affect the settlement of your claim—but by how much? To determine the answer, divide the actual insured value ($3.5 million) by the recommended co-insurance value ($4 million) and then multiply that figure (0.875) by the loss ($1 million). Then take the answer—$875,000—and apply the $2,500 deductible value to yield the final recoverable total of $872,500—$125,000 less than you would have received if you had maintained the minimum co-insurance value. So instead of paying just the $2,500 deductible, your company now must pay an additional $125,000 to repair the damage to its building. You most likely did not anticipate or budget for those additional funds, so that expense would be a considerable blow to your annual operating budget.

A BETTER WAY TO REDUCE INSURANCE COSTS

If you want to gamble on your ability to bear higher loss-related expenses, a better approach is to assume a higher deductible, which will lower your insurance premiums and allow you to invest the money you save back into the business. Instead, if you don't meet your co-insurance requirement, your company must absorb the additional $125,000 to repair its property, and it could face other financial hits, such as extended downtime, lost (or unhappy) customers, diminished revenue, and more.

Understand your coverage terms and conditions—and don't overlook or discount the insurance-to-value requirements. To fully discuss these issues and to learn more about property coverage, contact your insurance broker, risk manager, or insurance carrier. S

Dan Curran is senior vice president and underwriting officer for Willis Programs (Portsmouth, N.H.), which underwrites RecycleGuard®, the ISRI-sponsored insurance program. Reach him at 603/334-3027 or daniel.curran@willis.com. *RecycleGuard has prepared this article for informational purposes only. It is not intended to provide legal advice. Readers should not rely on this document or act upon any of the information it contains without first consulting competent legal counsel.*

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