



GUIDE TO UNDERINSURANCE



NDML
INSURANCE SPECIALISTS



WHAT IS UNDERINSURANCE?

Underinsurance means that a business's risks are greater than what their insurance can cover. Being underinsured means you will likely not be fully financially covered if a disaster were to happen to your business or property.

Generally, this is when the client has insured their business and loss of turnover for less than the true reinstatement figure.

To give an example; a building is worth £1,000,000 (in terms of the full reinstatement value of it) and it is insured for £500,000. So this building is 50% underinsured.

Underinsurance means the insurer will only pay a percentage of your claim; the more underinsured you are, the more you have to pay out.

Recent stats show that 50% of UK businesses and 80% of UK commercial properties are underinsured. What's worse, 1/4 of UK small businesses would close if they had an unexpected £50,000 bill. Which is likely if they had to make a big claim – and they turned out to be underinsured.

1	2	3	4	5	6	3
---	---	---	---	---	---	---

$$\square + \square = ?$$



IMPACT OF BEING UNDERINSURED

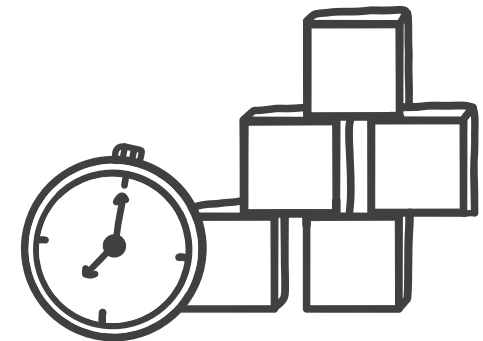
You'd think that being underinsured would mean you would only get a pay-out up to your policy limit. Unfortunately, it's worse than that.

If your business is underinsured, insurers impose a financial penalty equal to the percentage of your underinsurance. This means you will bear a pro rata share of the loss. This is in place to deter businesses from underinsuring deliberately in order to artificially reduce premiums.

This is called the 'Condition of Average'.
Using the previous example, with the building being

50% underinsured. All claims upon this building will therefore be paid out on a 50% basis

It's also important to remember that the reason for underinsurance is not taken into account. Whether it's a deliberate choice to reduce premium, or an oversight because of rising reinstatement costs, everyone is penalised in the same way.



THE UNDERINSURANCE FORMULA

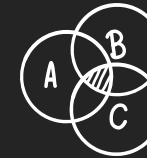
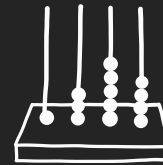
+ - x ÷ % = > < ≥ ≤

The condition of average can easily be calculated using the underinsurance formula:

(Policy Sum Insured / Correct Sum Insured) x Claim Value = Payment

Although the underinsured business's sums insured often way exceeds the claim amount, they would be left with a shortfall. Therefore the underinsured party will have to pay their own money to cover for this shortfall.

Let's put this into practice...



Venue Y has a sums insured of £720,000, however their true reinstatement value is actually £1,370,000.

Venue Y experiences a major fire at their premises with a total loss of £300,000.

When investigating the claim, the insurer identifies the discrepancy between sums insured and true reinstatement cost, so applies the condition of average using the formula we identified earlier:

(Policy Sum Insured / Correct Sum Insured) x Claim Value = Payment
(£720,000 / £1,370,000) x £300,000 = £157,665

This means that even though the client has a sums insured of £720,000, exceeding their claim value, the condition of average means they will only receive a settlement of just over half the claim value.

This means **the client has to find over £140,000 of their own cash** to reinstate their business – cash that most venues don't have lying around.





HOW TO PREVENT UNDERINSURANCE

There are a number of reasons a business could be underinsured, so it's important to identify these and then ensure you're not at risk of being caught out by them.

Some of the main reasons are:

- *Out of date valuations – the value of property & assets is constantly fluctuating. A huge range of factors could affect the reinstatement value of your property, so it's important to have regular valuations by a qualified surveyor.*
- *Undervaluing stock & contents – many businesses underestimate the true worth of the stock and contents on their premises. Pay close attention to the value of everything under your roof, and remember to update your sums insured if you have any significant increase in assets (due to things like renovation, or increased stock for seasonal events).*
- *Miscalculated Business Interruption Loss – There are many things that could unexpectedly stop businesses*

from trading. Fire, flood or theft could leave premises unusable. Calculating the costs you'll incur before trading again can be complex and easily lead to underinsurance.

- *Intentional Underinsurance – Whilst rare, in some cases businesses declare a lower sums insured to reduce the premium they pay. This puts them at huge risk, because one large claim with the 'condition of average' applied could see a business go under.*

The good news is, that as your broker we can support you in counteracting all of the above. At each renewal, we'll check with you to ensure that your sums insured are still accurate, and if you need support we can organise qualified surveyors to give you an accurate picture of your exposure and the cover you need.

If you have any questions, talk to our team and we can review your sums insured and identify if you need to make any changes.

**FOR MORE INFORMATION ON UNDERINSURANCE
& TO KEEP YOUR BUSINESS PROTECTED, TALK
TO OUR TEAM.**

0344 488 9205 | enquiries@ndml.co.uk



NDML
INSURANCE SPECIALISTS

