

# Underinsurance in the commercial market

What does it mean for businesses?



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# What is underinsurance?

Your premium is calculated based on your individual circumstances and the amount of cover you choose to take out to protect your business. Underinsurance occurs when you've not taken out the right amount of insurance cover for your needs. There will be a variety of factors to take into account when you assess how much insurance you need. If you're not sure about this you should get advice from a broker or valuation expert because if that amount is wrong, it's likely to impact the amount you're paid for any claim you need to make.



# What does it mean if I am underinsured?

Taking out insufficient insurance cover will essentially mean any claim will be insufficiently covered.

For example, if the cost to rebuild or replace your property or contents is £100k but you have taken out insurance that will cover you for £50k, then you would effectively be underinsured by £50k or 50%. Any claim you make will only be paid on the basis of the amount of cover you chose, based on what is called the 'average clause' – so in this example your insurer would only cover 50% of any claim, no matter the size of that claim. This would leave you needing to pay the remaining costs yourself which could be anything from hundreds, to thousands, to millions of pounds.

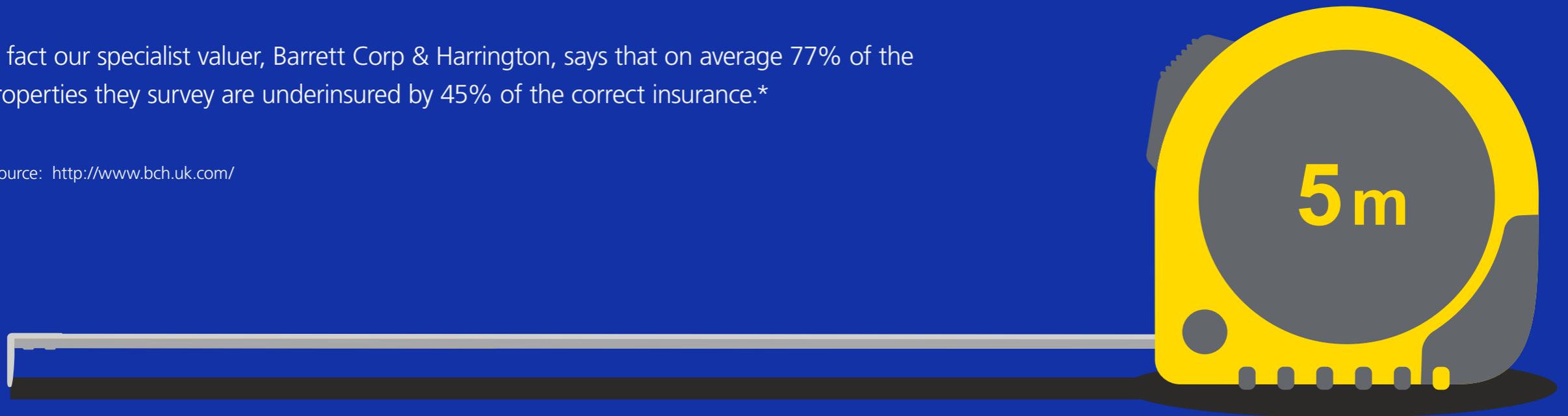


# How big is the problem?

Looking at a sample of 383 clients where underinsurance was a problem in 2014, our survey team referred 206 commercial property clients for a professional valuation. In the remaining 177 cases, our own risk management surveyors found that each customer had effectively underinsured their business by, on average, £486,000.

In fact our specialist valuer, Barrett Corp & Harrington, says that on average 77% of the properties they survey are underinsured by 45% of the correct insurance.\*

\*Source: <http://www.bch.uk.com/>



# Case study examples

## Underinsurance on stock

A hairdresser was carrying more stock than they had told their insurer they had. The figure they had provided was used to calculate the insurance cover. So when the business suffered a theft of more than £1,900 worth of stock, the owner found that the claim was covered but was based on an 'average clause' – i.e. it was paid based on the percentage of cover that was taken out rather than what the cover should have been. This left the owner underinsured by £900 and needing to find that money elsewhere.



# Case study examples

## Underinsurance on business interruption

A manufacturer had a fire at their premises and lost everything. When they took out their insurance they had decided that they could recover from any major event within 12 months and therefore had taken out business interruption insurance to cover them for loss of income for that period.

Unfortunately, although the repairs themselves were covered by property insurance, the extent of the damage and the specialist nature of their business meant that planning permission, repairs, the build time for machinery and time to regain lost custom would take three to four years. This was significantly longer than they thought when they calculated how long they would need business interruption insurance, meaning they were seriously underinsured.

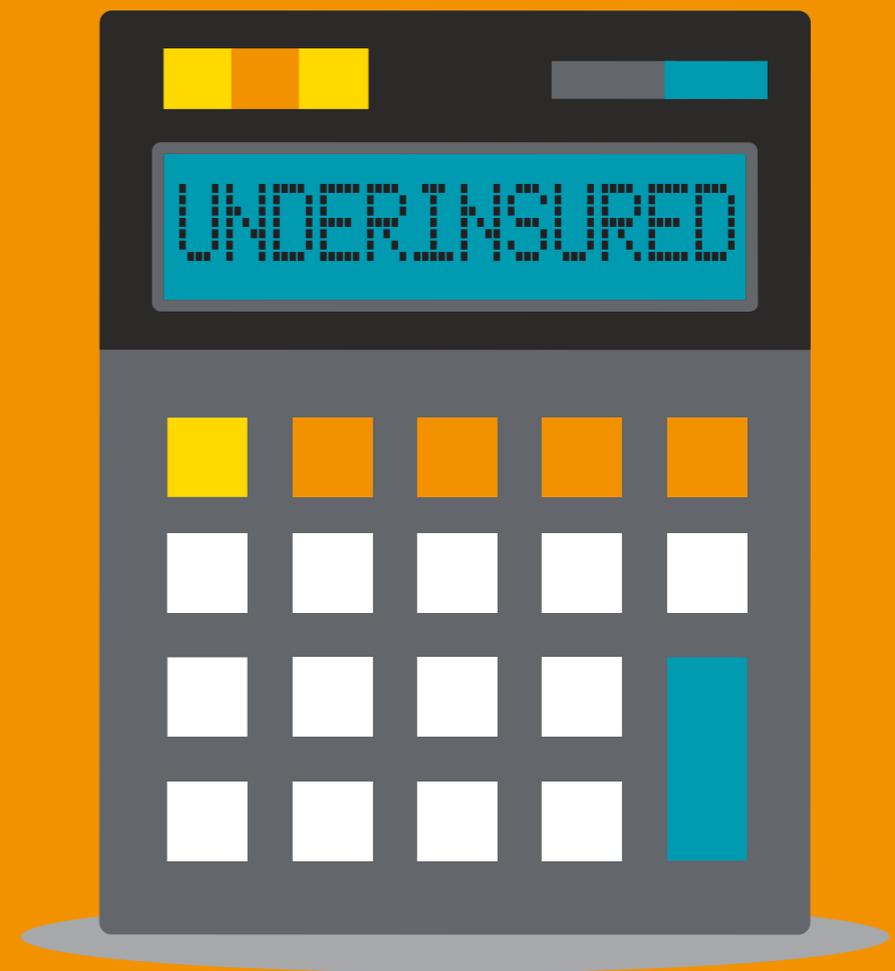
So the company would need to fund the costs related to the loss of income themselves after the insured 12-month period. The estimated amount they were uninsured for was around £7-10 million – costs they simply could not carry themselves. Sadly, the business had to close with the loss of a number of jobs.



# How do I know if I'm underinsured?

Make sure you let your broker know about any changes to your business. Ask them to help you understand how you should assess whether your cover is sufficient for your needs and what professional help may be available.

Remember that some changes to your business might not just relate to contents or building insurance. If you have, for example, bought specialist equipment that takes time to replace, this will impact the amount of time it might take for you to get back on your feet after say, a flood. Therefore this might impact the amount of business interruption insurance you need.



# How do I know if I'm underinsured?

To help you understand the sorts of things that might mean your business insurance needs have changed, we've put together a top 10 list to highlight when you might be underinsured. These points cover the impact on property and/or business interruption insurance.

You could be underinsured when:

**1** you haven't had your property professionally valued for insurance purposes in the last three years



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You could be underinsured when:



# 2

you have altered or extended the property



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You could be underinsured when:



# 3

your insurance cover has been based on the market value of the building when it should be based on what it would cost to rebuild your property



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You could be underinsured when:



# 4

you haven't factored in costs for gates, fences or car parking areas in your calculations



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You could be underinsured when:



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your property is a listed building – the time and cost of repairs/rebuilds are likely to be far greater than for an unlisted building, impacting your business interruption cover



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You could be underinsured when:



# 6

you haven't factored in the costs of professional fees such as an architect or surveyor



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You could be underinsured when:



7

you haven't factored in costs such as site clearance or access – particularly where your business might need, for example, a crane or heavy plant to help with remedial work as a result of a claim. This could also add time that needs to be taken into account for your business interruption cover



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You could be underinsured when:



8

you are carrying more stock now than when you took out your insurance policy



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You could be underinsured when:



9 you are now VAT registered



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You could be underinsured when:



# 10

you have some new plant or equipment that you haven't told your broker/insurer about. This could impact both the machinery cover you have and the business interruption you need – depending on how long it would take to source a replacement, if necessary



# What is business interruption insurance?

Business interruption insurance should be added to the overall business insurance policy, providing cover for loss of income and helping the business get back on its feet financially. Whilst property insurance would look after the resulting damage of, say, a major water leak, the impact of such an event might leave the business unable to complete its schedule of orders. This is where business interruption steps in to cover loss in revenue.

Your business interruption insurance is based on an accurate assessment of the amount of time it would take for your business to recover from an event that impacts your normal operations – this is called the indemnity period. Making sure you have calculated this correctly is key to protecting your business income and cash flow until the business is running as it was before any event occurred.

The recovery process often takes longer than you think – even small, straightforward businesses often need longer than 12 months' protection. For example, planning permission can often take months before any rebuilding works can even start. If you need specialist equipment think about how quickly it can be sourced.



# What is business interruption insurance?

Also, remember that if you haven't traded for even one year, your customers will have gone elsewhere. So you will need time to rebuild your customer base and for your turnover to return to pre-loss levels. This should be factored in when calculating the length of time you want your business interruption to cover.

Having the right level of business interruption cover is really important. Aviva's SME Pulse research\* found that around two thirds (62%) of UK SMEs do not have business interruption insurance or are not sure it is included in their current business insurance policy.

Despite this, one in five SMEs surveyed (21%) said they had experienced disruption to their business – it took up to three months for a quarter of them to get back to normal business trading, and for the remainder anything up to and beyond two years.

\* Aviva commissioned research with Redshift among 1,500 SME business owners and decision makers GB adults online in June 2014





It is important to get professional help to make sure you have the right amount of insurance cover for your business.

Buildings insurance reinstatement cost valuations should be carried out by qualified building surveyors, whose activities are regulated by the Royal Institution of Chartered Surveyors, following the guidance contained within current Practice Standards issued by RICS.

Aviva customers have access to a range of specialist suppliers who provide services, such as property valuations, at discounted rates.

For more information visit: <http://www.aviva.co.uk/risksolutions/>

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