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VICTOR O. SCHINNERER & COMPANY, INC.

Vol 2.1 (supplement)

Information and Risk Management Ideas for Public Entities

A QUICK WORD ON CO-INSURANCE

WHEN YOU BUY a property or windstorm insurance policy, the insurer expects you to buy insurance based on the full value of what it would cost to replace the property if it were totally destroyed. If you fail to purchase limits based on the total replacement cost value, you will be subject to reduced payments if a loss occurs.

First, if the property is totally destroyed, the maximum insurance payment you will receive is the value you purchase.

Second, if the value you purchase is less than a designated percentage of the actual replacement value, the amount you receive for either a partial or total loss will be reduced because you undervalued the building. This reduction in payment is called a Co-Insurance Penalty.

Most insurance companies give you an option for determining when a co-insurance penalty might apply. The most common rules for avoiding co-insurance penalties require you to value each building at either 80% or 100% of the actual replacement cost value. You have to make a decision on which option to use when you buy your policy.

Co-insurance at 100% usually has lower rates, but imposes penalties for

all claims if the total value purchased is less than 100% of the actual replacement cost value. Co-insurance at 80% usually has higher rates, but no penalties are applicable if the total insured value is at least 80% of the actual replacement cost value. However, the maximum insurance payment you will receive for any loss will never be more than the value you purchased.

How does the co-insurance penalty work? Assume you have a building with a \$1,000,000 actual replacement cost value and you bought the 80% coinsurance option. The minimum amount of insurance you must purchase to avoid a coinsurance penalty would then be \$800,000 (80% of the actual \$1,000,000 replacement cost). In this example, no co-insurance penalties would be imposed on any loss.

In the same example, if you purchased a value of \$600,000, which is only 60% of the actual replacement cost, then a co-insurance penalty would apply (Since you did not purchase at least 80% of the actual replacement cost value). If you underinsure a property, the maximum amount the insurance company will pay is based on the ratio of the value you purchased compared to the minimum required

value based on the co-insurance option selected. In this example, you purchased only 75% of the value you should have purchased (\$600,000 instead of the \$800,000 required). As a result you would then only receive a maximum of 75% of the value of any loss, even if the loss was less than \$600,000.

The co-insurance requirements are calculated separately for each scheduled location on your policy when a loss occurs. There are various ways to determine adequate values to avoid co-insurance penalties. The Texas Windstorm Insurance Association (TWIA) uses a method called the Marshall Swift/Boeckh (MSB) Replacement Cost Calculator as a guideline, but will accept other methods that are adequately justified.

Co-insurance is used to encourage insureds to adequately value their property. Failure to do so can result in substantial penalties when losses occur. Because property values change, the value of your property should be evaluated periodically and the insurance limits adjusted accordingly.

For further explanation for co-insurance contact Mike McClanahan at 713-652-2231 or Michael.J.McClanahan@Schinnerer.com. ♦

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