Understanding Commercial Property Coinsurance

Coinsurance is one of the most complicated and misunderstood terms in insurance. This concept is commonly included in a number of different policies, including property, health and directors and officers. However, coinsurance works differently for each type of coverage, and businesses that don't understand how it applies to property insurance may find their claims lowered unexpectedly.

Coinsurance is a common aspect of many commercial property policies. These clauses are essentially penalties that carriers use as an incentive for policyholders to purchase coverage close to the full value of their properties. And, if businesses don't get an accurate estimate of their property's value or purchase enough coverage, they may not have enough funds to pay for damage after any type claim.

Why Penalize Policyholders?

You can think of coinsurance as a type of smaller insurance coverage that's included in your policy, but carriers are the ones that are protected.

During the underwriting process, insurance carriers use a property's value to determine your policy's details, such as premiums, limits and the deductible. As a result, inaccurate property values can change how much funding carriers have after a loss, putting them at financial risk. Essentially, the penalties from coinsurance transfer some of this risk back onto policyholders.

Insurance carriers also want to discourage businesses from buying smaller amounts of coverage. Property insurance is generally intended to cover extreme losses, including those that cost up to the full value of a property. However, most losses are relatively minor when compared to the total destruction of a building. For example, a small fire at your business may require high clean up and repair costs, but not nearly as much as the complete collapse of the entire structure.

It may be tempting to save on premiums by only purchasing coverage for these smaller claims, but this puts your business at significant risk. In the event of a total loss, your policy wouldn't provide you with the funds you need to rebuild your business. Additionally, the gap between your policy's limits and your property's value affects the amount you get for every claim you make.

Calculating Penalties

Coinsurance clauses are included in many property insurance policies that offer reimbursement based on a replacement cost (the funds needed to reconstruct or repair a building with similar materials) or actual cash value (the replacement cost, minus any depreciation). These clauses specify a minimum amount of coverage—usually 80 percent of a property's value. If you submit a claim and an inspection finds that the amount of coverage doesn't meet the minimum limit, insurers will reduce the claims paid.

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It's important to note that insurance carriers base your property's value on the appraisal that takes place **after a claim** and not any figures you provide during the underwriting process. Any estimates of your property's value may be inaccurate or change over time, and insurance carriers need to use a figure that's based on the time of a loss and your unique policy.

A coinsurance penalty will reduce the final payout for all property claims based on the gap between the amount of coverage purchased and the minimum limit that's stated in the policy. Here are some examples that show how coinsurance can affect your property insurance claims:

Example 1: No Coinsurance Penalty

After conducting an appraisal, a business purchases a commercial property policy that provides $900,000 in coverage. The policy also includes a coinsurance clause that requires coverage for at least 80 percent of the property's value. After a fire causes $200,000 in damage, an inspection by the insurer finds that the property's value is actually $1 million. However, because the policy's limit ($900,000) is over the 80 percent minimum of the property value (in this case, $800,000), the insurer pays the full $200,000 for the claim.

Example 2: Coinsurance Lowers the Payout

The business mentioned in the previous example purchases a property policy with the same coinsurance clause. However, this time they don't conduct an appraisal and only obtain $600,000 in coverage. Because the policy doesn't meet the required $800,000, the insurer will lower all payouts by the percentage between the amount of coverage and the coinsurance clause. In this example, the 25 percent gap between the $600,000 of available coverage and $800,000 required by the policy would lower the $200,000 fire damage claim to $150,000.

Removing Coinsurance Clauses

Because coinsurance can only hurt policyholders, many businesses try to remove them when negotiating with carriers. There are two common ways to do this:

1. **Agreed value**—During the underwriting process, you and an insurer can negotiate on a set value for your property. This figure is then used during the claims process instead of a new value that's determined after a loss. However, the agreed value only applies to the policy's term, and you need to update this figure when renewing a policy.
2. **Value reporting**—You can report figures such a property's inventories, sales figures and operating costs to your insurer on a regular basis. These reports will give the insurer information on the property's value, and are especially useful for businesses that operate seasonally.

Getting Claims Paid in Full

Coinsurance penalties can greatly limit your ability to respond to a loss, especially if an inspection finds that your property's value is higher than you thought. Call (516) 466-6007 today to ensure that your property insurance will protect you from any loss.