

The Good, the Bad and the Ugly of Insurance

Replacement value

This is the amount needed to replace an asset at this very moment, at current prices. Costs to consider when determining replacement values include, among others, professional fees and debris removal. Another important factor that is often forgotten is import costs. These costs often fluctuate in a volatile economy and should therefore be reviewed often. Remember that replacement value not only refers to the obvious items such as buildings or vehicles, but to each and every asset owned or include in an insurance portfolio.

Think about computers, tools, office furniture, stock, machinery, etc. The list is endless, and all of these assets need to be insured at current replacement values. What this means in a nutshell is that the replacement value chosen must be sufficient to replace an asset when suffering a total loss. One of the biggest mistakes often made is not adjusting the replacement value because the asset is only a few years old.

**100% insured for:
Current replacement values**



Underinsurance

This occurs when the selected replacement value is insufficient to replace an asset. The principle of insurance is to place a business in the same position it was in, immediately before a loss occurs. If a business owner does not assign the correct value to an asset, he may not be able to claim the true value of that asset in full. Therefore, be sure to assign sufficient replacement values to replace assets such as computers, stock or machines with the up-to-date equivalent(s) should a total loss occur.

**Not 100% insured for:
Current replacement values**



Average

This is applied to a claim when an assessment determines that assets were not covered at replacement value.

Average formula

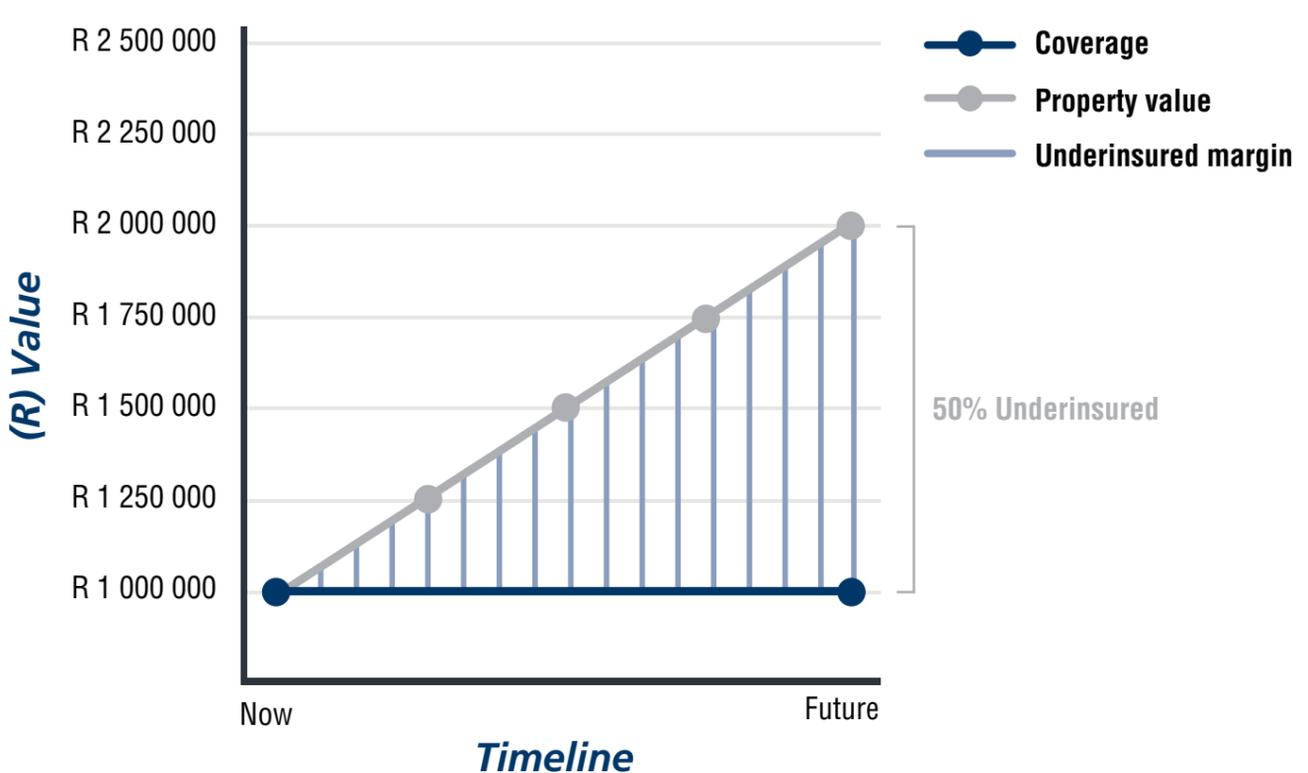
$$\frac{\text{Current insured value}}{\text{Actual value}} \times \text{Value of your claim} = \text{Settlement amount}$$

Example

When the client initially took out insurance for his business building, he **opted for cover of R1 000 000, and never reviewed it again.** Years later, the client submits a **claim for storm damages to his building.** An assessment estimates the **repair costs at R50 000** and determines the **rebuilding costs to the building at R2 000 000** in the event of a total loss.

Because the client's building was covered for **rebuilding costs of R1 000 000 only, the client is 50% underinsured.** The client will therefore **receive only R250 000 as settlement** towards building repairs.

When you use second-hand or outdated values, the insurer will apply average to your claim, which simply means your settlement will be proportionately reduced by the percentage that you are underinsured.



Please note

Underinsurance is a problem in the insurance industry enhanced by uncontrollable factors such as climate change and volatile markets. All clients are urged to reassess the values of all their assets on a regular basis.