DON'T GET CAUGHT BEING UNDERINSURED

LEGAL EXPERT

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Under-insurance can have dramatic consequences for a small business as it can leave you without sufficient cover. Under-insurance arises when property is valued for less than its value. For example, a business may insure the value of its stock at $100,000. A premium is calculated by the insurer on this basis.However, if there is a fire where the stock is stored and it turns out that the value of the stock had increased to $200,000, then when it comes to calculating the insured loss, under most liability policy wordings the insurer is entitled to impose a penalty via under-insurance averaging or co-insurance provisions. Accordingly, even though the sum insured on the policy is $100,000, the business is likely to receive something less, as the insurer expects the business to have insured the full amount of the risk.

Under-insurance also arises when a business fails to estimate accurately the value of claims which could be made against it by its customers. For example, an accountant acting as a sole practitioner may consider that an insured sum of $1 million for any claim in negligence would be sufficient. But consider an accountant providing advice about the sale of a business and associated assets. If the client then makes a claim for $2 million for failure to advise about the tax consequences of the sale of an asset, the accountant could be (at least) $1 million out of pocket.

With liability policies covering property and business stock, be careful to insure the full value (replacement cost), otherwise you risk receiving even less than the sum insured because of the averaging provisions in the policy. If the value of stock at the premises is increasing over time, or there are increases in business turnover, then you should inform your insurer. In any event, you will be obliged to make such disclosures at the time of renewal of the insurance policy. This may result in additional premiums being charged, but will more likely protect you against the consequences of under-insurance. For other liability policies, including professional indemnity and public liability policies which cover breach of duty, closely assess the risk of claims being made against your business and the potential quantum of such claims. In addition to reviewing your own business, this may require a detailed analysis of your client base and the business they are doing.

Carefully review the appropriateness of the sums insured on each of your policies on at least an annual basis. If there are significant changes to your business during the year, either in business turnover, stock value or building reinstatement and replacement costs, be sure to disclose this to your insurer.

Speak with a licensed insurance broker or insurance adviser who has experience with the type and level of cover required in your particular industry. Another consequence of under-insurance, depending upon the precise policy wording, is that the insurer may still have the right to conduct the defence of any claim made against your business and to engage its own lawyers to do so. However, your interests and those of your insurer may not always align, particularly if your business has a significant under-insurance exposure and there is a debate between you and your insurer on the question of liability. In those circumstances you may want to consider obtaining your own independent legal advice throughout the process. This comes at an additional cost, but will likely protect your interests.

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