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For Many, Business Insurance Is Foreign Policy

By COREY MURPHY, CIC

You are living your dream. The day has finally arrived where you are now working for yourself. You are running your own business, you answer only to yourself. It was a long process, corporation filings, working with the bank – and obtaining some insurance.

As you drive home excited from your first day of business, you pass a fire truck racing in the other direction. Something inside you tells you to turn around. As you head back to your new business you see it surrounded in smoke. Nothing like being in business for yourself. With some relief you think of the insurance policy that will help you get back up and running.

The next day you meet the claims adjuster at your building. The good news is that only half the building is damaged. You expect a very quick meeting ending with you receiving a check for half of the limit of the policy, \$200,000. But after a lengthy discussion with the adjuster you realize things will not be so simple. He begins to explain that your policy was written on what's known as an

actual-cash-value basis. To confuse you further he tells you that because the co-insurance was set at 100%, you are under-insured.

Although you understand little of this insurance-ese, you do understand one thing: you are getting a check for only \$106,000.

The adjuster quickly explains that your policy limit was \$400,000. To replace the whole building today would cost \$600,000. Therefore your co-insurance penalty will be one-third of the loss. Because the policy was written under 'ACV' and because he deemed the original building to be in "good condition," he is applying only a 20% depreciation adjustment to the value of the loss.

While this example may seem extreme and somewhat simplistic, it does illustrate some key insurance concepts that can make an insured individual happy when he or she pays the premium, but extremely upset when they have a claim.

To help understand what happened to our unfortunate business owner, we can identify a few mistakes that were made.

The first issue he came across was not having his policy written on a 'replacement cost basis.'

While this option may cost an additional amount of premium it is critical when it comes time to settling your claim. The standard property insurance policy determines the value of covered property on an actual-cash-value basis. This is generally defined as the cost, at the time of the loss, to repair or replace the property with similar kind and quality, less depreciation of the damaged property.

To simplify, this means that the value of the claim is settled by determining how much it would cost to rebuild or repair a building; then subtracting from that figure some depreciation that is determined by the adjuster based upon the condition of the original building.

The second issue arises from the new business owner's policy having a '100% co-insurance' requirement. What does this mean? Again, simply, if the value of the entire property is \$600,000, you need to have a limit of \$600,000. Anything less than that and you get less for

your claim. If, for example, you had a limit of \$300,000, (50% of the replacement value of the property) you would receive 50% of the value of the claim, even if the claim is valued at less than the \$300,000 limit on the policy.

So how can one elude these insurance traps? Ask your insurance agent if your policy will value claims on a replacement-cost basis or on actual cash value. Ask if there is a co-insurance clause and what the percentage is. Lastly, be sure to set your property limit to an amount equal to the cost to re-build / replace all of the property insured.

In an effort to make their policies competitive, most insurance carriers make changes to the standard property policy cited above. It is important to discuss with your independent insurance agent about how the different carriers handle this issues.

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