Tackling underinsurance for SMEs

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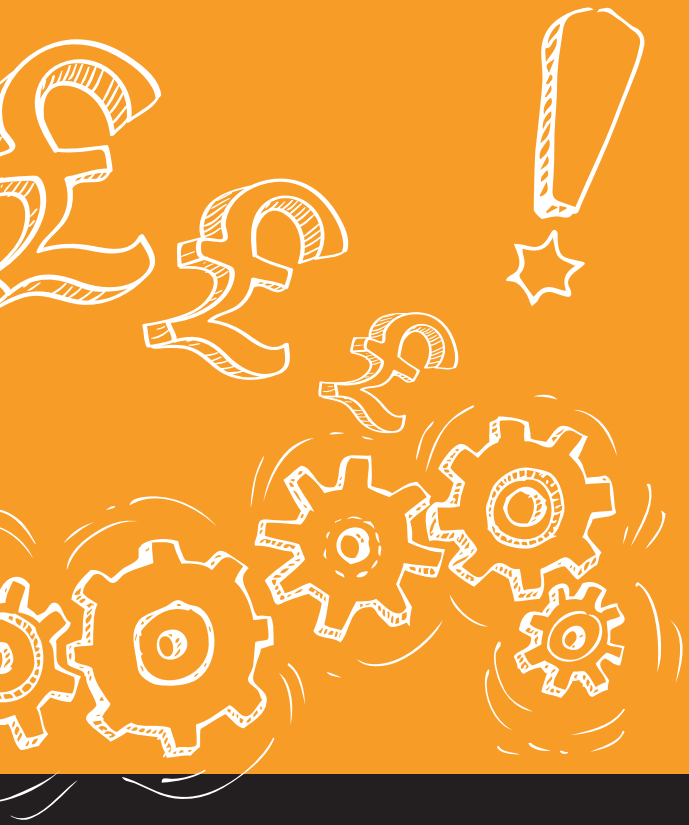

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Business owners understand their businesses

They know their markets, what customers need, how to differentiate themselves, and how their expertise, assets and staff come together to deliver a profit.

Understandably, they don't spend their evenings thinking about building reinstatement values or machinery replacement costs. They don't spend time wondering if it would take 12 months or 24 months to get back to their current trading position if something happened.

The consequences of being underinsured don't bear thinking about. But some can face challenges in not setting or reviewing their sums insured, estimates and indemnity periods accurately or regularly.

However, you (and we) can help, and together – we can make a difference.

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Customers need to understand what underinsurance is…

We don't want business owners to get their first experience of underinsurance when they make a claim. Unfortunately, we see this situation all too frequently.

Business owners are always busy. They don't want to spend time getting familiar with our definitions and setting their values and limits accordingly – and that's where our challenge lies: we have to help people, to teach them the importance of having the right policy.

At a stressful time, the last thing we want is for a business owner to discover underinsurance means he or she may have to bear the brunt of a loss.

We've all seen research that states a significant proportion of businesses are underinsured. Our analysis backs that up, and it shows that the amount of underinsurance should cause concern for us all.

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For commercial lines, there's so much to think about: the consequences of being underinsured can be catastrophic. It's not just about getting the buildings, contents, stock and machinery values right, it's about the resilience of the business and the livelihood of owners and their employees.

For example, a building's sum insured needs to take much more than the bricks and mortar into account. It should include things like professional fees, debris removal, and the cost of complying with local authority requirements.

The market value of property is how much it was bought (or could be sold) for on the open market. Many clients cite this, instead of the cost of rebuilding, when they're arranging buildings' insurance.

This is an area where you can provide real value for your client by guiding customers through the complexities of settling correct sums insured and estimates.

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Illustrative examples

We looked into some existing cases. In all three – a hotel, a block of residential flats, and an office suite – we'd been given a sum insured that could have resulted in owners having significant issues in the event of a claim:

Building	Sum insured	Rebuilding valuation	Difference	Change
Office suite	£1,540,000	£1,970,000 incl. VAT	£430,000	28%
Block of flats	£900,000	£1,500,000 incl. VAT	£600,000	67%
Hotel	£1,200,000	£2,140,000 excl. VAT	£940,000	78%

However, we worked with each client and their brokers pro-actively to get a full re-build valuation of their insured premises. This made sure all of these structures were appropriately covered, reducing the risk of underinsurance.

"Is VAT included?"

The need to include VAT or not depends on the client's individual circumstances. Where it was included in these examples, the decision to do so was based on information provided by the clients.

It's essential to set the correct levels of business interruption cover - including the length of indemnity period - to protect a business's financial position immediately after an incident, while the business is getting back to full productivity.

Businesses should be asking themselves these questions:

- "How easy would it be to find alternative premises that are fit for purpose, and how long would it take to negotiate a lease, move in and get up and running?"
- "What costs would we continue to have to pay to stay in business and would there be any increased costs in keeping the business running?"
- "Would our customers stick by us; how long would it take for turnover and profits to recover back to where they were?"
- "How long would it take to get back on our feet, how would we pay the wages, and how much profit would we lose by NOT being in business?"
- "And thinking about potential material damage - when was the last time I got a rebuilding cost revaluation?" Hint: if it's more than 3 years ago then it's time to get a new one.
- "Have I improved/extended my premises, perhaps upgraded the IT infrastructure?"
- "We buy new equipment quite often – when was the last time we updated our sums insured?"
- "How has the cost of new machinery increased and are there other factors like exchange rates or VAT I haven't taken into account?"

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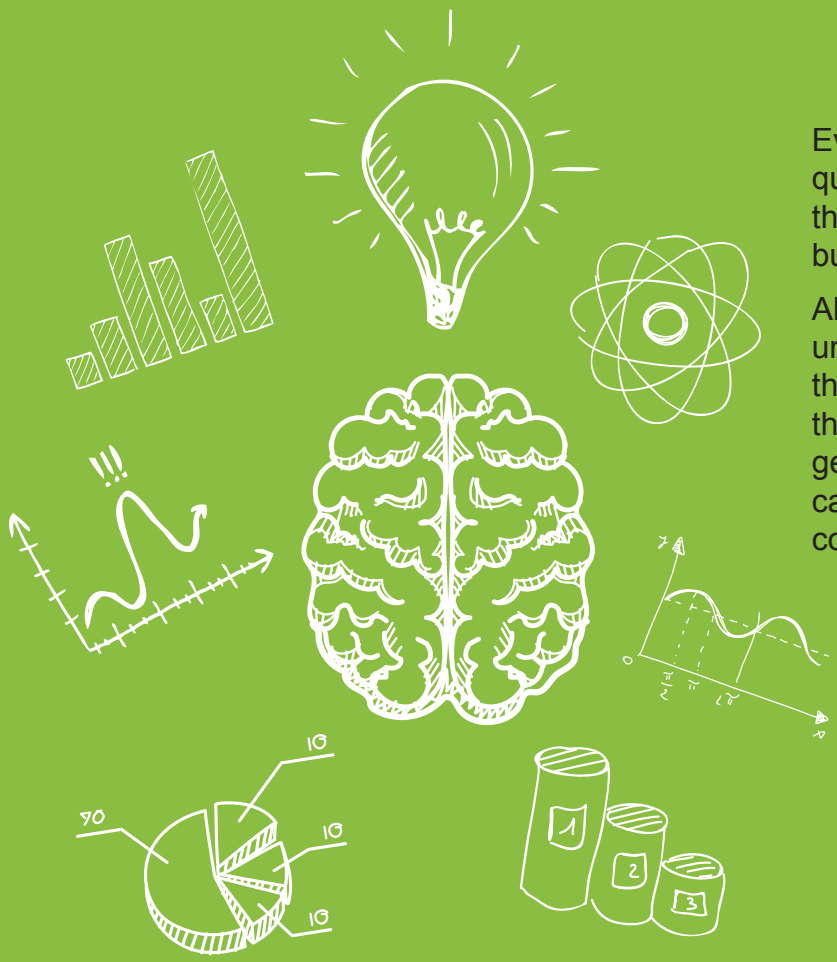

Even by simply running through those questions your customers may realise that the sums insured and estimates set for their businesses may be a long way from reality.

All of these factors may play a part in being underinsured. Raising customers' awareness that setting sums insured is more complex than it appears to be is the first step in getting an accurate evaluation – and you can help them understand more about the consequences of underinsurance.

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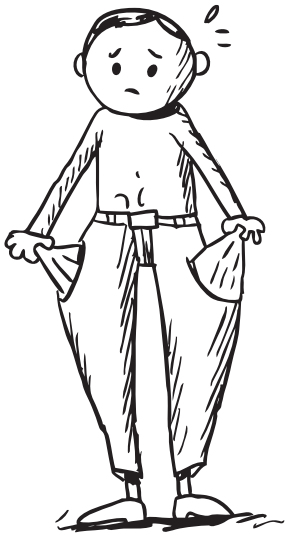
Customers need to understand the risks…

- Providing incorrect sums insured/ estimates could mean that a client does not receive the payment they were expecting in the event of a claim.
- We commonly see clients mistakenly giving the market value of a building rather that the cost to rebuild; this usually leads to under or over-insurance – depending on the location.
- Fluctuations in exchange rate for policyholders that import raw materials from abroad can lead to stock sums insured being inadequate, even if the physical amount held remains the same.
- If a building takes 18 months to reinstate, the business interruption indemnity period of 12 months is clearly insufficient. A full reinstatement cost assessment for a building should include the time it would be expected to take.
- The time needed to source alternative premises and machinery, adapt it for the business needs and move in can be very often underestimated. Some specialist machinery and plant can have a very long lead time, and is in limited supply on a second-hand basis.



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Customers need expert advice…

In addition to getting an up-to-date valuation, there are several experts that can help customers avoid the problem of being underinsured. One of those experts is you. Here's what you can do:

Get the language right

- Change your customer's mind-set first. When you're asking them for the declared insurance value of a property, refer to it as a 'rebuild value'.
- Run through some of the risks and factors specifically, for commercial customers alike. Be pragmatic about the cost of loss and refer to the sum as 'the market value'.

Tell the story

- Offer an example: it's easier for customers to process what may be involved if the worst happens to them, if they hear what may have happened to other people.
- For example, "So a fresh fruit carrier with a cold store would need to find alternative refrigeration premises…what would YOU need to carry on your business?"

Offer the expertise

- We work closely with Cardinus Risk Management, who are RICS* regulated. We would recommend anyone who utilises a third party for rebuild valuations to check they have the same level of accreditation.

Time spent getting cover right from the start is time well spent for everyone involved.

* RICS is a global professional body promoting and enforcing the highest international standards in the valuation, management and development of land, real estate, construction and infrastructure

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Real life examples

Here are some examples from our Commercial Risk team, which show the potential risks of underinsurance for a business

Example 1

We commissioned a building valuation of a large Victorian hotel, which had seen significant alterations to its structure with extensions over the years. The sum insured was set at less than £2m, but we found the true rebuild cost was over £4m with a timescale of over 2 years. The Maximum Indemnity Period for business interruption was only 12 months, which would probably not have been enough.

Example 2

A food manufacturer, in a highly competitive trade, suffered a significant fire loss in their production machinery. This put the premises out of action for a long time while it was repaired, cleaned and approved to be fit for purpose. The business was also in the process of buying another type of protective food-wrapping, to expand their business, and believed this would help ongoing trading and the recovery of trading. However, when the food-wrapping manufacturers heard about the fire – their prices went up, dramatically. The planned increased turnover and revenue stream hadn't been factored into future trading estimates and the business experienced severe financial strain as a result.

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Example 3

The 2015 Cumbria flooding caused widespread damage. One of the premises affected was an engineering company. Their buildings needed extensive repairs but specialist contractors were in high demand, delaying the work necessary to enable reoccupation. Many other local businesses were affected too, which led to short supply of alternative buildings nearby, and significantly inflated costs. The business had to set up again at a location over two hours drive away, something that didn't work for all employees. Unfortunately, the 12-month indemnity period wasn't enough to see the business back to the level of trading they enjoyed prior to the flood.

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