Coinsurance - Commercial Lines, Personal Lines, the Bottom Line Is It’s a Problem!!
Coinsurance…

Commercial Lines, Personal Lines, the Bottom Line is It’s a problem!!!

Presented by

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THE “COINSURANCE CLAUSE”

The majority of insurance professionals have never seen a coinsurance penalty applied to a claim, but to quote Mr. Dylan, “the times they are a changin’…”

*Commercial Property Form, BOP, Homeowners Policy… Is there a difference?? … Why does it matter?? … How does it REALLY work??!!*

A. Overview

1. Definition and Purpose of Coinsurance:
   - **Insurance to Value:** “A mechanism whereby the insurer agrees to a reduced rate if the insured carries a specific percent of insurance to the value of the property.”
   - **Fairness and Rate Equity:** Insurance is the spreading, sharing and transferring of risk, and all participants (i.e. insureds) are expected to pay their “fair share”.

2. Benefit to:
   - **The Insured:** A lower rate per $100 (the “large economy size”!).
   - **The Insurer:** A better premium level per risk
B. Coinsurance vs Valuation

1. Building and Personal Property Form - CP00 10:

“If a coinsurance percentage is shown in the Declarations, the following condition applies:

a. We will not pay the full amount of any loss if the value of Covered Property at the time of loss times the coinsurance percentage shown for it in the Declarations is greater than the Limit of Insurance for the property …”

- A “True” Coinsurance Provision – Carry what you “should” or you become a little insurance company!

- Applies to Buildings and Personal Property

- Applies to either ACV or Replacement Cost (note: ACV Loss settlement is always available even with RC option)
2. **Businessowners Policy – BP 00 03:**

   “… we will determine the value of Covered Property as follows:

   (b) If, at the time of loss, the Limit of Insurance applicable to the lost or damaged property is less than 80% of the full replacement cost of the property immediately before the loss, we will pay the greater of the following amounts …”

   - A Valuation Clause – **Determines** whether a loss will be settled ACV or Replacement Cost
   - Applies to **Buildings** and **Personal Property**

3. **Homeowners Policy – HO 00 03**

   “Covered property losses are settled as follows:

   b. Buildings covered under Coverage A or B at replacement cost without deduction for depreciation, subject to the following:

   If, at the time of loss, the amount of insurance … on the damaged building is less than 80% of the full replacement cost … we will pay the greater of the following …”

   - Also a Valuation Clause
   - Applies to **Buildings Only** (Good News/Bad News!)
The cost of building repairs or replacement does not include the increased cost attributable to enforcement of or compliance with any ordinance or law regulating the construction, use or repair of any property.

However, the following property will be valued at the actual cash value, even when attached to the building:

1. Awnings or floor coverings;
2. Appliances for refrigerating, ventilating, cooking, dishwashing or laundering;
3. Outdoor equipment or furniture.

"Stock" you have sold but not delivered at the selling price less discounts and expenses you otherwise would have had.

Glass at the cost of replacement with safety-glazing material if required by law.

Tenants' Improvements and Betterments at:

1. Actual cash value of the lost or damaged property if you make repairs promptly.
2. A proportion of your original cost if you do not make repairs promptly. We will determine the proportionate value as follows:
   a. Multiply the original cost by the number of days from the loss or damage to the expiration of the lease;
   b. Divide the amount determined in (a) above by the number of days from the installation of improvements to the expiration of the lease.
   If your lease contains a renewal option, the expiration of the renewal option period will replace the expiration of the lease in this procedure.
3. Nothing if others pay for repairs or replacement.

F. Additional Conditions

The following conditions apply in addition to the Common Policy Conditions and the Commercial Property Conditions:

1. Coinsurance

   If a Coinsurance percentage is shown in the Declarations, the following condition applies:

   a. We will not pay the full amount of any loss if the value of Covered Property at the time of loss times the Coinsurance percentage shown for it in the Declarations is greater than the Limit of Insurance for the property.

   Instead, we will determine the most we will pay using the following steps:

   1. Multiply the value of Covered Property at the time of loss by the Coinsurance percentage;
   2. Divide the Limit of Insurance of the property by the figure determined in Step (1);
   3. Multiply the total amount of loss, before the application of any deductible, by the figure determined in Step (2); and
   4. Subtract the deductible from the figure determined in Step (3).

   We will pay the amount determined in Step (4) or the Limit of Insurance, whichever is less. For the remainder, you will either have to rely on other insurance or absorb the loss yourself.

Example 1 (Underinsurance)

When: The value of the property is: $250,000
The Coinsurance percentage for it is: 80%
The Limit of Insurance for it is: $100,000
The Deductible is: $250
The amount of loss is: $40,000

Step (1): $250,000 x 80% = $200,000
   (the minimum amount of insurance to meet your Coinsurance requirements)
Step (2): $100,000 ÷ $200,000 = .50
Step (3): $40,000 x .50 = $20,000
Step (4): $20,000 - $250 = $19,750

We will pay no more than $19,750. The remaining $20,250 is not covered.

Example 2 (Adequate Insurance)

When: The value of the property is: $250,000
The Coinsurance percentage for it is: 80%
The Limit of Insurance for it is: $200,000
The Deductible is: $250
The amount of loss is: $40,000

The minimum amount of insurance to meet your Coinsurance requirement is $200,000 ($250,000 x 80%). Therefore, the Limit of Insurance in this example is adequate, and no penalty applies. We will pay no more than $39,750 ($40,000 amount of loss minus the deductible of $250).
C. How Does it Apply in Each Policy?

1. Building and Personal Property Form

   “Did”

   • Coinsurance Formula – The infamous “Should”!!

Loss Payment:

Insurance Carried
Insurance Required \( \times \) Loss = Recovery - Deductible

(Note: The deductible is applied after the coinsurance calculation)

Building $500,000
Deductible $1,000
Insurance Carried $300,000
Coinsurance Req. 80%
Fire Loss $100,000

Settlement:
1. XYZ Corp. owns a building which has a replacement value of $1,000,000. They have told their agent that they do not want to insure to full value, but they also do not want to be a coinsurer in the event of a partial loss. If their policy has an 80% coinsurance requirement, what is the minimum they must carry in order to avoid a coinsurance penalty at the time of a loss?

2. If the president of XYZ Corp. happens to be a bit “tight” with his money and insists he only wants to carry a limit of $600,000, with a $1,000 deductible, how much will he collect if he has a $10,000 loss?

3. If the president of XYZ Corp. is Mr. L. Cheapo and only carries a limit of $400,000, how much will the settlement be if the building is totally destroyed?

4. If the Actual Cash Value of this building is $700,000 and the policy is written on an ACV basis, what is the minimum Mr. Cheapo must carry to avoid being a coinsurer in a partial loss?
Agreed Value Option – CP 00 10

1. Agreed Value

a. The Additional Condition, Coinsurance, does not apply to Covered Property to which this Optional Coverage applies. We will pay no more for loss of or damage to that property than the proportion that the Limit of Insurance under this Coverage Part for the property bears to the Agreed Value shown for it in the Declarations.

b. If the expiration date for this Optional Coverage shown in the Declarations is not extended, the Additional Condition, Coinsurance, is reinstated and this Optional Coverage expires.

c. The terms of this Optional Coverage apply only to loss or damage that occurs:

(1) On or after the effective date of this Optional Coverage; and

(2) Before the Agreed Value expiration date shown in the Declarations or the policy expiration date, whichever occurs first.

➢ Suspends Coinsurance!
**Homeowners Policy**

...Covered property losses are settled as follows:

b. If, at the time of loss, the amount of insurance in this policy on the damaged building is less than 80% of the full replacement cost of the building immediately before the loss, we will pay the greater of the following amounts, but not more than the limit of liability under this policy that applies to the building:

1. The actual cash value of that part of the building damaged; or
2. That proportion of the cost to repair or replace, after application of any deductible and without deduction for depreciation, that part of the building damaged, which the total amount of insurance in this policy on the damaged building bears to 80% of the replacement cost of the building.

c. To determine the amount of insurance required to equal 80% of the full replacement cost of the building immediately before the loss, do not include the value of:

1. Excavations, footings, foundations, piers, or any other structures or devices that support all or part of the building, which are below the undersurface of the lowest basement floor;
2. Those supports described in (1) above which are below the surface of the ground inside the foundation walls, if there is no basement; and
3. Underground flues, pipes, wiring and drains.

**Businessowners Policy**

...we will determine the value of Covered Property as follows:

(b) If, at the time of loss, the Limit of Insurance applicable to the lost or damaged property is less than 80% of the full replacement cost of the property immediately before the loss, we will pay the greater of the following amounts, but not more than the Limit of Insurance that applies to the property:

1. The actual cash value of the lost or damaged property; or
2. A proportion of the cost to repair or replace the lost or damaged property, after application of the deductible and without deduction for depreciation. This proportion will equal the ratio of the applicable Limit of Insurance to 80% of the cost of repair or replacement.

c. You may make a claim for loss or damage covered by this insurance on an actual cash value basis instead of on a replacement cost basis. In the event you elect to have loss or damage settled on an actual cash value basis, you may still make a claim on a replacement cost basis if you notify us of your intent to do so within 180 days after the loss or damage.

d. We will not pay on a replacement cost basis for any loss or damage:

1. Until the lost or damaged property is actually repaired or replaced; and
2. Unless the repairs or replacement are made as soon as reasonably possible after the loss or damage.

e. The cost to repair, rebuild or replace does not include the increased cost attributable to enforcement of any ordinance or law regulating the construction, use or repair of any property.
2. Businessowners Policy and Homeowners Policy

- If Underinsured, Will Pay The Greater of: “The Formula” or ACV

  Building Repl. Cost $500,000
  Deductible $ 1,000
  Insurance Carried $300,000
  Coinsurance Req. 80%
  Fire Loss $100,000

(Note: The deductible is applied before the calculation)

Due to age and condition, this building has an Actual Cash Value of $250,000 (i.e. 50% depreciation).

Settlement:

How much would be paid if the ACV had been $450,000 (10% depreciation)?

How much would be paid if the ACV had been $375,000 (25% depreciation)?
D. Some Other Issues…

1. The Building Owner … You Don’t Know What You’ve Got ‘Til It’s Gone!

CP 00 10

1. Covered Property

Covered Property, as used in this Coverage Part, means the type of property described in this section, A.1., and limited in A.2., Property Not Covered, if a Limit of Insurance is shown in the Declarations for that type of property.

a. **Building**, meaning the building or structure described in the Declarations, including:

   (1) Completed additions
   (2) Fixtures, including outdoor fixtures
   (3) Permanently installed machinery and equipment
   (4) Personal property owned by you that is used to maintain or service the building or structure or its premises, including:

      (a) Fire extinguishing equipment
      (b) Outdoor furniture
      (c) Floor coverings
      (d) Appliances used for refrigerating, ventilating, cooking, dishwashing or laundering

   (5) If not covered by other insurance:

      (a) Additions under construction, alterations and repairs to the building or structure
      (b) Materials, equipment, supplies and temporary structures, on or within 100 feet of the described premises used for making additions, alterations or repairs to the building or structure.

➢ **Coinsurance applies to all of it!**
2. The Tenant, Lease Requirements and Coinsurance
(Potential E&O lurking around every corner!!)

CP 00 10

1. Covered Property

Covered Property, as used in this Coverage Part, means the type of property **described** in this section, A.1., and limited in A.2., Property Not Covered, if a Limit of Insurance is shown in the Declarations for that type of property.

a. **Building**, meaning the building or structure **described** in the Declarations, including:

   (1) Completed additions
   (2) Fixtures, including outdoor fixtures
   (3) Permanently installed machinery and equipment

“If a coinsurance percentage is shown in the Declarations, the following condition applies:

a. We will not pay the full amount of any loss if the value of Covered Property at the time of loss times the coinsurance percentage shown for it in the Declarations is greater than the Limit of Insurance for the property …”

- The value of improvements and betterments will be included in the coinsurance calculation
- *The policy doesn’t care who put them there!*
THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

ADDITIONAL PROPERTY NOT COVERED

This endorsement modifies insurance provided under the following:

- BUILDING AND PERSONAL PROPERTY COVERAGE FORM
- CONDOMINIUM ASSOCIATION COVERAGE FORM
- CONDOMINIUM COMMERCIAL UNIT-OWNERS COVERAGE FORM
- STANDARD PROPERTY POLICY

The following is added to PROPERTY NOT COVERED:

<table>
<thead>
<tr>
<th>Prem. No.</th>
<th>Bldg. No.</th>
<th>Description of Property</th>
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*SCHEDULE*

*Information required to complete this Schedule, if not shown on this endorsement, will be shown in the Declarations.*
3. Additional Property Not Covered (CP 14 20)

a. Can be used to add specific types of property, such as tenant’s improvements and betterments, to the list of “Property Not Covered” if insured does not want to cover this property and does not want it to be included in the coinsurance calculations.

b. Building owner must understand that if the tenant moves out or the tenant’s policy is inadequate or cancelled, the building owner’s policy will not respond for damage to those improvements and betterments.