

## Co- Insurance: A Potentially Devastating Financial Impact

By Kenneth Golsan  
Published in Auto Pro

### What is it?

Co-Insurance. Just about all commercial property insurance policies maintain a co-insurance clause. You better become acquainted with this clause, for in the event of even a minor loss your property policy may not indemnify your business to the extent expected.

First of all, what is an insurance “clause”? An insurance clause is a sentence or paragraph in an insurance policy describing various coverages, exclusions, duties of the insured, and conditions which suspend or terminate coverage. When it comes to the co-insurance clause, watch out if you haven’t complied!

What is co-insurance? Co-insurance is an insurance policy provision in which the insurance company agrees to a lower insurance rate per \$100 of coverage as long as the insured maintains insurance at a specified percentage of the total property values at risk. It is beneficial to the insured for two reasons. First, requiring a certain minimum limit of particularly considering smaller losses which occur most frequently.

### How Co-Insurance Works

With the co-insurance clause, the insured agrees to maintain a specific percentage between the amount of insurance carried and the value of his property at risk. If the insured does not comply with this agreement, he becomes a partner (a co-insurer) with the insurance company. In other words, the insured assumes a portion of the cost of each loss according to a formula set out in the policy. If insurance is maintained at the specified percentage (typically 80 or 90 percent of replacement cost of one’s total property value) the insurance company will pay the full amount of any covered loss up to the policy limit, of course.

Here’s the formula. One important note: the insurance company will apply this formula at the time of one’s loss in order to determine if the insured has complied with the condition:

$$\frac{\text{What Limit of Insurance Did You Carry}}{\text{What Limit of Insurance Should You Have Carried}} \times \text{Amount of Loss} = \text{Amount Paid / Recovered By Insurance Company}$$

(Example: 90% of Total Property Values)

Example: If a business insures their property with a replacement cost of \$100,000 on a policy with a 90% co-insurance requirement, the insurance required is \$90,000. If the business elects to carry a limit of only \$60,000, the the business becomes a partner with the insurance company in the event of a loss. Applying this example to our formula above, let’s say a business suffers a \$20,000 property claim:

$$\frac{\$60,000 \text{ Insurance Limit Carried}}{\$90,000 \text{ Insurance Limit Required}} \times \$20,000 = \$13,200 \text{ Paid By Insurance Company}$$

(A 90% Co-Insurance Clause x \$100,000 Total Property Value at Risk)

That means that our business would participate in the loss to a tune of \$6,800 (\$20,000 loss less \$13,200 paid by the insurance company after co-insurance is applied. No fun, especially considering the maddening consideration that the business originally purchased \$60,000 of property insurance to begin.

## **Co- Insurance: A Potentially Devastating Financial Impact**

By Kenneth Golsan

Published in Auto Pro

You see, if a majority of businesses chose to buy insurance limits at less than their total property value at risk, the premiums paid to insurance companies would be drastically reduced, while their losses would not be materially reduced because 95.5% of property losses are 50% or less of the property's total value. It makes sense that a business owner would chose not to insure to value, because chances are that a loss occurrence will be partial. Problem is, if that was allowed, then everybody would be underinsuring. Paid losses, loss ratios, from the insurance companies would approach 100% but premiums would never be sufficient to offset the losses, eventually causing insurance companies to raise property rates or declare insolvency.

Obviously the co-insurance clause can seem a bit tricky and confusing. There are ways to avoid its application in the event of a loss by your insurance carrier through the use of what is termed the 'agree value' option. Of course, that subject is an article in itself for another time. Or better yet, consult a property insurance professional.

**Visit <http://www.golsanscruggs.com/garage> to read other articles relating to auto services risk management by Kenneth Golsan.**