

UNDERINSURANCE: RECENT DEVELOPMENTS AND NEW HORIZONS

What the experts have to say



ROMERO
INSURANCE BROKERS





INTRODUCTION

Within these past 24 months we have paid witness to significant structural changes to the insurance market; some changes were expected, some were not. Brexit was a foreseen change, however the pandemic was not, yet both have drastically affected how we operate.

And while certain sectors have felt a larger impact, such as hospitality and leisure, all businesses will continue to be affected as the future remains far from straight-forward.

It is a good broker's responsibility to understand these issues, scrutinize new demands on sectors, and develop accurate responses to ensure businesses are not left vulnerable.

In these rapidly fluctuating times, there is currently no greater threat than underinsurance. As a broker we believe that communication is the best way to create strong relationships with clients and businesses. Therefore, we have laid out everything clients need to know about underinsurance and the steps they must take to combat it successfully.

In this examination of the evolving risks of underinsurance, we consider how a business can come to be underinsured, what the dangers of underinsurance are, and what can be done to avoid these risks.

Our examination is co-authored by Stuart Dobbins, Technical Claims Manager for Romero Insurance Brokers. A respected industry leader and excellent communicator, Stuart Dobbins gives an in-depth account of the dangers of underinsurance and also details why it is important to always be on top of the ever-changing risks.

A portrait of Stuart Dobbins, a man with a beard and glasses, wearing a suit and tie, smiling. The image is overlaid with a blue geometric pattern.

STUART DOBBINS

Technical Claims Manager

Stuart oversees client accounts from a claims perspective for Romero Insurance Brokers.

Having graduated from The University of Warwick in 1999, Stuart moved to Leeds and began a career in the insurance industry, holding senior positions within the Direct Line Group and RBS Insurance before becoming Claims Manager at a large brokerage in Leeds.

Joining The Romero Group in 2019, Stuart brings with him 20 years' experience of managing a broad portfolio of large and complex losses for high-value clients. Responsible for helping clients negotiate the diverse and often perplexing world of insurance claims, Stuart acts as both a referral point for our claims team as well as undertaking claims reviews for clients. He helps our clients manage their ongoing cases and is an expert at identifying claims trends in the insurance sector.



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WHAT IS UNDERINSURANCE?

Underinsurance means that a business's risks are greater than what their insurance can cover.

Being underinsured means you will likely not be fully financially covered if a disaster were to happen to your business or property.

STUART SAYS

Generally, this is when the client has insured their business and loss of turnover for less than the true reinstatement figure.

To give an example; a building is worth one million pounds (in terms of the full reinstatement value of it) and it is insured for five hundred thousands pounds. So this building is 50% underinsured.



CONDITION OF AVERAGE

Furthermore, because of the Average Condition which is applied to all buildings, contents insurance and other policies, businesses will face financial difficulties and dangers being underinsured.

The Condition of Average means that companies will bear a pro rata share of the loss suffered in accordance with their underinsurance percentage.

STUART SAYS

The condition of average is what happens when you encounter underinsurance.

Taking my previous example, with the building being 50% underinsured. All claims upon this building will therefore be paid out on a 50% basis.

The condition of average is effectively applying the proportion that you are underinsured – or perhaps adequately-insured would be more accurate terminology – and applying it to the level of your claim.

THE UNDERINSURANCE FORMULA

This can easily be calculated using the underinsurance formula.

$$\frac{\text{Policy Sum Insured}}{\text{Correct Sum Insured}} \times \text{Claim} = \text{Payment}$$

Although the underinsured party's sum insured often way exceeds the claim amount, they would be left with a shortfall.

Therefore the underinsured party will have to pay their own money to cover for this shortfall.

STUART SAYS

If that client with a one million pound building and only five hundred thousand pounds sum insured, if they made a claim for ten thousand pounds, their payout would be less.

The insurance company would notice that they are underinsured by half and therefore cut the claim in half, only paying five thousand pounds.



**AN ESTIMATED
40% OF UK BUSINESSES
ARE UNDERINSURED.**

**A QUARTER OF UK SMES SAID THAT
THEY WOULD CLOSE IF THEY HAD
AN UNEXPECTED BILL OF £50,000.**

**ARE YOU
FULLY COVERED?**

WHAT ARE THE CONSEQUENCES OF BEING UNDERINSURED?

Underinsurance is, more often than not, unexpected.

Rarely do businesses choose to be underinsured, however some will, operating under a bad brokers advice in the effort to achieve cheaper premiums. The consequence of underinsurance puts many businesses between a rock and a hard place, unable to afford to stump up significant funds were they to make a claim.

Underinsurance applies to many types of insurance. Building and Contents insurance are most commonly underinsured, whether it be contents incorrectly valued or the rebuilding of property not fully costed up. But other forms of insurance are commonly underinsured. Business interruption insurance - most businesses will require two years to get back to a "normal" level of trading, insurance policies must be able to cover for this and yet often fall short. Data and Cyber Insurance is also often undervalued, perhaps because it is not yet fully understood.

STUART SAYS

Underinsurance goes across the board in all types of covers that you can get. We see clients that have a very serious loss and all of a sudden find out they are underinsured. A half a million pound loss turns into ,what is essentially, a two hundred and fifty thousand pound fine, or worse.

Situations, most recently cropping up due to the COVID-19 business interruption claims, have appeared where new clients are found to be significantly underinsured.

WHAT CAN LEAD TO BEING UNDERINSURED?

There are a number of reasons as to why a business may be underinsured:

Out of date valuations

The value of property contents and business assets are always fluctuating, however this year especially has seen a rapid hike in property prices. Exchange rates, the economy and legislation changes such as thermal insulation have an effect upon replacement and reinstatement.

Valuations will need to be redone in order to more accurately ascertain a company's holdings to avoid being underinsured.

A common misconception is that valuations are expensive and always need to be in full. In fact, if nothing substantial has changed to the property, a reappraisal might be quicker and cheaper than expected.

Undervaluing stock and contents

Many clients, who may not have experience in valuing stock, will be asked to put a number on the worth of the complete content and stock of their business. This can be incredibly difficult to do accurately and as such should require the services of an expert.

Most clients undervalue their stock, and in the result of a fire or flood, would find the cost of replacement of these items to be well above their estimate. Being underinsured, they are then having to fund the shortfall.

"I've spoken to a client recently who said they only had £500,000 worth of contents in their property. I then went through all the different bits and pieces they should consider, and afterwards it came to about £1,500,000. This is why having an expert to run through the valuations with them is important. We can help them learn the true value of their belongings."

- Lee Peters, Client Manager, Romero Insurance Brokers

Specialist covers

Businesses may not be aware of specialist covers they need, such as cyber or terrorism insurance. They may assume their “standard” policy will cover them for incidents caused by these circumstances. However, the fine print of their policy will tell a different story.

The best way to ensure you are fully covered for all outcomes is to talk to a professional. Cyber insurance is becoming more popular and applied as a default policy, but this depends on the type of industry. There are an unlimited amount of specialist covers, and only through a detailed risk assessment and insurance portfolio review can businesses be sure they are covered for every eventuality.

Intentional underinsurance for cheaper premiums

Less cover generally means cheaper insurance. Some brokers may intentionally undervalue your buildings or contents in order to be able to offer a lower premium. This is highly inadvisable as it could result in a massive settlement reduction if a claim were to arise.

Businesses who see premiums skyrocket may try to find sneaky routes to bring the cost down – potentially at the cost of their business, if the risk doesn’t pay off. Some businesses may have hidden costs, or hide facts from an insurer in order to receive a cheaper valuation. If found out this could result in a voided policy and a fine, and leaving the business to find the money for a claim. There’s no winning scenario here.

Miscalculated Business Interruption Loss

There are many things that could unexpectedly stop businesses from trading. Fire, flood or theft could leave premises unusable. How long could a business stay afloat before falling into financial difficulty? Business Interruption Insurance is there to support them if something does go wrong and they’re unable to trade for a while. It provides the financial backing to help get businesses back up on its feet again.

According to the Building Cost Information Service, 40% of businesses don’t have enough Business Interruption cover. This form of underinsurance is commonplace due to the difficulty to accurately calculate the expense of a full return to normal working order.



Incorrect broker advice

Some broker's advice is just not good enough. Their valuations are incorrect or out of date, they do not fully appreciate a business or they do not have the experience to see exactly how long it would take to get a business back up and running.

Choosing a good broker is essential to getting an accurate estimate for your insurance as poor advice can result in drastic consequences.

STUART SAYS

Quite often it's not negligence. Brokers or businesses have not tried to fiddle the figures which can sometimes be an assumption people make. Clients can sometimes misunderstand how the figures are meant to be produced.

One of the classic examples is the difference between the reinstatement value of a property and its market value. A property worth two hundred thousand pounds, well to reinstate it from the ground up, from demolition to foundation to a range of fees, this could be six hundred thousand pounds.

Rather than the word of an estate agent, a client would be much better served by a good broker and getting a building survey done in understanding the full value of their property.

Most clients will not have big claims. However there are enough that it should be something all businesses are aware of. And ensuring you are not underinsured is key to keeping your business safe.

Because the subject is so technical and ever-changing, you really need a capable broker in order to guide you very clearly to ensure you don't find yourself underinsured.

WHAT RECENT DEVELOPMENTS HAVE PUT BUSINESSES AT RISK OF UNDERINSURANCE?

COVID-19 Pandemic

The COVID-19 pandemic has had a huge impact on businesses since its emergence in 2020. Being able to accurately value a business's expected turnover is extremely difficult in turbulent times.

The uncertainty of the future outlook causes insurers to tighten up and be less likely to offer deals on premiums. This is called the hardening of the market.

Hard markets can lead to underinsurance in a number of ways. Renewal processes take longer, insurers are less willing to offer wider policies, insurance is generally more expensive and offers less flexibility. The temptation to reduce costs is also greater as businesses face precarious financial positions, therefore insurers are also more stringent on the correct sums insured, imposing increasingly penalising terms.

STUART SAYS

The market certainly has changed. It was in the air I think before COVID-19 happened such as with the Grenfell tragedy. Insurance premiums, the availability of deals and the stringency with which claims are dealt all seemed to be shifting. However, these issues have been rapidly ramped up even further in the last two years due to the pandemic.

COVID-19 has thrown everything up in the air and we've entered a hard market. Many insurers are not prepared to do deals or negotiate and are acting on a take-it-or-leave-it approach.

Then as well you have further problems with some businesses being closed for months and months, but being asked to calculate their estimated turnover gross profit. They've had to make predictions on profits for upto two years at a time, and as such may have undervalued their estimated turnover not expecting to be doing a roaring trade upon reopening. Using leisure & hospitality as an example, lo and behold, there was a huge public demand when they reopened, and as an unfortunate result many businesses have undervalued their expected profits.

The multiple lockdowns have opened up the possibility of underinsurance across a lot of industries.

The hard market will certainly be in place for another twelve months, but the future does depend on COVID and the nation's recovery. But it can't last forever, it's always cyclical, and the market will soften.

Brexit

With the UK no longer a member of the EU, the impact has been seen on our use and selection of materials and labour. New rules have been applied to the buying and selling in foreign markets. The increased regulations and red tape, have slowed down the process and also increased costs. These increased costs need to be factored into valuations.

Petrol, steel, cement and timber are mostly purchased from sources outside the UK. This means rebuilding costs will most likely increase and so will downtime as delays to reinstatement are to be expected.

As a result of material shortages, many companies have resorted to stockpiling, whether it be high street shops or construction firms. Therefore, their stock and contents cover will need to be increased, and the risk of underinsurance goes up.

This phenomenon has already been seen in the steel industry. And each of these concerns will affect reinstatement times and businesses interruption, hence putting businesses at greater risk of underinsurance.

Business Interruption Insurance

Business Interruption has hit the headlines recently due to the FCA's Supreme Court case on COVID-19 and public health measures. This argued that businesses disproportionately affected by the COVID pandemic should be reimbursed by insurers for their loss in profits.

However, as Stuart discovered when dealing with the case, many clients did not have sufficient business interruption insurance. The insurance should be adequate to cover a business were it to lose its income due to an unexpected circumstance, such as a fire or flood.

Business interruption policies have become increasingly critical, but also increasingly difficult to value. Therefore this has increased the risk of being underinsured, forcing businesses to meet the shortfall of costs to keep the business operational.

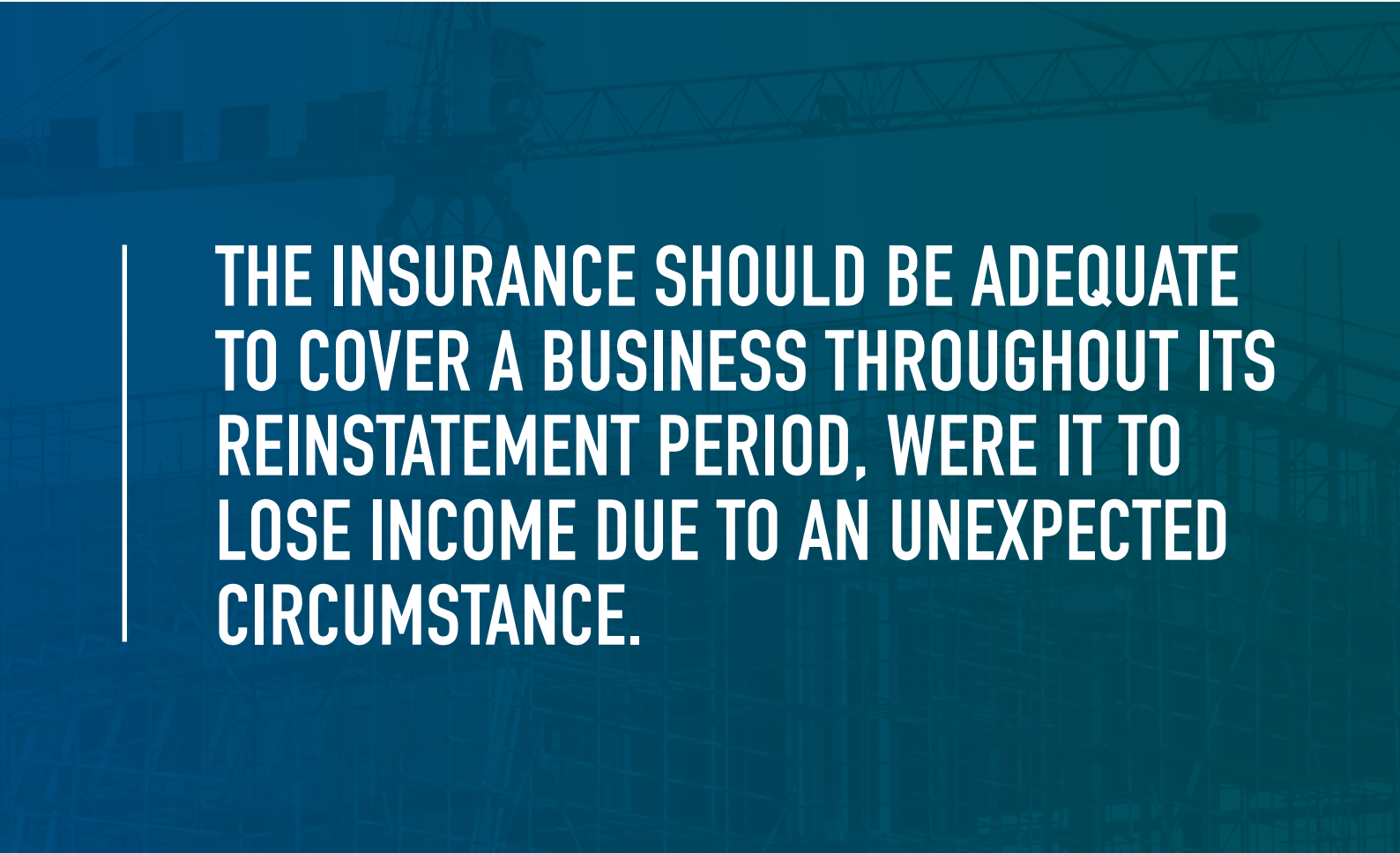
STUART SAYS

Business interruption is always based on an estimate. And the ability for people to predict their business is significantly hamstrung at the moment, and that inadvertently leads to them being underinsured.

On top of that there is a lot of misunderstanding as business interruption insurance is incredibly complex. Insurance does not just cover the bricks and mortar of the property, but also that the business can leapfrog the claim period and come out the other side. And very quickly, if the sum insured is incorrect, this will cause a lot of hardship. Outgoings need to be paid, percentage income is only a fraction of what it once was for a long period of time; the insurance needs to cover all this, which is very difficult to value.

If my pub burns down, for example, then I can set up elsewhere, rent a property, and business interruption will cover the costs because the solution – allowing trade to continue – is economically reasonable for the insurer, costing less than simply waiting for a rebuild. But if I'm underinsured, all of the things I might do to mitigate my loss, I'd have to meet the shortfall for. I'd have to pay the rent, hire or buy temporary equipment, and pay for many other things to meet the insurer's economically reasonable solution.

The business interruption needs to be sufficient in order for the business to sustain this trading water period. Reinstatement of buildings can take 36 months, that's a long time to cover financially.



**THE INSURANCE SHOULD BE ADEQUATE
TO COVER A BUSINESS THROUGHOUT ITS
REINSTATEMENT PERIOD, WERE IT TO
LOSE INCOME DUE TO AN UNEXPECTED
CIRCUMSTANCE.**

DATA AND CYBER UNDERINSURANCE

No insurance policy type is quite as difficult to predict as data insurance. This is because of how new the policy type is and the possibility for a company's data collection to rapidly increase in size. Underinsurance is highly likely.

Cyber insurance is also growing in popularity as more and more large companies fall to catastrophic data breaches. According to the Identity Management Institute, 90% of cyber attacks are successfully executed. It's very difficult to predict the outcome of a cyber attack due to their varied nature, and all risks cannot be eliminated.

This area of insurance is one of contention and concern. Romero Insurance Brokers will keep a close eye on data and cyber insurance as we expect the area to grow rapidly within the next few years.

STUART SAYS

The insurance of data is difficult because it's still a relatively new frontier.

There are scenarios where a company is growing and they take out cyber insurance for a thousand customers and by the end of the year they have fifty thousand customers, clearly this is a problem. Writing to a thousand policyholders about the potential breach of their information is hard enough, writing to fifty thousand is extremely time consuming and expensive.

Very quickly growing companies will burn through their sums insured and you'll find yourself having to stump up the cost.

WHAT DO BUSINESSES NEED TO DO TO ENSURE THEY ARE NOT AT RISK OF UNDERINSURANCE?

The best and most impactful action for any business to ensure they are not at risk of underinsurance is to utilise the services of a broker.

It's a broker's responsibility to ensure clients are fully covered. A broker will assist you through the range of services they provide, including valuations, risk management surveys and specialist policy types.

The best brokers put their clients first, they actively build a relationship with their clients and reinforce trust. We ask questions in order to offer innovative solutions, allowing us to work for you, negotiating our way around the hard market. We bring certainty to an uncertain landscape and understand the details of all the cover you need through our experience and dedication; therefore ensuring you are not underinsured.

STUART SAYS

The answer is to use a good broker. Use them and their services to ensure that your sums insured is correct. A good broker should be asking you a lot of questions, this is for a very good reason – to get to the centre of the cost of reinstating you when required.

Experience and aptitude are so important on the side of the broker. They should already understand what the common areas of concern are for businesses, how the market is changing, and how this could affect their client's policies. A good broker will be forthright in dealing with underinsurance, actively encouraging clients to update their policies and sum insured, and researching where their clients could be most at risk of underinsurance.

WHY ROMERO INSURANCE BROKERS?

Romero Insurance Brokers are experts in the field of business insurance. Our clients take advantage of our 25 years' experience and our dedicated professionals who fully understand the risks and consequences of underinsurance.

With us, clients have access to our resources, services and the ear of industry leaders such as Stuart Dobbins. We are on the cutting edge of the insurance sector and are first to learn of new developments such as proposed legislation changes which could drastically affect your cover.

In such difficult and turbulent times, the service of a top independent broker should not be understated. We offer a dedicated helpline and always put the client first. The cover we provide is invaluable. We are convinced in our message to avoid underinsurance; the cost of your policy will be only a fraction of the comparative potential costs were your sums insured not cover your reinstatement fees.

Romero Insurance Brokers is dedicated to protecting your today and your tomorrow. Our promise is to Treat Customers Exceptionally, and that means providing fully comprehensive cover which will never leave you with footing the shortfall.

IF YOU'D LIKE TO WORK WITH A SPECIALIST
BROKER THAT UNDERSTANDS YOUR NEEDS
GET IN TOUCH WITH THE ROMERO TEAM

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