coverlink
INSURANCE

THE COSTLY COINSURANCE PENALTY

How to Avoid this Expensive Mistake

PERSONAL INSURANCE

CONTENTS

DON'T IGNORE THE FINE PRINT!

If the devil is in the details, there's one section found in nearly every type of property insurance policy from homeowners insurance to business insurance that you'd be wise to become familiar with. It's usually found in the section titled "Conditions" and might seem rather harmless. **So what is this so called "detail devil"? Answer: Coinsurance**. The logical next question is what's coinsurance?

We'll start with the technical explanation...according to the International Risk Management Institute, coinsurance is:

> " A property insurance provision that penalizes the insured's loss recovery if the limit of insurance purchased by the insured is not at least equal to a specified percentage (commonly 80 percent) of the value of the insured property. The coinsurance provision specifies that the insured will recover no more than the following: the amount of the loss multiplied by the ratio of the amount of insurance purchased (the limit of insurance) to the amount of insurance required (the value of the property on the date of loss multiplied by the coinsurance percentage), less the deductible.

Confused yet? Don't worry, you're not alone. **Many licensed insurance agents don't understand this vitally important section of the policy which is where the**

real problem exists: if your agent doesn't understand this critical element of your policy, how can it be properly explained to you? We'll address that problem later in this report. For now, let's focus on precisely what coinsurance means to you.

Ask your insurance advisor to explain coinsurance to you. If you're met with a look of confusion, it's a red flag.

Simply stated, the coinsurance section of your policy gives your insurance company the right to penalize you by **reducing** the amount of your claim payment in the event the amount of insurance you purchased is inadequate. In most policies, the standard amount of insurance that must be purchased is equal to 80% of the replacement value of the property. This figure is referred to as the coinsurance percentage. Sounds fairly abstract, right?

THE INSURANCE POLICY LANGUAGE

Who wants to read the actual insurance policy? Perhaps if you're having trouble falling to sleep at night… but in this case, it's helpful to see the actual wording from the policy so we can further understand this often confusing concept:

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 to 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.

Well if you weren't scratching your head before, how do you feel now? Starting to understand why this coinsurance issue causes problems for so many people? Unfortunately, since it's so often misunderstood, it's not properly explained to those that purchase the policy and therefore, it leaves you to suffer substantial consequences if you have a claim and it's determined that you did not comply with the coinsurance requirement.

WHAT'S THE BOTTOM LINE?

Let's review a real-world example. This information is based on an actual client of CoverLink Insurance (the name has been changed of course). Prior to being a client, he contacted us to review his insurance policies with him. He felt that he was paying too much for his insurance. After a comprehensive review, **he was paying substantially more than he should have been,** but not in terms of his annual premium. What we found was that he was in violation of his coinsurance clause and had a claim occurred, he would have been paid substantially less than what he thought he would receive. So essentially, he was paying a premium for coverage amounts he would never receive. You might be wondering, how is that possible? Well here are the details:

- Fred was insuring his house for **$114,500**
- His policy had a coinsurance percentage of **80%**
- Fred had a **$1,000 deductible** on his policy
- For purposes of this example, we will assume Fred had a **$20,000 claim** when hail damaged his roof and his vinyl siding

We discovered the first problem with Fred's policy and that was, when he purchased his house years ago, he bought the insurance policy required by the bank. Sounds pretty familiar, right? So where's the problem? **The bank only required his insurance to be in the amount of his mortgage**, not the actual replacement value of his house. And to top it off, Fred's homeowners policy was not keeping up with inflation over the years. How does that translate to actual dollars? When we insured Fred's house, the replacement value was determined to be $217,000.

Here's what would have happened in the event that $20,000 claim occurred BEFORE we fixed Fred's policy:

According to the coinsurance clause, we have 4 steps to follow:

1. Multiply the value of the covered property ($217,000) by the coinsurance percentage (80%) = **$173,600**. This is the least amount of coverage Fred should have had in place to avoid the coinsurance penalty.

2. Divide the limit of insurance of the property ($114,500) by the figure determined in step 1 ($173,600) = **66%**

3. Multiply the total amount of the loss ($20,000) by the figure determined in step 2 (66%) = **$13,200**

4. Subtract the deductible ($1,000) from the amount determined in step 3 ($13,200) = **$12,200**

AND THE RESULTS ARE...

Simply stated, a very unhappy individual (Fred) receiving the phone call of bad news if he had experienced a loss under his old policy. Since no one ever explained the details of the coinsurance provision to Fred, he simply thought if he had a $20,000 claim, he would be paid $19,000 after he paid his $1,000 deductible.

The fact is, Fred would only have received $12,200... a full **$6,800 less** than he expected to receive simply because he was subject to the coinsurance penalty. Without his knowledge, Fred's deductible (in this hypothetical claim) wasn't $1,000, it was **actually $7,800**!

So what can you do?

The short answer is, make sure your coverage meets the coinsurance requirement. The fact is, your insurance agent should be discussing this with you. Too many times, agents try to cut the cost of the policy by reducing the coverage offered. It might not seem like a big deal and chances are, you would probably be comfortable with the limit of coverage being recommended. However, the devil in the details could severely impact your coverage in the event of a claim.

This is precisely why you deserve, and should expect, to work with a trusted insurance advisor. Insurance is very similar to so many other products you likely purchase on a daily basis... **you get what you pay for!**

ABOUT THE AUTHOR

Matt Simon, CIC, CPCU has been a licensed Insurance Advisor with CoverLink since 2006. Prior to joining the team at CoverLink, he worked as an Underwriter with a multi-state insurance company located in Columbus, Ohio. Matt is a Certified Insurance Counselor (CIC) and Chartered Property and Casualty Underwriter (CPCU), having successfully completed the rigorous coursework and exams to earn these designations. He's the Vice President at CoverLink, serves on the Board of Directors for the Professional Insurance Agents Association of Ohio and the Associated Risk Managers of Ohio. In 2013, Matt was awarded and recognized as the National Young Insurance Agent of the Year. He can be reached at:

Phone: (937) 592-9076
Toll Free: (877) 592-9076
msimon@coverlink.com

WHAT COVERLINK CLIENTS ARE SAYING

“ Not only are the people at CoverLink working for me, but they have also become friends over the years because they are the type of individuals you can count on and who honestly care about their people from a business and personal standpoint. I would not put my business and family in the hands of anyone other than the wonderful, professional, and dedicated staff at CoverLink Insurance. Thank you CoverLink staff for a job well done!

Mark Muirhead

“ The entire team at CoverLink has been a great source of advice when it comes to protecting my family and business with insurance and sound risk management. When I have a question I simply call or email and it gets answered promptly, it’s nice having people who truly care about me and my family’s well being. I highly recommend you call them for a second opinion for your home, auto, life and business insurance needs.

Matt Brown

CoverLink Insurance

CoverLink Insurance is an industry leading, independent insurance agency, that has been obsessively protecting and caring for its clients since 1920.

It begins with a simple question: why? Why do we do what we do? What do we believe?

At CoverLink, we care deeply about our clients. We want to be there to pick up the pieces when tragedy strikes their lives. We exist because of our unwavering commitment to, and compassion for, our clients. To us, it's about people, not policies. People have assets to protect. People have loved ones they care for and employees who depend on them. People have dreams to pursue. We believe it's our responsibility to safeguard the people we care about.

Request a Proposal

CoverLink Insurance
coverlink.com

Bellefontaine Office
200 Dowell Ave
Bellefontaine, OH 43311

Phone: (937) 592-9076
Fax: (937) 599-2568

Urbana Office
121 Miami St
Urbana, OH 43078

Phone: (937) 306-7781
Fax: (937) 653-4457

West Jefferson Office
98 E Main St
West Jefferson, OH 43162

Phone: (614) 454-6687
Fax: (614) 879-9622