Risk insights
Underinsurance

Underinsurance - what it means to you and your business

You've probably noticed everyday price rises caused by inflation. However, have you stopped to consider how it might affect a claim on your business insurance?

Inflation, supply chain issues and labour shortages are all affecting the cost and speed of getting businesses back up and running after an incident – with some prices rising faster than others.

We're seeing underinsurance becoming a more pressing issue for businesses[2] – where the level of cover underestimates the true value of your property, assets and business. And, if you ever need to make a claim, it could lead to a significant shortfall when your business is at its most vulnerable.

What is underinsurance?

Put simply, underinsurance happens when you don't have enough insurance cover to meet your needs. If the stated value of your property and assets aren't correct, or the time it takes to get your business back up and running after a loss are underestimated, you could be underinsured.

Unfortunately, the unexpected can happen and you may need to make a claim. If you do, the last thing you want to hear is that the level of insurance cover you have won't cover your costs. But that's exactly what could happen if you are underinsured.

What happens when you're underinsured?

The short answer is that you put yourself or your business at risk of having a shortfall to pay should you need to make a claim. The example below gives further insight into what happens when you're underinsured.

Did you know?

10% of SMEs - that's more than half a million UK businesses - believe they **wouldn't survive** if they had to pay up to £10,000 towards a claim that wasn't fully covered by insurance.[2]

A distribution company owns a series of warehouses and offices

1. After a valuation, their broker recommends their Sums Insured limit is increased to cover a total of **£4,451,000.**

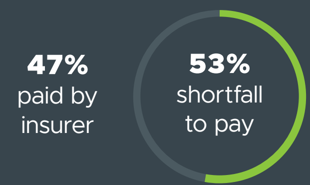
2. Before the valuation, they were only insured to the sum of **£2,100,000.** That's only **47%** of the recommended amount.

3. If they were to make a claim without adjusting their cover, **their insurer would only pay 47%** of the loss amount, no matter how big or small.

4. This would lead to **substantial shortfalls** when they need to make up the remaining **53%** themselves.

5.

Claim for losses	Amount paid by insurer (47%)	**Shortfall to pay (53%)**
£5,000	£2,350	**£2,650**
£50,000	£23,500	**£26,500**
£500,000	£235,000	**£265,000**



Why won't an insurer always cover the full loss?

Any claim will only be paid based on the amount of cover chosen. This is called the 'average clause'.

We always urge you carefully consider the percentage difference between the recommended cover limits and the amount you choose to cover, rather than simply focusing on the total amounts.

%

The 'average clause' explained

Any claim you need to make - big or small - will be impacted by the percentage difference between your recommended total sum and the actual sum for which you're insured.

How big is the problem?

For businesses, SMEs in particular, the problem is bigger than you might think.

Aviva estimate **42% of SMEs** who insure buildings with them are underinsured[1]

Despite this, **91% of SMEs** are confident they have the right level of cover in place[2]

And **10% of SMEs** could not operate if they had to pay up to £10k due to underinsurance[2]

Even though **19% of businesses** haven't reviewed their indemnity period in the last 2 years[2]

It's not just businesses that are at risk though.
More than **9 out of 10** UK buildings are insured for the wrong amount.

Commercial properties

80% underinsured

15% overinsured

Residential properties

82% underinsured

13% overinsured

Figures relate to RebuildcostASSESSMENT.com most recent 29,000 Rebuild Cost Assessments completed as of 31st August 2023

[1] Based on Aviva's modelled data on SME customers with buildings insurance, September 2022.

[2] Figures relate to a survey of 502 micro, small and medium sized businesses, carried out by YouGov on behalf of Aviva in September 2022.

How you could be underinsured?

Incorrect Sums Insured limit

It's not nice to think of, but if you were to suffer a large loss tomorrow, how much would it cost to completely rebuild and reinstate your business? This is what your Sums Insured limit covers. And it's not just the bricks and mortar. This covers the cost of replacing key components including plant machinery, and equipment.

Inadequate Business Interruption (BI)

If you've thought about the cost of rebuilding and reinstating your business, how long do you think it would take to get all of that building work agreed and completed, and your equipment ordered and installed? Not to mention the time it will take to build back your customer base to previous levels. This is where your business interruption period comes into play. If your BI limit isn't adequate, you may not be able to cover the full estimated loss of earnings during a period of reinstatement, leaving you financially vulnerable.

Not reviewing these limits regularly

If you haven't had an independent professional valuation done in the last 12 months, we'd highly recommend you do so. It can be difficult to understand exactly how much cover you need at the best of times, but right now, it's trickier than ever - inflation, increased cost of building materials, supply chain disruption and a shortage of skilled workers are all causing the cost of getting back to business to go up.

What about indexation?

If the initial Sums Insured are too low, the indexation applied to your policy in line with inflation may have little to no impact. What's more, inflation indexation alone won't account for costly delays or increases in other costing factors.

The hidden dangers of underinsuring your business

When you're considering what being underinsured could mean for your business, you need to think about the wider impacts, not just the shortfall you might have to pay.

Making sure you know how long it will take you to get back to normal is also key. We call this the 'period of indemnity'. Making sure you have calculated this correctly protects your income and cash flow if anything impacts normal operations.

It can take longer than you think to bounce back. For instance, if a building needs to be rebuilt after a fire, attaining planning permission could delay work for months.

- **Production delays**
- **Loss of revenue**
- **Cash flow problems**
- **Impact on share price**
- **Reputational damage**
- **Supply chain problems**
- **Loss of key employees**
- **Employee wellbeing issues**
- **Disappointed customers**

How you can reduce the risk of being underinsured

Get a professional valuation

Working out how much accidents, and other business interruptions, could set you back can be complex. But having to pay more than you bargained for – or waiting longer than you thought to get back up and running – could leave your business struggling.

An expert valuation can help you get a true idea of the total value of your assets, so you can choose an appropriate level of cover.

Have regular catch-ups with your broker

It can be difficult to stay on top of market conditions that could affect your insurance policy – such as labour shortages, rising material costs, or wider supply chain issues. Regular catch-ups with your broker can help you understand how much cover you need.

It's also important to tell them about changes you've made. Things like new plant and machinery, property alterations and inflated stock levels can impact the level of cover required.

Make sure your period of indemnity is correct

SMEs estimate, on average, that it would take just under six months for their business to be able to return to normal operations following a major loss such as a fire or flood.[3]

But a recent analysis of large claims made by Aviva customers found that the average lifecycle to close a claim was 385 days.[4]

[3] Figures relate to a survey of 502 micro, small and medium sized businesses, carried out by YouGov on behalf of Aviva in September 2022.

[4] Based on analysis of large claims (more than £100,000) that were settled by Aviva between 2018-2021.

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