



## UNDERSTANDING THE COINSURANCE CLAUSE

Coinsurance is in place to reward the person who carries the proper insurance to value and to penalize the person who does not. If a person agrees to insure to 80, 90 or 100% of value, a credit is provided. If a person chooses to not insure to that amount, a surcharge is exacted and the property may not be eligible for some of the preferred insurance products. A great idea but what if someone makes the promise and then reneges on that promise? That is the purpose of coinsurance. It is the penalty for reneging on a promise. Instead of the company paying the entire loss, the policyholder becomes a co-insurer – someone who must pay part of the loss out of his or her own pocket.

### COINSURANCE

There are three pieces of information needed to determine if a coinsurance penalty is appropriate:

1. The value of the Covered Property at the time of loss (the value at the inception of the policy is not relevant).
2. The coinsurance percentage selected. The named insured may choose 80, 90 or 100% in most cases, or none at all. If no coinsurance is purchased, a surcharge is applied. Program rates are developed assuming 80% coinsurance, so no surcharge or credit is applied. Levels of 90% and 100% coinsurance offer credits of 5% and 10%, respectively.
3. The Limit of Insurance is not required to be the value times the coinsurance. The Limit of Insurance should be reflective of the maximum value that could be expected during the policy period. (If fluctuations are anticipated, the insured should consider a reporting form or a peak season endorsement. The named insured may choose to insure for the 100% value, but keep the coinsurance at 80% or 90% in order to avoid a penalty.

### EXPLANATION OF COINSURANCE

If an insured is having difficulty understanding coinsurance, possibly the following explanation might help.

Insurance policies are promises of utmost good faith. The insured believes the insurance company will keep a promise in return for the premium paid. The insurance company believes the insured has been honest with information provided on the application. The premium the insured pays is based on the statements made on the application. When a promise is made, there are ramifications when it is broken.

The property premium is computed using the limits supplied with the understanding that they are accurate. If they are not accurate, the premium is not sufficient. If enough insureds lie on their applications, the company will not have sufficient money to keep their promises to pay. Rather than voiding the policy because of inaccurate policy value information, the insurance company chooses only to exact a penalty and basically say "You didn't keep your part of the bargain, therefore, we will only honor part of ours."