

Inflation and the consequences of under-insurance



What does this mean for policy holders?

PIB Insurance Brokers' Technical Managers Stuart Copperwheat and Kate Slater discuss the current situation and what this means for our policy holders.

With inflation currently at its highest level for decades, the cost of products, materials and labour has significantly increased as a result.

Geo-political conflict, the impact of Brexit and the continued disruption caused by Covid-19 are all contributory factors to issues such as supply chain bottlenecks, enforced factory closures, shipping container shortages and congestion, restrictions at ports and a shortage of labour.

Consequently, there is pressure on the costs at all stages of production, from raw materials, energy, labour, packaging and transport.

What does this mean for you?

It is now more important than ever that close attention is paid to the replacement values declared to insurers.

With no immediate end to the inflationary pressures being experienced globally, continued price rises mean that you may be unwittingly underinsured or in danger of becoming underinsured during the period of your policy.

We recommend that you discuss matters with us regularly (not just at renewal) to ensure you are assessing and reviewing the replacement value of your property and assets along with evaluating the adequacy of your Business Interruption indemnity period.

With most insurance policies being subject to Average (the underinsurance clause), the financial consequences of underinsurance for a company can be devastating. The amount that insurers will pay in the event of a claim could leave you with insufficient funds to rebuild your premises or replace equipment and stock if the sums insured are not adequately stated.



Some important considerations

Property Damage – Buildings

Our experts comment: “There is a marked difference between market value and rebuilding costs. These two are never the same and it is always the rebuilding costs which should form the policy sum insured.”

We recommend you consider the following:

- > Professional Valuation:
 - > Has a professional reinstatement valuation ever been undertaken?
 - > Has this been reviewed in the last three years?
- > Alterations and extensions undertaken – Sum Insured must be reviewed to ensure remains adequate
- > VAT Status - Where an Insured is not VAT registered, VAT should be included in any building sum insured
- > Policy Definition would usually include:
 - > Landlords Fixtures and Fittings
 - > Outbuildings
 - > Walls, Gates, Fences
 - > Car Parks, Roads, Drives & Pathways
- > Additional Costs – Professional Fees & Site clearance need to be factored in with the associated VAT
- > Index Linking cannot be relied upon and will not provide security if the buildings sum insured has been set too low historically. Not every policy allows for indexation nor has necessarily been set at a rate to keep pace with the continued construction cost inflation
- > Rebuilding Cost Inflation for 2022 alone is currently estimated to exceed 10%

Property Damage - Machinery, Plant and Stock

- > Machinery, Plant & Contents – machinery and equipment under most policies should be insured for the current replacement value as new
- > Remember to factor in availability and lead-times – both can affect the replacement cost
- > Stock – the correct basis of insurance for stock is cost price to an Insured. With the pressures on the costs of products (raw materials through to finished goods) even an existing stock level is likely to cost more to replace should there be a loss. Left unchanged, a sum insured that may have been adequate at last review may not be adequate now.

Furthermore, in order to protect against price rises, some businesses are adapting the way they purchase stock from a ‘just in time’ basis to a ‘just in case’ basis and consequently are holding higher levels of stock than they normally would

Business Interruption – Indemnity Period

It is important to consider

- > How long will it take to reinstate the Premises in the event of a significant loss? Consideration needs to be given to the current material and labour shortages and along with the move towards a more carbon neutral future and the associated longer approval times to obtain local authority planning permissions Has the lead time to source replacement machinery and stock changed? These factors need to be considered when estimating an insurance period which is sufficient to cover the period from the point of any claim up to the point the business is back to it’s pre-loss trading position

How can we help?

- > Firstly, don’t wait until the renewal of your insurance policy to review your sums insured; keep in regular contact with your PIB Representative to keep them appraised of any changes in your business
- > Review the adequacy of your Business Interruption sum insured and indemnity period - again you don’t need to wait until renewal of your policy to do so
- > If you have a business continuity plan (BCP), ensure it is updated to reflect current supply chain disruptions and lead times for replacement equipment and stock. These are likely to have changed since the policy was established/last reviewed
- > Consider having a professional valuation undertaken of your buildings. We have partnered with RICS accredited specialist companies who offer rebuild cost assessment options to suit your specific needs

If you have any questions about your policy and you are concerned you maybe underinsured, please contact your usual PIB representative.