Coinsurance

The term coinsurance has a variety of meanings within the insurance industry. Here, we'll focus on the role it plays in Commercial Property insurance, specifically on Building, Business Personal Property and Business Income coverages.

Building and Business Personal Property

With respect to Building and Business Personal Property, coinsurance is a condition that requires the insured to carry a specified percentage of the covered property's value. This percentage, known as the coinsurance percentage, is shown in the declarations of the policy. Let's explore a few real world examples of how this is applied.

If the amount of insurance is less than the required percentage, loss payments are typically reduced and calculated based on the following formula:

$$Loss\ Payment = \left(\frac{Amount\ of\ Insurance\ Carried}{Amount\ of\ Insurance\ Required} \times Loss\right) - Deductible$$

In this calculation, the amount of insurance required is the property's value immediately before the loss occurred, multiplied by the coinsurance percentage.

Real World Example

Value of the covered building at time of loss	$200,000
Limit of insurance	$140,000
Coinsurance percentage	80%
Amount of loss	$40,000
Deductible	$1,000

At the time of loss, the amount of insurance required is calculated by multiplying $200,000 (value of the covered building at the time of loss) by 80% (the coinsurance percentage), which is $160,000. Since the limit of insurance was $140,000, the amount of insurance carried does not meet the coinsurance requirement, and the loss payment is adjusted using the formula as follows:

= ($140,000/$160,000×$40,000)-$1,000
= (0.875×$40,000)-$1,000
=$35,000-$1,000
=$34,000

If the amount of insurance is equal to or greater than the required percentage, a covered loss will be paid in full, subject to any applicable deductible.

Real World Example

Value of the covered building at time of loss	$200,000
Limit of insurance	$190,000
Coinsurance percentage	80%
Amount of loss	$40,000
Deductible	$1,000

At the time of loss, the amount of insurance required is calculated by multiplying $200,000 (value of the covered building at the time of loss) by 80% (the coinsurance percentage), which is $160,000. Since the limit of insurance was $190,000, the amount of insurance carried meets the coinsurance requirement, and the loss payment does not need to be adjusted, other than applying the deductible.

Business Income

While the concept of coinsurance for Business Income is similar to that of Building and Business Personal Property, the basis for coinsurance is not the value of property, but rather the projected net income plus continuing operating expenses of the insured expected for the policy year.

As was the case for Building and Business Personal Property, if the amount of insurance for Business Income is equal to or greater than the required percentage, a covered loss will typically be paid in full, subject to any applicable deductible.

If the amount of insurance for Business Income is less than the required percentage, loss payments are typically reduced and calculated based on the following formula:

$$Loss\ Payment = \left(\frac{Amount\ of\ Insurance\ Carried}{Amount\ of\ Insurance\ Required} \times Loss\right) - Deductible$$

Real World Example

Net income plus continuing operating expenses	$500,000
Limit of insurance	$300,000
Coinsurance percentage	80%
Amount of loss	$100,000
Deductible	$2,500

At the time of loss, the amount of insurance required is calculated by multiplying $500,000 (net income plus continuing operating expenses) by 80% (the coinsurance percentage), which is $400,000. Since the limit of insurance was $300,000, the amount of insurance carried does not meet the coinsurance requirement, and the loss payment is adjusted using the formula as follows:

= ($300,000/$400,000×$100,000)-$2,500
= (0.75×$100,000)-$2,500
=$75,000-$2,500
=$72,500

Real World Example

Net income plus continuing operating expenses	$500,000
Limit of insurance	$475,000
Coinsurance percentage	80%
Amount of loss	$100,000
Deductible	$2,500

At the time of loss, the amount of insurance required is calculated by multiplying $500,000 (net income plus continuing operating expenses) by 80% (the coinsurance percentage), which is $400,000. Since the limit of insurance was $475,000, the amount of insurance carried meets the coinsurance requirement, and the loss payment does not need to be adjusted other than applying the deductible.

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