BOARD OF CONTRIBUTORS Being overinsured or underinsured wastes premium dollars

Insurance coverage should match main risks, liabilities

Commentary by Robert Friedman

Everyone is looking to trim costs in this economy, and insurance is a significant business expense. Most businesses are both underinsured and overinsured at the same time, leading to a waste of premium dollars and potential gaps in coverage.

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To efficiently buy insurance, companies need to appropriately match their insurance with their main risks and liabilities. And to reduce premiums companies should choose policy deductibles that are as high as possible while maintaining adequate reserves to pay claims within the deductible. Liability limits should be sufficient for realistic worst-case scenarios and property coverage limits should be within current property valuations.

CONTRACTUAL COMPLIANCE

A good insurance broker can provide benchmarks to ensure that a company's coverage limits are within a range of coverages purchased by peer companies. But all companies have unique liabilities and legal obligations. One area that can be overlooked is ensuring that insurance coverages comply with insurance requirements in commercial contracts. Insurance requirements are often found in leases, supplier agreements, construction contracts, mortgage and loan documents and various indemnity agreements. These contracts must be reviewed in conjunction with an insurance review that ensures that the company is in compliance with

its contractual obligations. Failure to comply with contractual insurance requirements may constitute breach of an important contract. In the event of a casualty, the breaching party may be forced to self insure beyond its expectations — and ability to pay.

The right contractual insurance requirements clause can be an effective tool that allows companies to save money on their own insurance premiums by taking advantage of other companies' insurance. By using contract language that requires the company to be added as an additional insured on another company's policy, a business can secure a secondary source of insurance protection without paying an additional premium. Better yet, if the language requires the additional insured coverage to be primary and non-contributory, a company can avoid having to use its insurance altogether.

Requiring certificates of insurance from business partners before a contract is signed will help ensure that the partner has purchased the requisite insurance. But certificates of insurance do not confer rights, and often are erroneously issued by brokers, so it is always best to request and review copies of the policies themselves.

Insurance coverage plays an important role in backing up contractual indemnity promises. In this economy it should not be assumed that the required insurance has been purchased or that your business partners can afford to indemnify you out of their own pocket if they have failed to purchase adequate insurance.

CLOSE GAPS

Companies should also make sure that they are not leaving themselves exposed to liabilities due to gaps in coverage. Although comprehensive general liability insurance covers companies for liabilities they face due to bodily injury or property damage claims, specialized policies or endorsements are needed for other liabilities. Common examples of claims for which companies may have gaps in coverage are employment claims, intellectual property disputes, and claims or regulatory action due to data breaches and privacy violations. In addition, although most standard insurance packages include some fidelity coverage in the event an employee embezzles money or otherwise commits crimes against the company, standard crime limits are often insufficient to cover a large theft. Crime and fidelity claims have increased in recent years given the soft economy, and these risks warrant particular attention in this economic environment.

From a property insurance standpoint, companies often overlook ordinance and law coverage, which reimburses a company for the cost of bringing a building up to code in the event the building needs to be substantially or completely rebuilt. Companies should also make sure that they have sufficient business interruption insurance, which pays for lost profits and reimburses normal operating expenses if the company is unable to operate after a fire, hurricane, or other casualty.

One way to reduce property insurance premiums is to have property values reappraised based on current market conditions. Property insurance premiums typically are calculated based on the replacement cost of the structure. Property values and construction costs have declined significantly in recent years. Policyholders who have not reassessed their properties in the last five years likely are paying higher premiums than necessary.

DON'T UNDERSTATE VALUES

Companies should not intentionally understate property values, as that would subject them to a co-insurance penalty that can significantly reduce coverage limits in the event of a loss. But businesses should make sure they are not needlessly paying extra premiums for property insurance limits that they could never reach, even in the event of a total loss. In particular, master condominium association policies and builder's risk policies on stalled projects may contain inflated insurable values. Business income limits may need to be adjusted downward as well, if a company's revenues and profits have suffered significant declines.

Every company's property portfolio and liability profile is different, so it is important for businesses to work with their brokers and coverage counsel to ensure that they have an appropriate amount of insurance. Premium dollars likely can be put to better use in protecting a company against risks which, in this shaky market, can push a floundering company over a financial cliff.

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