

Transcript: 2008

# Underinsurance “It may happen to you”

Duration:  
11 min 17 secs

Date of release:

File size:

## LEANNE KORTE - ZURICH FINANCIAL SERVICES

Hi I'm Leanne Korte from Zurich Financial Services.

Dr Allan Manning has worked as a Chartered Loss Adjuster for 25 years.

During his many visits to businesses who have suffered a loss, such as a fire or storm damage, he's become aware that many business owners don't know what it means to be properly insured, and that in the event of an incident, a large number of these businesses are unable to rebuild and forced to close their doors for good.

Although they have insurance, the sum insured is often insufficient to cover the costs of rebuilding the business, or they simply didn't have a business interruption policy at all.

Shortly I'll be talking to Dr Allan Manning about under-insurance, But first let's take a look at the following TV News footage, which shows we should all, be aware.... It can happen to anyone!

Video of ABC news covering a factory fire in Queensland

## NEWS READER INTRODUCTION

Twenty Gold Coast workers are facing an uncertain future after two large factories were gutted by fire. It's believed chemicals started the blaze at Yatala the damage bill is more than two million dollars

## VIDEO

## REPORTER

Plumes of thick black smoke billowed into the sky as two family businesses were destroyed. Forty fire fighters rushed to the souvenir factory and stationary supplier. The fire so intense they were forced to battle it through doorways and holes they cut in the walls

## FIREMAN INTERVIEW

Unfortunately the fire spread quite rapidly through the building and we had the whole building involved when fire fighters started active fire fighting.

## REPORTER

Ten people were working in the factory when the fire broke out. After running to safety they watched heartbroken

**DAVID NASRAWI (BUSINESS OWNER)**

I've seen it a lot on TV and I never thought it would happen to me...and here I am watching my factory go to pieces.

**ENDS**

**VIDEO OF ALLAN MANNING ON THE SAME SITE 18 MONTHS LATER**

We have just witnessed the video of this graphic fire which occurred some 18 months ago at this site. You have probably seen it yourself in your own neighbourhood where a business has gone up in smoke and many many months later it's standing there unoccupied. Why is it so? We have full insurance in this country we should be able to rebuild quickly and get on with our lives. This video clip is going to discuss why so many businesses don't survive.

**CLIP ENDS**

**LEANNE**

Allan, that is a very sad story.

Now I gather you are not in a position to comment on the particulars of that incident, but can you give us a general idea on how businesses usually fare after a large loss like we have just seen.

**ALLAN**

My research shows that about 50% of the businesses fail which is really quite sad as you say. When people have spent their life building up that businesses invested in it so heavily, so passionately then it all to go up in smoke.

**LEANNE**

So is it only just fires?

**ALLAN**

No, it's not just fires. Storms are another big factor, but it can be impact, aircraft, earthquake we have all sorts of things happening in Australia.

**LEANNE**

So how and why is it that so many businesses don't survive?

**ALLAN**

The major issue is, in a nutshell, under-insurance.

People just don't invest enough in protecting their business, making sure they have the right cover with the right insurance cover. It amazes me that people go out and buy a lottery ticket every Saturday thinking they will make it big. They don't take the time to make sure that they are going to protect their business. Thinking that it will never happen to them. Statically there is a much greater chance of their business having a fire tonight than them winning the lotto. When you think how hard people have worked to build up their business, you would think they would take a little more time to protect it correctly.

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### **LEANNE**

So the first point to take away from this video is that there is a real need for insurance because it can happen to them.

### **ALLAN**

That's right Leanne.

It's not just any insurance though. You get what you pay for you need to have a quality product that's going to really protect the business.

### **LEANNE**

I suppose many people think insurance is like a generic product that is all the same.

### **ALLAN**

That's right. But Insurance is not like soap. It's not taught in school and there is major differences between the products.

### **LEANNE**

Besides understanding the need for quality insurance, is there anything else?

### **ALLAN**

The next thing is to have an adequate sum insured.

So many business owners in Australia think that all they need to do is pick a sum insured and they will be able to claim the full amount up to that sum insured. That's not the way the policy works. Most policies in Australia, when you insure buildings, machinery and plant, stock, business interruption or any other contents in the business, then when there is a claim you've got to be insured fully otherwise there will be some test for co-insurance and a penalty applied if you are not fully insured. And that will happen for any claim over 5% to 10% of the declared value.

### **LEANNE**

Right so, even for a partial loss, the business may be asked to meet part of the loss themselves?

### **ALLAN**

That's right Leanne,

Let's assume that a client owns the building worth a million dollars and they insure it for half that \$500,000.00.

That means they are taking the risk for 50% themselves. The insurance industry is a bit generous and they'll let the client be 20% under insured under a business pack.

So when it comes to a claim say when the building was damaged in a storm for say \$300,000.00

The client would get the sum insured over 80% of the value at risk times the loss. That's \$500,000 the sum insured over 80% of the value at risk, one million dollars times the loss of \$300,000.00. That means the client gets 62.5% of \$300,000.00 or \$187,500. So the insurer would pay that amount and the insured would be left with an uninsured loss of \$112,500. The business owner has to work out how they are going to fund that. What the client has to do is set the sum insured adequately for the full replacement value of the assets or the full gross profits of the business, if it's insured under business interruption so they don't get caught with that test. The trick is though; it's not just a one off test. You have to do it every single year because

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the way prices increase.

### **LEANNE**

So is this cost escalation a big issue?

### **ALLAN**

It's a huge issue. I did some work with Zurich. And looking at their policies only one policy in four gets reviewed in a year. Over a three-year cycle less than 50% of sums insured are increased.

Now, let's have a look at those costs over the last three years the construction costs of buildings have gone up over more than 20% in most states, in states like Queensland and Western Australia where there has been a mining boom it's well over that it's more than 30%. The reason for that is that steel, a major component of modern building construction has gone up 30% in the last 12 months alone. Concrete's gone up \$8 a cubic metre. Plastic products have gone up inline with petroleum products. On top of that you've got freight cost increasing and the increasing costs of labour. That what's brought this huge increase in costs coming around and if people haven't reviewed their insurance for three years then they are going to be caught for sure with under insurance.

### **LEANNE**

So this means that the premium does not always equal the total cost of risk to the business.

### **ALLAN**

You hit one of the biggest urban myths that there is out there.

Insurance premiums are not the total costs of risk. Insurance premiums are the price of risk transfer. When you are in business there are many, many risks that you encounter. Some you insure, some you don't. Some you can insure, some you can't.

As I say, premium is just the cost of risk transfer; the total cost of risk is claims that are not paid because of a deductible.

Claims that are not paid because you don't have the cover in place.

Claims that are not paid because of under insurance. You can go further than that. It's the cost of risk management inside the business and it can go right through to the loss of brand reputation. These things are the total cost of risk.

### **LEANNE**

So it is false economy buying insurance on price.

### **ALLAN**

It certainly is! For a business paying the premium is something they can budget for and it's also a tax deduction. When they don't insure something and something happens that's a risk that they alone bear. And Murphy's Law is alive and well and certainly something will happen when they least expect it.

### **LEANNE**

Protecting the physical assets of the business is one thing. The other is protecting the bottom line.

Now I understand that only around 40% of the fire polices with Zurich have attaching Business Interruption insurance.



**ALLAN**

While that statistic is very low Zurich's proportion of policies is in fact higher than the industry's average. That's because at Zurich you only deal with intermediaries.

**LEANNE**

How many do have business interruption insurance?

**ALLAN**

Zurich carried out some very good research in this area and they found that 23% of SME business operators have never heard of it.

Another 43% had heard of it and thought it was not necessary for their business.

I really find that heartbreaking, as I know that without it the business has very little chance of surviving a major loss.

**LEANNE**

So can you explain how the policy works?

**ALLAN**

Business interruption insurance continues to pay the expenses of the business that continue after the event,

The big ones here are the wages of the owners and employees and just as important the ongoing financing costs.

It also meets the cost of new expenses not normally paid, which are required to allow the business to recover. These are things such as relocation, extra rent,

Air freighting new stock or equipment,

Overtime and a whole raft of similar expenses. Finally it protects the net profit of the business. This means the lifestyle of the owners, management and employees is protected.

But to obtain the full benefit, the Indemnity Period, or period the policy will protect the business must be long enough.

However it's not all doom and gloom -

While the man in the video clip didn't own the building, and he never thought it would happen to him, he did have the good business sense to engage a good insurance broker, and working together, he had adequate property and business interruption insurance.

And as a direct result of that, his business survived.

**LEANNE**

Well thank you Allan for your valuable insights and let's hope today we've helped business owners avoid the pitfalls of underinsurance.

**ALLAN**

Be really great if we did. Thank you very much.

We've only touched on a few of the major points about under-insurance today. And I'll just quickly wrap them up for you.

So... Clients need to understand that insurance should not be seen purely as a cost, but a protection for their business, and that business risks are very real.

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- \* They should understand the significance of adequate sums insured and the consequences of being under-insured.
  - \* That it is vital to review sums insured on an annual basis.
  - \* And that business interruption insurance is likely to save their business in the event of a major loss.
- Thank you for your time.

Ends

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