Co-Insurance

Co-insurance is arguably one of the most confusing and frequently misunderstood concepts in the world of insurance. Some people think it is a way around paying full price for their insurance. Others think that if they have co-insurance, that the insurance company will never have to pay out the full amount of their loss. The answer to both of these statements would be true, but false. To understand co-insurance better we need to understand its intention.

"It's a way to avoid paying full price on insurance"
Co-insurance means that the policy is permitted to carry only a percentage, usually 80-90%, of the buildings full replacement value. This is where the illusion of avoiding full price comes from. But of course, as expected, there is a price to be paid for the savings, and that is one of self-insurance in the event of a loss. Self-insurance works similar to that of the deductible concept whereas the policyholder is responsible for paying for a portion of the loss. The difference is that a deductible is a fixed amout and applies to all losses, where co-insurance is a percentage and varies based on the amount of loss, the replacement value of the building at the time of loss, and the amount of coverage purchased.

"The insurance company never pays out the full amount of a claim"
Co-insurance in its simplest definition is a math formula: "Did" divided by "Should" times "Loss". For example a policyholder owns a building with a replacement value of $500,000. The co-insurance requirement is for 90%.

<u>Example 1</u>) Insurance carried for $400,000
Claim submitted for $300,000

Did = $400,000
Should = $500,000 x 90% ($450,000)
Loss = $300,000

$400,000
----_------ X $300,000 = $266,667
$450,000

In this example the insurance company would pay $266,667 and the policyholder would pay the remaining $33,333

<u>Example 2</u>) Insurance carried for $450,000
Claim submitted for $300,000

Did = $450,000
Should = $500,000 x 90% ($450,000)
Loss = $300,000

450,000
---------- X $300,000 = $300,000
450,000

In this example the insurance company would pay the full loss as the policyholder has met the co-insurance requirement

<u>Example 3</u>) Insurance carried for $450,000
Claim submitted for $500,000 (total loss)

In this example the formula for did/should x loss does is not used as the loss exceeds the amount of coverage purchased. When a policyholder purchases an amount of insurance less than what would be needed to pay out a total loss, then s/he would be responsible for the loss amounts in excess of his policy face value.