

The Coinsurance Clause in Fire Insurance

Paper read by Mr. Fred A. Burgess, Manager of the Insurance Department of Messrs. Waghorn, Gwynn & Co., Limited, of Vancouver, before the Insurance Institute of Vancouver, on February 11th, 1918.

The percentage of coinsurance principally used in fire insurance is 80%, and the clause is usually worded as follows:

"It is a part of the consideration of this policy, and the basis upon which the rate of premium is fixed, that the insured shall maintain insurance concurrent in form with this policy, on each and every item of the property hereby insured, to the extent of at least 80 per cent. of the actual cash value thereof, and that, failing so to do, the insured shall be a coinsurer to the extent of an amount sufficient to make the aggregate insurance equal to 80 per cent. of the actual cash value of each and every item of the property hereby insured, and, in that capacity, shall bear his, or her, or their proportion of any loss that may occur."

To this clause is generally added the following:

"In the event that the aggregate claim for any loss is less than \$2,500 (provided, however, such amount does not exceed two per cent. of the total amount of insurance upon the property described herein and in force at the time such loss occurs) no special inventory or appraisal of the undamaged property shall be required."

The 80% coinsurance clause is an obligation on the part of the assured to maintain insurance during the currency of the policy equal in amount to at least 80% of the actual value of the property insured. The fixing of values in advance—i.e., at the time of the effecting of the insurance—as a basis for the settlement of the loss in connection with this clause, is not sufficient. In the actual settlement of losses account must be taken of changes in values, by reason of increased or decreased cost of materials or labor or depreciation through age, use or fluctuation in market prices of commodities. A revaluation of buildings or plants after a term of years, and stocktaking at least once a year, or at seasons when stock fluctuates should therefore be recommended.

The 80% coinsurance clause would not affect the settlement of a loss under a policy in the following cases:

1st. When the property insured is totally destroyed, as the full amount of insurance would be paid upon satisfactory proof of such total loss.

2nd. When the property is insured for not less than 80% of its actual cash value, whether the loss be total or partial.

A percentage coinsurance clause affects the settlement only when both the amount of the loss and the percentage of insurance carried to value are below the coinsurance percentage stated in the policy as per the following example:

Assured sustains a loss of \$400 on property worth at the time of the fire \$1,000. He holds a policy for \$700 subject to the 80% coinsurance clause.

Sound value of the property at the time of fire.....	\$1,000
Amount of insurance required under the 80% clause.....	800
Amount of insurance actually held.....	700
Showing a deficiency (which is the amount the assured contributes on as a coinsurer) of.....	100

The loss, amounting to \$400, is apportioned as follows:

The company insured \$700 and contributes 700/800ths of the loss	\$350
The assured is a coinsurer for \$100 and contributes 100/800ths of the loss	50

Showing the assured a loser by \$50 for not having maintained insurance up to 80% of the value, as agreed upon under the 80% coinsurance clause.

One of the first features noticed by the underwriter in examining a report of a policy issued on a building of ordinary, substantial or fire resistive construction is whether

the contract carries a coinsurance clause, and this also applies to risks on stocks or to special hazards, after the commercial rating of the assured has been accepted as passable.

It will thus be seen that from the standpoint of the insurance company coinsurance is considered one of the most important features in the contract, and it naturally follows that there must be sound reasons for this. If you will kindly bear with me and not be too critical I shall endeavor in as simple a way as possible to elucidate.

I will take a simple example of a building which we will say for the sake of argument is not encumbered in its revenue producing career by a mortgage and therefore not compelled to carry insurance at all. Our good friend the owner finds he has a very valuable piece of ground in the heart of this city and decides to erect a fine building of such construction and appearance as to last many years and thus insure tenantry. He studies the fire-fighting apparatus, water supply and personnel of the city's fire department and decides that on account of the class of exposing buildings and the class of any new ones likely to be erected, he does not believe his block will have one chance in a hundred of being totally destroyed or even damaged to a very high percentage by fire. Like every other human being he wants a very low rate of insurance, claiming that on account of the superior construction of his block and of those blocks exposing, his building cannot be totally destroyed by fire. He obtains his very low rate, not only because he wants it, but because the system of rating gives it, and then proceeds, after being canvassed very ardently, to place an amount of insurance, say \$30,000, which, to his mind, is about the maximum amount of damage which could be done before the city's department extinguished a fire. The agent may be successful in persuading his company, he tries hard anyway, and succeeds if the company represented by him is hungry for premiums or is new in the agency and wants to cultivate it, to write the risk. The company will, no doubt, be in receipt of some very nice letters telling it how to properly underwrite and what a nice lot of new risks it will get if it takes this line; but on the other hand the owner of the building will be probably told by the agent that he is in receipt of a letter from his company to the effect that it does not care to only insure the painting, wood trim, glass and frescoe work of the building without insuring the rest of the structure. This argument or stand of the company is no doubt considered by the owner to be unreasonable and befogging, but the agent says the company knows that its stand is not clear to the owner but if he will agree to insure his block up to 70, 80 or 90% of the value and maintain that amount of insurance they will give him certain percentages of reduction from the very low rate which the owner at present enjoys. The owner argues in vain and has in mind that he probably will start an insurance company some day and run it properly.

In 1902, after several years of labor, a committee of thirty-four eminent fire insurance men of the United States closed its work of endeavoring to form what was called a Universal Schedule. This committee went into the question of coinsurance very carefully, and in the Universal Schedule the reasons for the coinsurance clause from the companies' standpoint are carefully set forth and give a clear conception of the why of coinsurance and the reduction of rate therefor.

The experiences of companies as to the distribution of losses according to percentage of value in fire department cities is about as follows:

68% are under \$100 in amount.

15% are over \$100 and under 25% of the value of the property.

7% are between 25% and 50% of the value of the property.