INSIGHT 02

HOW UP-TO-DATE PROPERTY VALUATIONS HELP SAFEGUARD INSURANCE COVERAGE

In our latest insight, we discuss the importance of up-to-date property valuations and the critical impact they can have on insurance coverage. CoverageClubb are delighted to have collaborated with Richard Shreeve, Executive Director – Valuations & Analytics EMEA at John Foord to discuss the important role independent valuation companies play in the insurance product life cycle.

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THE BACKGROUND

In the world of property insurance, up-to-date and accurate property valuations are critical for ensuring appropriate insurance protection and avoiding financial pitfalls. The valuation of insured property directly influences the levels of coverage, program structure and the indemnity received in the event of a claim.

This insight explores why maintaining up-to-date property valuations is vital, examines the impact of underinsurance and overinsurance on claims settlements, and discusses coverage developments in the specialty insurance market that ensure adequate property values can be demonstrated by Insureds.

THE IMPORTANCE OF UP-TO-DATE PROPERTY VALUATIONS

Up-to-date property valuations provide a reliable basis for determining the sums insured, ensuring that coverage aligns with the true value of the property, and can help ensure that the values align with the basis of settlement / basis of indemnity / basis of valuation / basis of reinstatement clause contained in the policy wording.

Property valuations establish a clear understanding between the Insured and the Insurer about an asset’s worth. This clarity becomes crucial when claims are made, as it can help to minimise disputes and can help to ensure fair outcomes for all parties involved.

Conducting regular valuations helps avoid reliance on outdated or inaccurate figures, which could leave Insureds vulnerable to financial loss or excessive costs. Up-to-date property valuations also reflect changes in market conditions, inflation, labour costs, and improvements to the property, keeping coverage aligned with the real-world value.

LMA5514 – PROPERTY DAMAGE VALUATION AND AVERAGE CLAUSE

An effort in recent years to encourage Insureds to undertake regular property valuations came in the form of the issuance of the Property Damage Valuation and Average Clause, LMA5514 in November 2020 by the Lloyd's Market Association's (LMA) Onshore Energy Business Panel.

The LMA5514 outlines that it is *"the expectation of (Re)Insurers that the (Re)Insured is able to demonstrate adequate property values which are mutually agreeable and in line with the basis of valuation within the policy".* The LMA5514 also outlines how such adequacy is expected to be achieved *"by conducting periodic valuations of Insured Property and subsequently annually taking into account any other relevant factors, including but not limited to addition and removal of assets, inflation, and industry cost indices".*

In cases where there is no mutually agreed property valuation, an independent valuation is required, utilising the services of a valuation company that is acceptable to Insurers. Until such time the updated values are endorsed to the policy, an Average Clause applies, proportionally reducing payouts if the insured property values are below actual property values.

JOHN FOORD'S VALUATION SERVICES

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One such independent valuation company is John Foord, which provides insurance focused valuation services to Insureds on a global basis. Their industry specialised valuers are able to support insured parties and stakeholders in assessing their assets and ensuring that accurate values are provided as part of the insurance process.

Common challenges affecting accurate sums insured include reliance on outdated asset registers or net book values that fail to reflect current market conditions, the use of generalised indices or factors leading to underinsurance or overinsurance, and inconsistent asset data, often including data obtained from third-party sources or data that accompanies the transaction of recently acquired assets. Additionally, the Insured's internal teams often lack the depth of expertise required to accurately assess replacement costs for insurance purposes, leading to misalignments between perceived asset knowledge and true reinstatement values.

Valuations can be undertaken using various approaches, including analytical solutions, desktop assessments, and site surveys, depending on the Insured's specific requirements. In addition to reinstatement cost valuations, John Foord provides specialist valuations such as those for asset retirement obligations, decommissioning, and agreed value assessments.

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CONSEQUENCES

UNDERINSURANCE

Underinsurance occurs when the sum insured is less than the actual value of the property. In this scenario, Insureds face significant challenges:

1. Reduced Claim Payouts:

If the policy includes an Average Clause (or Coinsurance Clause), this will proportionally reduce claims settlements if the property is underinsured. For example, if a property is insured for 50% of its actual value, any claim payout would also be halved. In addition to an Average Clause, depending on the prevailing law and jurisdiction applicable to the policy, other remedies may be available to Insurers in cases of underinsurance.

2. Financial Vulnerability:

Insufficient insured values leave Insureds bearing a substantial portion of the repair or replacement costs in the event of a claim, potentially causing severe financial strain.

3. Breach of Policy Requirements:

Failure to insure for the full value might violate policy terms and conditions, complicating the claims settlement process or leading to policy cancellation.

OVERINSURANCE

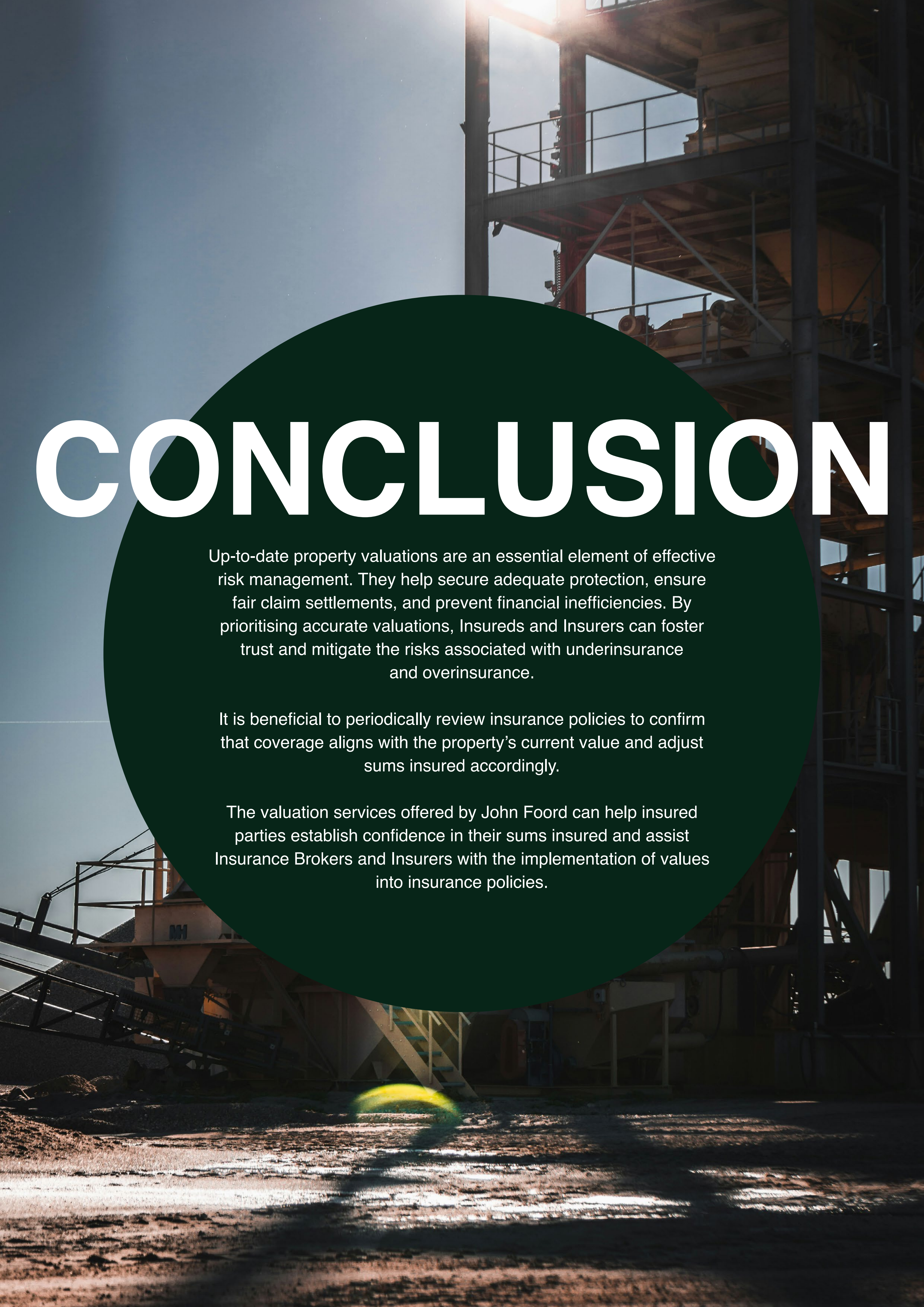
Conversely, overinsurance arises when the sum insured exceeds the actual value of the property. Consequences of overinsurance include:

1. Excessive Premiums:

Insureds may pay higher premiums without the potential for increased claims payouts.

2. Misallocation of Resources:

Overinsurance diverts funds that could be better utilised elsewhere, such as risk mitigation or asset improvement.



CONCLUSION

Up-to-date property valuations are an essential element of effective risk management. They help secure adequate protection, ensure fair claim settlements, and prevent financial inefficiencies. By prioritising accurate valuations, Insureds and Insurers can foster trust and mitigate the risks associated with underinsurance and overinsurance.

It is beneficial to periodically review insurance policies to confirm that coverage aligns with the property's current value and adjust sums insured accordingly.

The valuation services offered by John Foord can help insured parties establish confidence in their sums insured and assist Insurance Brokers and Insurers with the implementation of values into insurance policies.

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