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## Co-Insurance: What is it and how does it work?

Most commercial policies covering property (Building, Stock, Equipment, and Business Interruption) contain the following clause or similar clauses known as the **Co-insurance Clause**:

*The Insured shall maintain insurance concurrent with this form on the property insured to the extent of at least the Co-insurance percentage stated in the Declarations (face page of your policy) of the actual cash value thereof, or as modified by the new replacement cost endorsement, and, failing so to do, shall only be entitled to recover that portion of any loss that the amount of insurance in force at the time of loss bears to the amount of insurance required to be maintained by this clause.*

The Co-insurance percentage is usually stated as 90% for building stock and equipment; and 50%, 80%, or 100% for business interruption.

### What Is It?

The **Co-insurance Clause** requires you to insure for the amount of insurance equal to the percentage stated in your policy. If 90% is shown, you should be insured for at least 90% of the value of your property. This clause allows the insurance company to penalize you for under-insurance by making you responsible for the amount of the shortage. For example, if you were insured for 50% of the value of your property and you have a partial loss, the insurer will penalize you and will not pay your loss in full.

### How Does It Work?

In the course of investigating and settling a loss, an adjuster will determine if you have purchased a sufficient amount of insurance to comply with the Co-insurance requirement.

If you fail to do so you will receive less than the full amount of your loss. If you comply with the Co-insurance requirement you will receive full

compensation up to the amount of coverage, subject to the applicable deductible or other limitations contained within your policy.

The following formula is used to calculate the amount of payment on a claim with the application of the Co-insurance clause (Co-insurance percentage of 90%):

$$\frac{\text{What you did insure for}}{\text{What you should insure for}} \times \frac{\text{amount of loss}}{\text{amount you receive}} = \text{amount}$$

Using an example of a building valued at \$350,000, 90% Co-insurance clause with an amount of Insurance on the policy of \$200,000 and a loss valued at \$100,000, the calculation would be:

$$\frac{\$200,000}{\$315,000} \times \$100,000 = \text{Settlement } (\$63,492) \text{ (90\% of } \$350,000)$$

You will only receive 63.5% of your loss as you're insured for 63.5% of the required amount of insurance. Keep in mind that you can never collect more than the amount of your insurance. So in this example, if insured for 90% and you sustained a total loss (\$350,000), you could only collect \$315,000. This is why it is better to insure 100% of your property, rather than 90%.

If the amount of insurance was \$315,000 or more, the full amount of the \$100,000 loss would have been paid by your insurer. To under-insure or to be unaware of your insurance to value requirements can be a disastrous mistake for the future of your business.

At HED Insurance, we review your coverage annually, and strongly encourage you to maintain proper amounts of insurance. Surprises such as under-insurance at a time of loss can affect the profits realized by your business, and depending on the amount of loss, may ultimately impact its survival.