

## THE CO-INSURANCE CLAUSE

### HOW IT WORKS

When an insurance policy is written with a “*co-insurance clause*” the insurer is expecting the client to insure **at least** a minimum amount of the value of the property to be covered. Otherwise, the assured can end up being a *co-insurer* to the loss and therefore pay part of the claim himself.

-**Minimum Limit Required (MLR)** is a percentage (most often 80%) of the actual cash value of the property (which means its reconstruction cost minus depreciation for age).

-**Limit Actually Purchased (LAP)** is the limit of insurance in force at the time of loss

The claim settlement is calculated by reducing the cost to repair the damages by the appropriate depreciation percentage (as we cannot get “new” for “old”), then subtracting the policy deductible, and finally applying the co-insurance clause using the following formula:

$$\frac{\$LAP}{\$MLR} \times \$\text{Amount of loss (minus the deductible)} = \$ \text{Settlement Payment}$$

Therefore if the **Limit Actually Purchased** on a building is \$300,000 and 80% of its actual cash value at the time of loss is calculated to be \$400,000 (**Minimum Limit Required**) and the **deductible** is \$1,000, then the assured would receive the following **Settlement Payments** in the examples shown below:

-If the depreciated cost of the damages are \$45,000:

$$\frac{300000 \text{ (LAP)}}{400000 \text{ (MLR)}} \times (45000 - 1000) = \$33,000 \text{ (settlement payment)}$$

-If the depreciated cost of the damages are \$350,000:

$$\frac{300000 \text{ (LAP)}}{400000 \text{ (MLR)}} \times (350000 - 1000) = \$261,750 \text{ (settlement payment)}$$

-Evidently if the **LAP** is equal or greater than the **MLR** the insurer will pay the full amount of the loss up to the policy limit such as in the next two examples:

$$\frac{400000 \text{ (LAP)}}{400000 \text{ (MLR)}} \times (45000 - 1000) = \$44000 \text{ (settlement payment)}$$

$$\frac{425000 \text{ (LAP)}}{400,000 \text{ (MLR)}} \times (475000 - 1000) = \$425,000 \text{ (Limit of the policy which in effect is the LAP)}$$

**\*Note:** When the policy carries a **Replacement Cost Endorsement** no depreciation is calculated so the **Minimum Limit Required** is 80% of the **reconstruction cost** and claims are paid **without deduction for depreciation**.