

Insurance industry figures show that approximately 40% of South African insurance policyholders are under-insured. This means that a large percentage of consumers are exposed to financial loss in the event of a claim as they risk being paid out only partially for the loss they have suffered as a result of being under-insured.

“Hence, ongoing consumer education on what under-insurance is, the effects thereof, and how insurance companies operate remains integral going forward – and this is where the greatest challenge lies,” says Neil Ashcroft, marketing executive at Centriq Insurance – a specialist insurer with an established presence in the cell captive and alternative risk transfer segment.

“Many consumers don’t realise that insurance companies, like banks, are trustees of public money and simply do not understand that if 100 vehicles, for example, have been insured, and 50 of these vehicles are involved in any form of accident whatsoever, the premiums paid by the other 50 policyholders who haven’t suffered any losses, together with the premiums paid by the 50 policyholders who have suffered motor vehicle damage or losses, are used to settle any valid claims. Hence, by under-insuring any of the vehicles, the pool of funds available to pay for the claims is inadequate and all policyholders ultimately suffer,” he explains.

With this in mind, Ashcroft strongly believes that financial services providers need to continuously update and improve the channels they use to communicate to the public as a whole. “We need to make consumers aware of the reasons why it is crucial for every policyholder to pay a premium in line with the amount of risk he introduces into the pool in order for the afore-mentioned basic insurance principle to operate effectively.”

Thus, if policyholder A owns a building with a replacement value of R1 million, and policyholder B in the same area owns a similar building with the same replacement value, then both policyholders should pay the same premium.

“If policyholders insure their assets for less than their full values and pay less than the premium required to cover that risk, the risk pool cannot be sustainable. Hence the introduction of the average clause, whereby policyholder A, for example, would only be entitled to only claim R500 000 in the event of a loss if he paid a premium based on the fact that he under-insured his building worth R1 million by 50%. Each policyholder is only entitled to a claims payment in line with the percentage of the risk insured and the premium payments he made. As such, the average clause essentially equalises a potential situation in which one policyholder could pay less than their fair share for the risk by being under-insured and receiving the same benefit as a policyholder who has paid a fair share,” he says.

The unfortunate destruction of New York’s Twin Towers is a more dramatic example of the average formula. “While it was in all likelihood a deliberate strategy by the owners of the building to insure the two towers for the value of one in order to save on insurance costs as the probability of something happening to both towers at once was low – they risked only being compensated for one tower – should they not have been able to argue that because of the two planes – the towers were destroyed by separate events.”

Ashcroft notes that overall, under-insurance is more predominant in personal lines than corporate business - the reason being that corporate business insurance policyholders usually have good corporate risk management policies in place which help them to identify, manage and protect their assets more effectively. Many corporate entities also tend to use brokers to evaluate and manage their risk profiles, enabling a more realistic reflection on the replacement values of potential losses, which minimises the risk of being under-insured.

“While under-insurance may be unintentional because consumers underestimate the value or replacement value of their assets and possessions and for this reason insure their household content based on what they think the actual value or replacement value is – the fact of the matter remains that under-insurance is an unintentional consequence of poor risk management or ignorance regarding the valuation method required by the policy.”

He adds that the above-mentioned can be addressed in a more effective manner by means of an obligatory inventory list on insurable goods above a certain value so as to ensure a thorough inventory and valuation of the assets and risks to be insured.

“The values declared to the insurer should be updated at least annually, taking into account issues such as currency fluctuations with regard to imported assets and replacement values that reflect current market conditions,” he says.

Some consumers, on the other hand, intentionally cut on insurance premiums to off-set other expenses. By embodying in our service a survey of assets and values on a regular and more consistent basis – we can add significant value to our customers’ overall insurance experience while mitigating the moral risk of under-insurance,” says Ashcroft

Overall, Ashcroft believes that a lack of understanding surrounding the implications of under-insurance is one of the main reasons for the legacy of mistrust and animosity between the insurance industry and their clients.

In addition, it is important to keep in mind that just as policyholders will avoid over-insurance to ensure they do not pay more than their fair contribution to the risk pool, so insurers must avoid exposing the risk pool to risks for which the correct premiums are not paid,” concludes Ashcroft.