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Underinsurance and average clauses: a costly oversight

Insurance policies contain many moving parts — some of which aren't immediately obvious until a claim is made. One that often catches business owners off guard is the underinsurance clause, also known as an average clause.

Many businesses assume underinsurance becomes a problem only in the event of a total loss. But the average clause applies to partial losses too, meaning any shortfall between your sum insured and your property's actual value can affect your claim.

A recent case before AFCA highlighted this issue: a business owner's property was damaged when a car crashed into it during a police chase. The damage bill came to almost $300,000. However, the property was insured for just $452,000, well below the assessed value of more than $1.8 million. As a result, the insurer applied the policy's underinsurance clause, reducing the payout to only 35% of the repair costs.

The underinsurance or average clause reduces payouts when cover does not reflect current costs. Typically, if the insured amount is less than 80% of the property's true value, the insurer will reduce the claim payout proportionally.

For example, if a property is valued at $1 million but insured for $500,000 and suffers $300,000 in damage, the payout is calculated based on the ratio of the insured sum to 80% of the property's full value, which is a typical threshold in many policies.

Underinsurance can occur for several reasons. Property values may not have been updated to account for rising construction, materials and labour costs. Additional expenses such as demolition, debris removal and professional fees might be overlooked. Or businesses may deliberately select lower sums insured to reduce premiums, without fully understanding the potential financial impact.

The good news is that underinsurance can be avoided with regular reviews. This includes arranging up-to-date professional valuations, factoring in all rebuild-related costs, and reviewing coverage annually to account for business growth, inflation or asset upgrades.

If you're unsure whether your insurance accurately reflects the value of your property or assets, now is a good time to revisit your cover. Ensuring the right sum insured today can prevent unnecessary financial stress in the future.

The risks of splitting your insurance purchases

More businesses are taking an active role in how their insurance is arranged, balancing cost, convenience and coverage. But the latest Vero SME Insurance Index shows splitting insurance between direct purchases and broker-arranged cover is becoming more common, and it may not always deliver the protection businesses expect.

Nearly half of SMEs surveyed for this year's report now manage their insurance this way. It's easy to see why – different providers and channels can offer flexibility, and businesses are often looking to keep premiums competitive.

The index shows clear patterns in how this split typically plays out. Policies such as compulsory third party and car insurance are more commonly purchased direct, while more complex covers – such as property, liability and business interruption insurance – are usually arranged through brokers.

The challenge is that, without a co-ordinated view, businesses may end up with overlapping cover, unintended exclusions or gaps. Fragmented insurance can also limit how effectively policies respond to evolving risks. Emerging exposures such as cyber threats, supply chain interruptions, AI use or the shift to renewable energy don't always fit neatly into traditional categories. A broker is well-placed to assess how these risks intersect with all areas of your business, ensuring nothing slips through the cracks.

Unfortunately, satisfaction levels with brokers have dipped slightly, particularly among smaller businesses and those under financial pressure. But the report also shows that businesses that stay closely engaged with their broker continue to achieve better outcomes. That's because insurance works best when all policies are viewed together, not in isolation.

A strong broker relationship means there's a clear, co-ordinated understanding of how cover fits your business as a whole. Regular conversations ensure advice stays relevant, gaps are identified early, and coverage evolves alongside your operations.

Underinsurance is also raised in the report as an ongoing issue. Less than half of businesses surveyed review their sums insured annually, despite ongoing inflation and rising costs across building materials, labour and equipment. Managing insurance piecemeal can make it harder to see if overall limits still reflect today's operating realities.

The takeaway from this year's report is that it's worth taking stock of how your insurance is structured and whether all parts are working together.

Being prepared to claim when disaster strikes

Natural disasters rarely arrive with much warning, and Ex-Tropical Cyclone Alfred is the latest reminder of how severe weather can wreak havoc, often revealing cracks in preparedness and planning.

It's not just the immediate damage that catches businesses off guard. The claims process that follows can be equally stressful – particularly when there's uncertainty around what to do next.

Insurance plays a vital role in protecting against financial loss, but knowing how to navigate the claims process can relieve pressure in moments of crisis.

It's often during the claims process that gaps in preparation or documentation become obvious. Missing information, unclear records or misunderstandings about policy coverage are some of the most common reasons claims get delayed or disputed.

Fortunately, there are steps businesses can take well before an incident occurs that will make things much easier in the event of a claim.

Clear, detailed records are crucial. Keeping an updated inventory of assets, along with supporting documents such as receipts, valuations and photos, helps ensure you have evidence ready when it's needed. It's also worth making sure key business documents – including insurance policies – are stored securely and are accessible.

Understanding the details of your policy is another important step. Knowing exactly what's covered, what's excluded and where limits apply means you won't face unexpected delays or surprises when it's time to lodge a claim. This includes understanding additional areas such as business interruption cover, which can help protect your operations while repairs are under way – a critical safeguard for many businesses.

When the unexpected does happen, acting quickly but safely is key. Once everyone is safe and the immediate danger has passed, securing the premises and preventing further damage can help support your claim. Taking photos of damage, gathering any relevant reports and documenting key details while they're fresh will also smooth the process.

Importantly, your broker is there to assist. Engaging us early means we can guide you through each step, liaise with the insurer on your behalf, and help ensure your claim is handled efficiently. We can also advocate on your behalf if complications arise, helping to resolve issues and keeping the process on track.

Taking a few simple steps now to review your records, policies and processes can reduce stress and disruption down the track.

Using the market shift to strengthen your cover

While conditions vary across lines of insurance, some commercial classes are beginning to show signs of softening. That means insurers are becoming more competitive on pricing and, in some areas, more flexible with coverage and terms. For businesses, this creates an opportunity to reassess and improve their insurance position.

Insurance pricing moves in cycles. In a hard market, premiums rise, capacity tightens and underwriting becomes more selective. In a soft market, the reverse tends to occur: there's more capacity, premiums often ease, and insurers may be more open to negotiating terms or broadening cover. For some commercial risks, that shift is already under way.

For businesses, this can be a good time to revisit the structure of your insurance program. It might be possible to increase limits that were previously scaled back, negotiate broader cover, or review exclusions and sublimits that may no longer be fit for purpose. These details – often overlooked at renewal time – can make a significant difference when it comes to claim time, affecting how much you're paid or whether a claim is covered at all.

You may also be in a position to lock in favourable terms through longer policy periods or continuity clauses – options that are harder to come by in a harder market. This can provide some premium stability and stronger negotiating power in future cycles.

With more flexibility in the market, there's also scope to align your insurance more closely with your business strategy. This could mean expanding cover to support new service lines, assets or supply chain risks that may have emerged in recent years. Businesses that have grown rapidly or made changes to their operations may find this a particularly useful time to review and refine their cover.

Of course, lower premiums can be an appealing motivator, but it's important not to chase price at the expense of protection. Cover that doesn't respond when needed can end up costing more in the long run. That's where we can add value: helping you take advantage of market conditions without losing sight of your overall risk position. We can also help anticipate how your cover might need to shift again when the cycle turns.

As the market evolves, it's worth taking a strategic view of your cover; not just renewing what you had last year but using this window to strengthen your protections for the year ahead.

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