

TECHNICAL BULLETIN - DAY ONE BASIS

I thought I would write a short note on the matter of "Day One wordings" as I think it's an area that is much misunderstood. We frequently get asked to write business on a day one basis with a 30% uplift, which in the current economy and low inflation makes no sense to us at all. I think Brokers generally think this gives their clients better protection against under insurance, whereas it actually does the opposite.

The concept of "Day One" wordings and the high uplift was born in the seventies as a result of the rampant inflation the world and the UK in particular was suffering at the time. Unfortunately, I was in my youth at the time so I remember it well. The problem was that even a conscientious Client insuring for the correct sum insured when they took out the policy couldn't be certain that would be sufficient when it came to actually rebuilding, bearing in mind that the loss could occur on the last day of the policy period and could take a year or more before completion of a rebuild. i.e. two or more years inflation would be effecting the cost of the rebuild.

I have looked at several day one wordings and they all require the value at "Day One" to be correct and apply average on the basis of that sum insured. i.e. they over-ride the standard average clause in the policy. So, if a client insures a building that would cost £1,000,000 to rebuild for a sum insured of £900,000 and suffers a partial loss of £500,000 after 6 months and lets assume building inflation runs at an annual rate of 3% the loss would be adjusted as follows:

Cost to rebuild £1,015,000 (£1m x 3% x 6/12ths).

Sum Insured £913,500 (£900k x 3% x 6/12ths). The wording allows for annual inflation up to 30%.

"Day One" Average	Sum Insured	900,000	} x £500,000 = £450,000
	Cost to rebuild at Day One	1,000,000	

Most policies these days contain an 85% average clause within the Reinstatement Clause, and so in the above mentioned scenario the Client would have been better off without the "Day One" wording and would have been paid the full £500,000. Only in a total loss situation is the Client marginally better off with a "Day One" wording. i.e. £913,500 instead of £900,000. Even if inflation ran at 30%, to achieve the full benefit of a 30% "uplift", the Client is still not protected against under insurance better than the standard wording in any but total loss situations despite the fact that the standard policy would now apply average. i.e.

Cost to rebuild £1,150,000 (£1m x 30% x 6/12ths)

"Day One" Average	Sum Insured	900,000	} x £500,000 = £450,000
	Cost to rebuild at Day One	1,000,000	
85% Average	Sum Insured	900,000	} x £500,000 = £460,359
	(85% of rebuild at time of loss, £1,150,000)	977,500	

Here's another thought, you ask Insurers for a "Day One" wording and it turns out after a loss that the client is worse off than taking the standard policy, is that an E&O claim in the making?

The moral of the story, make sure the client understands that he must Insure for the correct value when taking out the policy and add a percentage to allow for inflation a) assuming the loss occurs on the last day of the policy period and b) during the rebuilding period. The downside? The sum insured should be marginally higher to ensure that the Client will always be better off and as a result the Premium will be proportionately higher too. Although having said that Insurers will often charge for Uplifts exceeding 10%.

If you have questions or any other views or would like to disagree with me on any points I would be pleased to hear from you.

Stephen Haynes F.C.I.I.
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Appendix 1 Day One wording
Appendix 2 85% Average Clause

Appendix 1 Day One wording

A percentage uplift amount as stated in the Schedule on the Declared value for Items of Buildings and Contents. The uplift amount may be increased on the request of the Insured and agreement of Underwriters. This Additional Coverage shall be subject to the following Definition Conditions and any additional premium that may be required.

Definition

Declared value: shall mean the Insured's assessment of the cost of reinstatement of the Property insured at the level of costs applying at the inception of the Period of Insurance but ignoring inflationary factors which may operate subsequently and making due allowance for:

1. the additional costs of reinstatement to comply with European Union Legislation or Public Authorities requirements
2. professional fees
3. debris removal costs

in so far as the insurance by the item provides for such costs to be covered.

Conditions

At the inception of each Period of Insurance the Insured shall notify Underwriters of the Declared value of the Property insured by each of the said item(s). In the absence of such declarations the last amount declared by the Insured shall be taken as the Declared value for the ensuing Period of insurance.

It is understood that the following wording shall replace Special Condition 4 of General Conditions 3 – 'Basis of Claims Settlement' :

Each Item under this Condition is declared to be separately insured subject to the following Condition of Average namely:

If at the time of Damage the Declared value of the Property insured covered by such Item is less than the cost of reinstatement at the inception of the Period of Insurance then the Company's liability for any amount insured shall be limited to that proportion thereof which the Declared value bears to such cost of Reinstatement.

Where by reason of any of the above Special provisions no payment is to be made beyond the amount which would have been payable under this Section if this Condition had not been incorporated therein the rights and liabilities of the Company and the Insured in respect of the Damage shall be subject to the terms and Conditions of this Section and of the Policy including any Condition of Average as if this Condition had not been incorporated except that the Sums Insured shall be limited to 105% of the Declared values

Appendix - 2 85% Average Clause

3 Basis of claims settlement

- g) all other property including buildings – subject to the following Special conditions the cost of reinstatement of the property lost, destroyed or damaged
- 4 General Condition 20 – Underinsurance is deemed to read
If at the time of reinstatement the sum representing 85% of the cost which would have been incurred in reinstatement of the whole of the property covered by any item subject to this Basis of claims settlement sub-paragraph exceeds its sum insured at the commencement of any loss, destruction or damage, then the insured shall be considered as being his own insurer for the difference and shall bear a rateable proportion of the loss