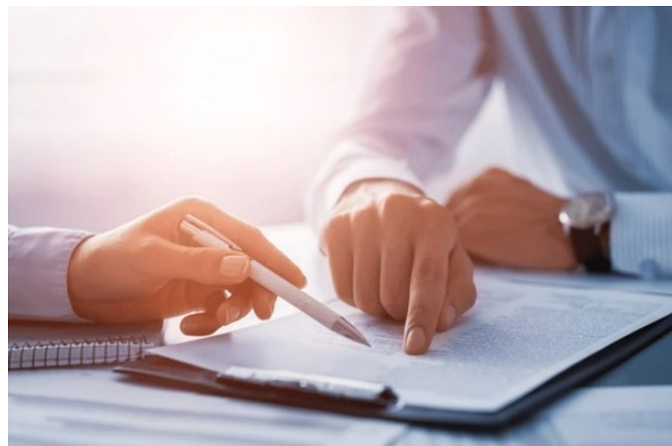

Explaining "Insured Value" and "Co-Insurance" in a Policy

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How Does the Valuation Clause Work?

Every shipper's interest cargo insurance policy includes a "valuation" clause, which defines how the insured value of a shipment must be calculated. The value is then multiplied by the policy rate to define the transaction premium. Commonly, the policy insured value is defined as: Cost [commercial invoice value] plus Freight [all transportation-related expenses] plus 10% [uplift to address unforeseen costs].

In most circumstances, a claimant will be unable to collect a settlement in excess of the originally insured value, so the additional 10% is intended to address exceptional claim-related expenses beyond those specifically defined in the policy.

Settlement of the additional 10% is not automatic; exceptional loss-related expenses must be realized by the insured and supported by documentation. This "uplift" usually is limited to 10% to avoid moral hazards because excessive uplifts could incentivize unscrupulous insureds to commit insurance fraud to profit from a loss. Higher uplifts may be approved by the underwriter, but they must be negotiated prior to risk attachment, and the insured is generally required to provide a reasonable explanation for the request.

Over Insurance vs. Under Insurance

When a shipment is overinsured compared to the policy valuation clause, there are minimal consequences. The final settlement of a covered claim will be limited to the amount stipulated by the policy (i.e., C&F + 10%), and the insured only loses the excess premium they initially paid.

The consequences associated with underinsuring cargo compared to the policy valuation clause can be much more severe and often could result in a very dissatisfied cargo owner.

The principle of co-insurance stipulates that when an insured fails to insure the full value of a shipment, they essentially become a "co-insurer" (along with the insurance company) because they retain the risk of loss for the undeclared/uninsured value of the shipment.

The ratio of a final claim settlement to the adjusted loss amount must be consistent with the proportion of the risk transferred to the insurance company. This is represented by the proportion of the insured cargo value compared to the value that should have been insured per the policy valuation clause.

The concept is obvious when applied to total losses. For example, if an insured purchases a machine for $100K but insures it for only $50K and the container falls overboard, the insured will collect only $50K in settlement from the insurer. Typically, no one expects to collect more than the value for which they initially purchased insurance.

The concept becomes more complicated when applied to partial losses. In a similar example, where the machine is partially damaged in transit resulting in a $10K repair cost, the insured would only be entitled to recover $5K from insurers. Since they only insured 50% of the cargo value, they are entitled to recover only 50% of the claim amount from the insurer, and the retained portion of the loss (i.e., co-insurance penalty) would be $5K.

To calculate a claim settlement subject to a co-insurance penalty due to underdeclared value, the following formula can be used:

$$\left(\frac{\text{Actual Insured Value}}{\text{Policy Defined Insured Value}} \times \text{Adjusted Loss Amount} \right) - \text{Deductible} = \text{Final Settlement Value}$$

The Importance of Insuring Goods up to their Full Value

Because many cargo owners are unaware of the principle of co-insurance, transportation intermediaries must encourage their clients to insure the full value of their shipment(s) whenever they expect to collect the full value of a potential claim.

Some cargo owners may want to purchase cargo insurance to address a deductible assigned in another cargo insurance policy or only insure the value of goods in excess of a carrier's limit of liability, so they only declare a portion of the cargo value to the intermediary for insurance. Without making necessary arrangements with the insurer in advance, these situations will not only result in co-insurance penalties, but also may lead to complications involving "other insurance" and "subrogation" clauses defined in the insurance policy.

For questions about insured value or co-insurance, or to insure a shipment for a value other than as defined in your policy's standard valuation clause, please contact World Insurance at **info@worldinsuranceagency.com.**