

Basis of Sum Insured & Indemnity for Electronic Equipment



This article endeavors to clear the confusion around how the Sum Insured for Electronic Equipment should be taken and what is the basis is of claims settlement.

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It is generally seen that every corporate at some point of time, has felt the need to know the methodology of arriving at the correct sum insured so that the dreaded 'under-insurance' factor or the Average Clause is not applied when a claim is reported. This is an oft repeated question asked almost universally in all kinds of seminars, meetings and particularly at the time of renewals.

We have discussed Sum Insured methodology under Fire Insurance in an earlier article. In this edition we shall look at Sum Insured methodology under Electronic Equipment Insurance (EEI) and All Risk Insurance.

As you know EEI is extended to electronic equipment which is stationary while All Risk Insurance is extended to portable electronic equipment. The terms and conditions of both the policies can be the same.

Basis of Sum Insured

It has been observed that a lot of confusion and misconception prevails around the Sum insured to be taken for electronic equipment. ***A common fallacy is to take the depreciated value of the electronic equipment as the Sum insured.*** Such a practice leads to an under insurance charge at the time of a claim which can sometimes result into a substantial deduction from the claimed amount. The insured generally misreads this as fraudulent behavior on part of the insurer.

The Sum Insured clause under EEI says that "It is a requirement of this insurance that the **Sum Insured shall be equal to the cost of replacement of the insured property by new property of the same kind and same capacity**, which shall mean its replacement cost including freight, dues and customs duties, if any and erection costs." The same basis should be adopted for portable electronic equipment also.

We know that the rate of obsolescence in electronic equipment is high. It is also known that the replacement models are generally in same price range (unless the technology has changed substantially) although with better features. Since putting a price to such enhancement in features is a tedious and an inaccurate task, **it is advised that the purchase price of the equipment should be kept as the Sum Insured in the subsequent years also unless the price has increased in which case the increased price should be taken as the Sum insured.**

The sum insured of the equipment insured should also include the value of 'System Software' if purchased separately.

Basis of Indemnity

A similar confusion prevails around the amount that will be paid by the insurer in case of a loss. Again clarity should be obtained from the tariff which defines the basis of indemnity as:

- a) *In cases where damage to an insured item can be repaired the Company will pay expenses necessarily incurred to restore the damaged machine to its former state of serviceability plus the cost of dismantling and re-erection incurred for the purpose of effecting the repairs as well as ordinary freight to and from a repair-shop customs duties and dues if any, to the*

extent such expenses have been included in the Sum Insured. If the repairs are executed at a workshop owned by the Insured, the Company will pay the cost of materials and wages incurred for the purpose of the repairs plus a reasonable percentage to cover overhead charges.

No deduction shall be made for depreciation in respect of parts replaced, except those with limited life, but the value of any salvage will be taken into account. If the cost of repairs as detailed hereinabove equals or exceeds the actual value of the machinery insured immediately before the occurrence of the damage, the settlement shall be made on the basis provided for in (b) below.

Simply put, in case of partial loss the insurer will reimburse the complete amount spent by the insured to restore the equipment to the condition it was prior to the loss. However if items with a limited life span are replaced then suitable depreciation will be deducted on them.

To avoid dispute it is advised that the rate of depreciation (depreciation schedule) should be finalized with the insurer at the time of policy issuance.

- b) *In cases where an insured item is destroyed, the Company will pay the actual value of the item immediately before the occurrence of the loss, including costs for ordinary freight, erection and customs duties if any, provided such expenses have been included in the sum insured, such actual value to be calculated by deducting proper depreciation from the replacement value of the item. The Company will also pay any normal charges for the dismantling of the machinery destroyed, but the salvage will be taken into account.*

Simply put, in case of total loss the insurer will reimburse the new replacement cost of the equipment minus suitable depreciation.

Again it is advised that the rate of depreciation (depreciation schedule) should be finalized with the insurer at the time of policy issuance to avoid disputes.

- c) *In cases where the Insured item is subjected to total loss and meanwhile it becomes obsolete, all costs necessary to replace the lost or damaged insured item with a follow-up model (similar type) of similar structure/ configuration (of similar quality) ie low, average or high capacity – will be reimbursed.*

If the sum insured is less than the amount required to be insured as per Provision - 1 hereinabove, the Company will pay only in such proportion as the sum insured bears to the amount required to be insured. Every item if more than one shall be subject to this condition separately.

As mentioned above, it is better to err on the side of caution and take the purchase price as the Sum insured in the subsequent years also. However this should be suitably adjusted if the price of equipment has seen substantial increase in the preceding year.