

Understanding averaging provisions: Are you underinsured?

A joint fact sheet from the Insurance Council of Australia (ICA) and the National Insurance Brokers Association (NIBA).

- Insurance Council of Australia: www.insurancecouncil.com.au
- National Insurance Brokers Association: www.niba.com.au

Terminology note

This fact sheet uses the following terms interchangeably, as they all refer to the same concept:

- Averaging provisions
- Underinsurance clauses
- Co-insurance clauses

Throughout this guide, we primarily use 'averaging provisions' for consistency.

What are averaging provisions?

Averaging provisions are a common feature of many business insurance policies.

Averaging provisions are rules in insurance policies that limit how much you can get paid if you haven't insured your property for its current value (also called sum insured).

This means that in the event of a claim, if you have insured your business and/or business assets for less than its current value, any insurance payout you receive may be reduced proportionally to reflect the amount or percentage of underinsurance.



Averaging provisions explained

Averaging provisions reduce your claim payout when you're underinsured.

If you insure your property for less than its current value:

- ✓ Your insurance premium pays for only part of your cover
- ✗ You receive a proportionally lower payout when you claim.

DISCLAIMER: This fact sheet provides general information only and does not constitute financial or legal advice. Always refer to your specific policy documents and consult with your insurance professional for advice tailored to your circumstances.

A simple example

Scenario:

Sum Insured: Building A is worth \$1,000,000, but the policyholder insures it for \$600,000.

This means they have insured it for 60% of its replacement cost.

Building A is damaged, resulting in \$100,000 worth of damage.

The claim payout:

Because the policyholder only insured 60% of the building's value, the insurance policy will only pay 60% of the damage cost — which is \$60,000.

What does this mean?

The policyholder will have a shortfall of \$40,000 because their policy only covers 60% of their claim. The claim payout doesn't cover the full \$100,000 damage.

This is a simple example of how averaging provisions can reduce claim payouts if a policyholder's insurance cover is less than the current value of their asset. The exact calculation may vary depending on your insurance policy terms and conditions.

Your legal protection

Insurers must clearly explain if your policy includes averaging provisions and how they work.

Section 44 of the Insurance Contracts Act 1984 outlines how averaging provisions can be used and requires insurers to clearly inform their customers of the nature and effect of any averaging provisions in their policy.

Why do insurance policies include averaging provisions?

Averaging provisions encourage customers to insure their property for its current replacement value. This is crucial for ensuring sufficient cover and avoiding underinsurance. Without it, a claim settlement could be insufficient to cover the total cost of repairs or replacement.

Supporting premium fairness

Without averaging provisions, people who underinsure could pay lower premiums yet still receive the same benefits as those who pay higher premiums for full cover. When businesses insure their assets at their current value, it helps keep premiums fair for all customers.

What types of insurance policies include averaging provisions?

Averaging provisions are typically found in business insurance policies (from sole traders to large companies), including, for example:

- Commercial building insurance (owned or leased commercial properties)
- Business contents insurance (equipment, furniture, stock)
- Business interruption insurance (loss of income after damage).

Why is this important information?

Understanding how averaging provisions work helps ensure you understand what you are covered for and how your claim settlement is calculated.

Key points

- Averaging provisions reduce your payout if your insured amount (often called the "sum insured" or "declared value") is less than the current value of your property and assets, which can impact your ability to make repairs or support your business in the event of an insured event.
- Reviewing your cover regularly ensures it accurately reflects your assets' current value and can help prevent unexpected reductions in payouts during claims.
- Check your insurance policy documents to identify any averaging provisions and understand how they might affect your cover and claims.
- Speak to your insurance adviser if you have any questions.

Reviewing your cover regularly

You should review your cover and sums insured:

- ✓ Annually — asset values change over time due to inflation, market conditions, and depreciation.
- ✓ After renovations or improvements — building upgrades and fit outs increase value.
- ✓ When purchasing new equipment — new assets need to be added to your cover.
- ✓ Before policy renewal — this is a good time to adjust your sum insured amounts.
- ✓ After business expansion — increased inventory, stock, or operations affect total values.
- ✓ Following major purchases — significant new assets should be reflected immediately.

Pro tip: Consider professional valuations every 3-5 years for high-value assets to ensure your key assets are fully protected.

Need help?

If you're unsure about your cover or how averaging provisions work, you should check your insurance policy documents.

You can also talk to your insurance broker — they can help you understand your policy and ensure you have appropriate cover for your needs.

These are some good questions to ask your broker.

Before you purchase or renew a policy

- Does my policy include averaging provisions?
- How much cover do I need?
- How should I determine the current value of my business assets?
- What is included in the sum insured of my policy?
- Should I use replacement cost or current market value?

During your policy term

- In the event of a change in your business, how does it impact my insurance cover?
- Do I need a professional valuation?

Remember: Your insurance broker represents you, not the insurer. They can help you understand your policy and ensure you have appropriate cover for your needs.