Do you need earthquake insurance?

Guest editorial
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The risk of earthquakes has been a topic of discussion in various geographic areas for decades. Recent occurrences have even caused insurance companies to implement temporary moratoriums on issuing earthquake policies in those areas for fear of a more catastrophic event to follow. So, that leads to these questions: Should you buy earthquake insurance? What does it cover?

The majority of property insurance policies exclude earthquake or any "earth movement," for that matter. In an insurance policy, earth movement is described as: "…earthquake, landslide, mine subsidence or earth sinking (other than sinkhole collapse), rising or shifting, volcanic eruption, explosion or effusion..."

That's a broad definition, especially considering it's all excluded on your current property insurance policy. (Note that most standard property policies will cover fire and glass breakage resulting from earth movement.)

Because of this exclusion, if you want coverage for an earthquake, a separate policy must be purchased for that exposure alone. Earthquake can be difficult and expensive to insure, as frequency and severity is hard to accurately predict. Also, coverage is difficult to procure because it supports the practice of adverse selection — meaning only those in earthquake-prone areas are likely to buy it, which makes a desirable spread of risk for the insurance company difficult to achieve.

So, when you do purchase earthquake insurance, and what does it cover? It can be purchased at full limits — meaning all of your building, contents and loss of income coverage combined. It can also be purchased at a sub-limit agreed upon between you and the insurance company. Let's say you have $2,000,000 of total property values, but only want to insure $1,000,000 of that limit for earthquake. This is called a sub-limit, and you can usually negotiate that lower limit with the underwriter. This is also the case if you want to insure *only* the building or *only* the contents, etc.

You can include sprinkler leakage coverage, which is highly recommended by most insurance professionals. This would provide coverage for your property if an earthquake set off your automatic sprinkler system and there was resulting damage to your building or contents. Just imagine if you had earthquake coverage — but not for sprinkler leakage — and a small earthquake occurs, causing no real direct damage. Except, it set off your sprinkler system, which flooded your building and ruined your computers, etc.

Earthquake policies have deductibles, as do standard property policies. However, the deductible on an earthquake policy is different in its application.

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- Your standard property policy will have a deductible of a particular dollar amount for each loss. For example, if you have a $100,000 fire loss and your policy has a $1,000 deductible, you should receive $99,000 for your loss (with any other existing requirements being met, such as insurance to value, coinsurance requirements, etc.). It's an easy calculation.
- Your earthquake policy will have a percentage deductible, usually 5 or 10 percent, subject to a minimum dollar amount. The policy would typically apply the deductible as follows.
  - All claims from one earthquake will be adjusted as one loss. This means your policy would consider any aftershocks part of the initial earthquake, and there is usually a time limit of about three to four days in which it considers all events to be one.
  - Each loss will be subject to a 5 percent deductible, subject to a minimum of $25,000. (Note, these figures are for illustration purposes only; insurance policies vary on deductible percentages and minimums.)
  - The percentage is applied as a percentage of the replacement *cost of each separate item that's covered*. This is important because the percentage is not a percentage of the loss, it's a percentage of the actual replacement *cost of each separate item* (for example, each building and the contents for each building would all be separate items, and the deductible would apply separately for each).

As you can see, the deductibles on an earthquake policy can potentially add up to a hefty out-of-pocket expense. But, if the worst was to happen, most policyholders would likely be grateful for the coverage.

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