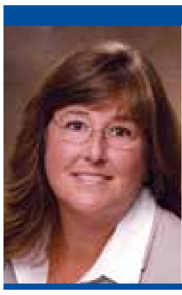
Do you need earthquake insurance and what does it cover?



Guest editorial
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Earthquake risk has been the topic of discussion in various geographic areas for decades. Past earthquakes 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 the question…should you buy earthquake insurance and what does it cover?

The vast majority of property insurance policies currently 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. (It's important to note, however, that most standard property policies will cover fire and glass breakage resulting from earth movement.)

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

So, when you do purchase earthquake coverage, what does it cover? It can be purchased at full limits, meaning all 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 million of total property values, but only want to insure $1 million of that limit for earthquake. This is called a sub-limit, and you can usually negotiate the lower limit with the underwriter. This is also true if you want to insure only the building or only the contents.

You can include sprinkler leakage coverage, which is recommended by most insurance professionals. This would provide coverage for your property in the event 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. Now imagine there's a small earthquake resulting in no real direct damage except it set off your sprinkler system, which flooded your building and ruined computers, etc.

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

- 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 (i.e., insurance to value, coinsurance requirements, etc.). It's an easy calculation.
- Your earthquake policy will have a percentage deductible, usually 5% or 10%, 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 all events are considered to be one event.
  - Each loss will be subject to a 5% 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 to note 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.)

Earthquake policy deductibles can potentially add up to a hefty out-of-pocket expense in the event of an earthquake, but if the worst was to happen, most policy holders would likely be grateful they purchased the coverage.

The next time you see a news story detailing the aftermath of an earthquake, don't wonder what you would do if that happened where you live. Be proactive and discuss this important coverage with your insurance professional.

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