International Nuances of Insurance Valuation Practice
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It is often said that Britain and America are "two nations divided by a common language." Extending this thought to how the request for an "insurance valuation" might be interpreted on each side of the Atlantic, or perhaps even further afield, we learn that such a simple term has infinite subtleties.

In the UK, the basis for an insurance valuation or: "appraisal" as it is called in the United States, is replacement cost new or "reinstatement cost." Below-grade assets such as foundations, footings, buried piping and wiring, etc. are included as a matter of course, though occasionally the valuer is directed to exclude these assets. This is a similar practice to that conducted in Germany, Italy and Spain. In the United States, these "exclusions" were historically shown as a separate number in an insurance valuation. It has now become default to include them unless directed otherwise by the instructing insured, broker and/or underwriter.

An "indemnity value" may be requested where the aim is to provide a value based on the premise that the insured's property is replaced in like kind, in terms of function, efficiency, age and condition. It is normal practice in Spain and Portugal to request both replacement cost new (RCN) and replacement cost less physical depreciation (RCNLD), and occasionally an allowance for functional obsolescence. It then becomes a business decision between the client and broker as to the basis of insurance. In the United States, the term used is actual cash value (ACV), which is a depreciated insurable value that may include allowances for physical depreciation and functional and/or economic obsolescence depending on the policy language. The typical default is to consider only physical depreciation.

There are also times, particularly in Germany and the UK, when there may be a request to look at assets on a functional replacement basis, i.e., what it would cost to replace production capacity, to help establish upper loss limits.

Escaping the Northern European climate for Brazil, the rule there is to insure with the lower of RCN or RCNLD with a multiple of two. So an asset with a RCN of £100 and a RCNLD of £60 would be insured for £100, or RCN (£100 < £60 x 2). If the same asset had a RCNLD of £40, it would be insured for £80, or RCNLD x 2 (£100 > £40 x 2). Thus, when depreciation is higher than 50 percent, RCN is not used. Brazil refers to this as "maximum insurable value."

Valuers in the UK may also be asked to provide their opinion of "allowances", consisting of the cost of demolition and debris removal and construction cost escalation to the midterm of the policy and rebuild periods.

These allowances are generally estimated at a facility level of detail and tend to be provided more often in the Middle East than anywhere else (approximately 50 to 75% of the time), as well as in the UK (approximately 30% to 40% of the time). Allowances are only requested as part of an insurance valuation in the UK and current and former commonwealth countries such as Australia and New Zealand, though not in India.

In addition, a regular request in the UK is for an estimate of the rebuild period, largely to help determine the indemnity period for business income cover.

In some countries, there are codes regulating insurance appraisals. The Italian Association of Insurance Companies (ANIA) has compiled a code that represents a guideline for everybody working in the insurance valuation field. A valuation performed according to these guidelines and by a firm well known for its experience and professional level allows a client to have some economic and technical advantages when applying for insurance coverage.

Once the basis of the valuation has been agreed to, the scope of the inspection may well vary from country to country. In Italy, it is convention to always create a new inventory as a client's fixed asset records are not considered reliable as a result of many revaluations in the past 20 years altering historical costs, and the asset lists are rarely updated or reconciled. The ANIA guidelines require a level of detail that is difficult to find in an asset list created for administrative scope which does not include asset location and production areas. Conversely, in Russia and Germany there is access to fixed asset registers that are very detailed and complete, reflecting all current assets operated by a company and including such information as inventory number, quantity, date in, gross and net book values, division name and asset location. Creating a new inventory in this situation is perceived as unnecessary. In the UK, the site inspection might include the creation of a new inventory of the plant and machinery, or it may be based on the company's fixed asset records with a high-level verification. Key to any insurance valuation is for the assets to be allocated by floor by building to enable detailed underwriting analysis.

As we can see, a simple request for an "insurance valuation" can be interpreted in many different ways depending on your part of the world. It is critical to ensure that all parties understand what is required by the insurance contract, and what will be included/excluded in the valuation conclusions.

The article is published with Duff & Phelps permission and was initially placed in *Insurance Insight* (October 2013) and now defaults to:

http://www.postonline.co.uk/post/analysis/2314419/europe-insurance-valuation-processes

Next month read Duff & Phelps' article that discusses ***Concluding insurable values by trending historic costs***.