

Consumer guide to replacement vs. indemnity insurance

Replacement insurance

This is a policy under which an insurance company will replace a lost or destroyed item with a new one or repair the item, so it is as new as practically possible.

Most houses in New Zealand are insured under replacement cover policies. If they are damaged or destroyed, insurance companies will pay the cost of repairing or replacing them.

However, there are some limits that will apply (e.g. to jewellery claims) and customers should check with their insurance provider and check the policy wording. Certain items that become obsolete very quickly or items over a certain age may not qualify for replacement value.

With replacement insurance, the item is usually repaired or replaced. If you want a cash settlement you may only get the indemnity value of the item, depending on the wording of your policy.

There is also an upper limit on what you can claim. For a Nominated Replacement Value type policy, this is specified in the insurance policy as the sum insured. For a Full Replacement value or open – ended type policy, usually available for buildings, the limit is the area of the damaged structure.

Indemnity (present day value)

An indemnity policy puts you back in the same financial position you were in prior to the loss occurring, so that you are no better or worse off than you were immediately before the loss.

The settlement is based on how much you would pay for the item second-hand or the replacement cost of the item less an allowance (depreciation) for age and use. Indemnity value may also be referred to as Market Value or Present-day Value. Your policy document will explain this for you.

Examples

Sporting equipment such as a carbon fibre road bike is generally insured for indemnity under a household contents policy as this type of item can depreciate significantly in value over time.

Personal effects (items which are worn or carried, including clothing, mobile phones, watches, and cash).

Motor vehicles are usually insured for indemnity (market value). New or near new vehicles may be able to be insured for replacement value though some insurers offer an agreed value policy for motor vehicles.

Furniture, furnishings and home appliances are some items that are generally insured for replacement value but may revert back to indemnity cover over a certain age. Check your policy.

Houses can be insured for indemnity, nominated replacement or full replacement value.

The type of cover accepted by an insurer will depend upon the nature of the risk, e.g. age, maintenance, security, type of use etc. As part of your insurance contract you have an obligation to protect and look after your property. The general rule for Reasonable Care put simply is "Common Sense". An insurer would perceive leaving your house unlocked while away as not taking reasonable care.