Do You Need Earthquake Insurance? What Does It Cover?

GUEST EDITORIAL
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The risk of an earthquake, and the impending "big one", have been topics of discussion in various geographic areas for decades. Recent earthquakes have even caused insurance companies to implement temporary moratoriums on issuing earthquake policies in certain areas for fear of a more catastrophic event to follow. This leads to the question at hand: Should you buy earthquake insurance, and what does it cover?

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

This is a very broad definition, especially considering that 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 this exposure alone. Earthquakes can be difficult to insure and can also be quite expensive. One reason is because their frequency and severity can be very difficult to predict with much accuracy. The coverage can also be difficult to procure because it supports the practice of "adverse selection", meaning only those who are in earthquake-prone areas are likely to buy the coverage. It makes it difficult for the insurance company to achieve a desirable risk distribution.

Once you do purchase an earthquake policy, what does it cover? The coverage can be purchased at full limits, meaning that all of your building, contents and loss of income coverages can be combined. It can also be purchased at a sub-limit that is agreed upon by you and the insurance company. For example, if you have $2,000,000 of total property value, but you only want to insure $1,000,000 of this limit for earthquake damages, this is called a sub-limit. You can usually negotiate the lower limit with the underwriter. This is also the case if you only want to insure the building, the contents inside, etc.

In addition, you can include sprinkler leakage coverage, which is highly recommended by most insurance professionals. This would cover your property if an earthquake triggered your automatic sprinkler system and caused resulting damage to your building or contents. Just imagine if you had earthquake coverage that did not include sprinkler leakage and a small earthquake caused no real direct damage except for setting off your sprinkler system. The activated sprinklers could flood your building, ruin your computers, etc.

Similar to standard property policies, earthquake policies have deductibles. However, the deductible on the earthquake policy is quite different in its application, as explained in the following scenarios:

- A standard property policy has 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.). This is a very easy calculation.
- An earthquake policy, however, has a percentage deductible, usually 5% or 10%, that is subject to a minimum dollar amount. This policy would typically apply the deductible as follows:
  - All claims from one earthquake would be adjusted as one loss, meaning that your policy would consider any aftershocks as part of the initial earthquake. There is usually a time limit of about 3–4 days in which all events are counted as one.
  - Each loss would be subject to a 5% deductible with a minimum of $25,000. Please note that these figures are only for illustration purposes. Deductible percentages and minimums vary based on the policy.
  - The percentage would be applied as part of the replacement cost of each separate item that's covered. It is important to note that this is not a percentage of the loss but of the actual replacement cost of each separate item. For example, each building and its contents would all be separate items, and the deductible would apply separately for each.

Clearly, the deductibles on an earthquake policy could potentially add up to a hefty out-of-pocket expense in the event of an earthquake. But, if the worst scenario occurred, most policy holders would likely be grateful that they had purchased this coverage.

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