



**STATE OF TENNESSEE**  
**DEPARTMENT OF COMMERCE AND INSURANCE**  
Nashville, Tennessee

TO: Tennessee Citizens

FROM: Julie Mix McPeak, Commissioner

RE: Knowing Your Insurance Policy: Actual Cash Value v. Replacement Cost

DATE: September 21, 2012

The purpose of this Memorandum is for the Tennessee Department of Commerce and Insurance (“TDCI”) to explain Actual Cash Value (ACV) and Replacement Cost terms so that consumers can make educated decisions when purchasing or renewing homeowners insurance policies.

**Actual Cash Value** policies pay consumers for replacement costs minus any applicable depreciation. Depreciation can be thought of as “wear and tear” or age.

**Replacement Cost** policies will pay consumers for what the damaged/destroyed item or structure would cost in today’s dollars. The policies do not account for any wear and tear or for the age of the item.

Replacement Cost benefits will generally pay more for a claim than will ACV benefits. However, not all dwellings/items will qualify for full replacement benefits—determinations may be made on a situation-by-situation basis as companies inspect properties to resolve coverages that they may make available based on the property’s condition and the company’s unique underwriting guidelines.

A hypothetical \$10,000 roof that is now five (5) years old will provide an example. In the example, assume that the roof needs to be entirely replaced and the homeowner has a \$1,000 policy deductible.

- Under an **Actual Cash Value** policy, the insurance company may determine that \$500 of wear and tear (“depreciation”) occurred each year since the roof was installed. At the time of the claim, the company would pay **\$6,500**. Depreciation would have reduced the payment by \$2,500 (5 years multiplied by \$500 wear and tear per year) and the \$1,000 deductible would have reduced the payment the other \$1,000. The consumer would have the option of making up the difference to pay for a roof of similar quality, or using the money to install a roof available at that price.
- Under a **Replacement Cost** policy, the insurance company would pay the amount required to replace the roof with similar quality materials at today’s cost, minus the deductible. In the event that the same roof costs \$11,000 at the time of the claim, the company would pay **\$10,000**—\$11,000 for the replacement roof, minus the \$1,000 deductible. (Note: Insurance companies may initially pay the actual cash value for the roof, \$6,500, and then reimburse the difference following submission of a receipt).

Tennessee insurance consumers should NOT feel that they must accept a policy that does not cover their needs. **TDCI encourages consumers to shop around when seeking a policy and at renewal to ensure that they receive the coverage that they want at a price that they can accept.** Consumers should also read their policies to better understand their coverages and should feel free to ask questions of agents, brokers, and/or TDCI if they have trouble understanding the contracts.

Any questions about the intent of this Memorandum should be directed to the Insurance Division, 4<sup>th</sup> Floor, Davy Crockett Tower, 500 James Robertson Parkway, Nashville, Tennessee, 37243, and/or telephone number (615) 741-2176.