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Property insurance "margin" clause: A new hidden danger

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Insurance agents have done a good job over the years in finding ways to get around the onus of the coinsurance clause and specific limits at multiple locations in commercial property policies via the agreed amount endorsement and blanket coverage. Thus, agents and insureds alike have slept more soundly, not fearing the application of the coinsurance clause, which penalizes at the time of loss to the same percentage by which the property is uninsured, or specific insurance limits at specific locations.

Insurers, however, have begun making subtle changes to this arrangement, and in late-2008 the Insurance Services Office added the provision of a margin clause under blanket policies, the application of which would be at the option of the insurer.

Let's start with the basic steps. In order for an insured to qualify for blanket coverage a statement of values (SOV) is typically required, on which the insured lists locations where coverage is to apply and specifies the amount of building and/or contents values at each, then selects a coinsurance percentage of either 90% or 100%, forming the blanket limit. The coinsurance provision can then be waived via the addition of an agreed amount endorsement whereby the insurer agrees with the insured as to the adequacy of values insured in advance of any loss.

The margin clause changes all of that. Essentially, the clause limits the amount by which the originally-stated value can increase at the time of loss (from 10% to 50%) and will limit the claim recovery, accordingly, even though the total amount of the blanket limit at the time of loss is still accurate and appropriate. And, if the policy is written on a blanket basis without the agreed amount endorsement, and regardless of whether the total values are within the coinsurance percentage on an aggregate basis, if the individual values vary by more than the specified margin percentage a coinsurance penalty can be applied.

An example of how this would work is as follows: An insured completes an SOV containing four building locations valued at $1.5 million each for a blanket limit of $6 million. The policy on which coverage is to apply has a 100% coinsurance provision, replacement cost valuation, and a $5,000 deductible is to apply per loss. The policy also contains a 25% margin clause.

A loss occurs, destroying one of the buildings, and the insured learns that the actual cost to replace each of the insured buildings would be $2.1 million. Applying the margin clause to the value shown on the SOV would mean that the maximum amount available for this loss would be $1.875 million ($1.5 million times 125%). To determine the amount of claim recovery, the amount of insurance carried ($6 million) is divided by the amount that should have been carried ($8.4 million), yielding a factor of .7143, (the equivalent of a 28.57% coinsurance penalty since the entire schedule was underinsured) which would then be multiplied by the amount of the loss ($2.1 million) resulting in a loss payable of $1,500,030., less the $5,000 deductible, or $1,495,030. Because this amount is less than the maximum available after margin ($1.875 million) the insured would collect the $1,495,030 amount, resulting in a combined penalty amount of $604,970.

If the insured had had agreed amount protection, the coinsurance step would have been avoided, making the loss payable $1.875 million less $5,000, or $1.87 million, which, while still representing a $230,000 shortfall, would save the insured from suffering the additional $374,970 loss.

The inclusion of a margin clause in a policy's wording may not be obvious, so you should be sure to ask your agent and read your policy carefully.

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