



# Forrest Sherer

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## THE INSURANCE NEWSLETTER

Fall 2008

### Beware the Margin Clause

We have written often about the importance of buying the proper amount of insurance on your buildings and their contents. Almost all property policies contain coinsurance clauses, which simply state that if you don't carry insurance limits equal to some percentage (usually 80%, 90% or 100%) of the actual value of the property, any claim payment will be reduced by an amount proportionate to the deficiency in the limit. If you want to be happy when claim time rolls around, you have to insure to the full value of your properties.

The problem with this is that setting correct limits can be as much an art as a science. Local conditions will vary widely, of course, but in general during the recently ended real estate bubble, money was easy to come by, contractors and builders were running flat out, and replacement cost values on buildings of all types increased substantially. In the current economy, real estate values are down, construction has slowed to a crawl, and building costs can be either flat or actually down, depending on where you are. We have also learned from recent natural catastrophes; hurricanes in the South and wildfires out West have taught us that after a widespread, regional property loss event, local construction costs can skyrocket.

Property insurance buyers have always known that an important tool to avoid uncertainty at claim time is the agreed value clause. If the underwriter is satisfied that you are carrying adequate insurance, he'll grant this coverage, which suspends the coinsurance clause. You have to apply for this coverage each year, but if a claim is presented the adjuster can then skip coinsurance calculations and go right to adjusting, and paying, the claim.

Unfortunately, the agreed value clause won't get you any more money if the limit you picked isn't adequate. Insurance buyers covering a single location are out of luck at that point, but owners of multiple properties or locations have always had an advantage dealing with uncertainty in insurable values. They can buy a blanket property insurance policy (with an agreed value clause).

The advantage of a blanket policy is that the total blanket limit of insurance is available to cover a loss at any individual property covered on the policy. Here's a quick example: our buyer has three buildings to insure, one worth \$75,000, one worth \$100,000, the third worth \$175,000. Instead of buying a specific limit of liability for each building, he buys a blanket policy with a limit of \$350,000, and an agreed value clause.

A tornado levels the \$100,000 building. It turns out that it actually costs \$150,000 to rebuild. That's less than the \$350,000 blanket policy limit; the policy pays the \$150,000 claim, in full (less any deductible, of course).

The blanket property policy is a terrific tool for owners of multiple properties to be sure that an unintentional mistake in estimating the insurable value of any one location doesn't result in an uninsured or underinsured claim. Most policyholders who are candidates for blanket insurance have come to understand the advantages of this type of coverage and specifically request it, and insurance companies have generally been willing to offer it. Underwriters will want to be satisfied that the values declared for each location are close to what they think the insurable value should be, but once satisfied, they'll not only write a blanket limit, they'll include an agreed value clause, too.

to be high. As a practical matter, if your company has a retirement plan, even just a plain vanilla 401K, you should carry Fiduciary Liability Insurance. This insurance has always been quite inexpensive, and that is not likely to change after *LaRue*.

What might change is the way these policies are underwritten. If it is going to be easier for individual

plan participants to make claims for losses in their accounts, underwriters may want to start looking more closely at how a plan handles investment instructions from participants. With that possibility in mind, you might want to consider reviewing your plan procedures to be sure that you have appropriate internal controls to minimize the likelihood of similar errors taking place.

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