

Blanket Coverage & Margin Clause New Challenges for Agents

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For years many agents and insureds have relied on the “blanket” protection most standard insurers offer on property coverage to protect against inadequate limits on buildings or personal property. When blanket coverage combined with the “Agreed Amount” endorsement to waive coinsurance is provided by the carrier, loss settlement worries with regards to the limits are greatly reduced and in most instances, eliminated.

With the Insurance Service Office (ISO) 2007 introduction of the CP 12 32 06 07 – Limitation on Loss Settlement - Blanket Insurance (Margin Clause) endorsement that took effect November 1, 2008, the safety net that used to be provided under blanket coverage may be forever altered. Agents and insureds should beware of this endorsement. Recovery reverts to the statement of values on file with the insurance company for each individual property item plus a stated percentage of that value. Typically margin percentages have been anywhere from 110% to 125% of the stipulated value. So long blanket coverage.

Blanket versus Scheduled Limits

By combining the limits of various scheduled property into one large limit, blanket limits offer a reassuring allowance for error. Some carriers “blanket” buildings, contents and business income separately; others blanket all property limits together. Some will provide an “occurrence” limit that could be less than the total values combined, but would cover the maximum probable loss at any one location. The occurrence limit is usually a form of blanket coverage. Loss limits, however, rarely have any blanket component. A loss limit is the most the policy will pay in the event of a loss. Recovery is limited to the amount shown for the property item on the statement or schedule of values on file with the insurance carrier.

Statement of Values

A statement of values is filed with insurance carriers by the insured. The statement of values outlines the properties and the replacement cost or actual cash value of the properties the insured is covering under their property policy.

The below schedule of values will illustrate the various ways the limits can be insured:

Example of Scheduled Limits on File with the Insurance Carrier				
Location	Building	Contents	Business Income	Total Location Values
1	\$400,000	\$250,000	\$75,000	\$725,000
2	\$300,000	\$100,000	\$60,000	\$460,000
3	\$250,000	\$40,000	\$45,000	\$335,000
4	\$600,000	\$400,000	\$125,000	\$1,125,000
Totals	\$1,550,000	\$790,000	\$305,000	\$2,645,000

- Blanket limit of \$2,645,000 based on the statement of values.
- Blanket limits as follows: \$1,550,000 for buildings, \$790,000 for contents, and \$305,000 for business income.
- Blanket building and contents limit of \$2,340,000 and a separate blanket business income limit of \$305,000.
- Occurrence limit of \$1,125,000. This is the most that will be paid in any one loss. This limit was determined by establishing the maximum loss possible at any one location.
- Loss Limit of \$1,125,000. This is the most the policy will pay, which, once again, represents the maximum loss at any one location. However, recovery is limited to the amount shown on the statement of values. If location 1 building suffered a \$450,000 loss, the most the policy would pay is \$400,000 assuming there were no coinsurance issues.
- The new ISO margin clause endorsement applies. The policy has a blanket limit of \$2,645,000; however recovery is limited to the amount shown on the statement of values plus a margin percentage of 120%. If location 1 building

suffered a total loss of \$450,000, the policy would pay a maximum of \$480,000 (\$400,000 x 1.20) assuming there were no coinsurance issues. The insured would be paid the total loss of \$450,000 less deductible.

It should be noted in *all* the above scenarios, the *premium* is based on the *total insured values (TIV)*...in this case \$2,645,000.

Anytime a margin clause applies, a detailed statement of values is required. Some carriers have specific methods for determining the value of the property if the values are not individually shown on the statement of values and this new ISO CP 12 32 06 07 – Limitation on Loss Settlement - Blanket Insurance (Margin Clause) endorsement is no exception. The endorsement says “...*If the statement of values does not state individually the value of each building and the value of contents at each building or premises, we will determine values as part of the total reported prior to application of the Margin Clause Percentage*”. Determining the value of a property after a loss is inviting loss settlement disputes and should be avoided by preparing a detailed statement of values.

Why wouldn't Agents always request blanket coverage?

Blanket limits are recommended whenever possible. However, other alternatives are used usually for the following reasons:

- The carrier has a capacity problem...they cannot provide the full values
- Premium costs are prohibitive
- Facultative reinsurance agreements may impose restrictions
- Blanket is not available...many carriers refuse to blanket certain property exposures

Problems with valuing property

Underinsurance has become a problem for insurers where blanket coverage has been provided along with the agreed value option. Indeed, several studies by insurers and independent property valuation firms reveal that somewhere between 70 and 75 percent of all properties are underinsured. The average amount of underinsurance ranges from 25 to 35 percent. It is the responsibility of the insured, often counseled by his or her

agent, to provide property values to the insurance carrier. Some insureds rely on the blanket limit and knowledge that the penalties of coinsurance have been waived by the agreed amount endorsement; others may not understand what a policy (loss) limit means or how coinsurance applies. Since premiums are based on the total insured property values, insureds are often motivated to underestimate their property values to save cost.

Some carriers will calculate values based on valuation software they use in-house and will only continue the coveted blanket coverage and coinsurance waiver if the insured increases their values to a more appropriate level. Others will insist upon appraisals, while some carriers pay very little attention to what the insured submits...especially if written on a loss limit or schedule value basis and/or a coinsurance clause applies as the insured will be penalized for underinsuring in the event of a loss.

Insurance carrier decisions to continue blanket coverage and coinsurance waivers with known inadequate limits can be motivated by competitive factors. (e.g., soft market, desire to secure the order on the account or carriers relinquish to market pressures to retain an account). The insurance carriers have a legitimate complaint with blanket coverage and coinsurance waivers. The insured often underinsures yet carriers are providing high limits with no consequences for underinsuring. In the event of a loss, the entire blanket limit is available to the insured to pay for the loss without any coinsurance worries.

Margin Clause

Margin clauses have actually been in use for quite some time. For those agents insuring property in high hazard areas such as those areas subject to earthquakes and hurricanes, there is a good chance these agents rarely have the opportunity to write blanket coverage. Most of the property written in the excess/surplus lines or wholesale market is written on a scheduled basis often using loss limits. The pricing is based on the total values the insured has, but coverage is limited to a policy limit and further restricted by referring back to the statement of values as the maximum amount the carrier will pay for the item involved in the loss.

In the example above, the insured has \$2,645,000 in total values at four locations, but the maximum probable loss at any one location is \$1,125,000. Therefore, the insured buys a policy with a \$1,125,000 "loss limit". This does not mean the insured has \$1,125,000 in coverage for any loss. It means this is the most the policy will pay is \$1,125,000. It is important to remember the policy reverts to the schedule of values on file with the company to determine the limit of any individual property item in the event of a loss. To reiterate, if the insured had a loss for \$450,000 on building 1 that is reported as \$400,000 on the statement of values on file with the insurance carrier, all the insured would collect is \$400,000 less the deductible even though there was a \$1,125,000 loss limit.

Hence, the need for a margin clause. Margin clauses came about as a goodwill gesture. Many insureds with multiple properties attempt to value all their property correctly, but mistakes are made. Appraising the replacement value of property is not an exact science and the true value is never really known until you replace it. If every effort has been made to insure property correctly and blanket coverage is not available, many carriers would add a margin clause to the property coverage for this type of situation.

Had the above insured had a 120% margin clause the loss would have been adjusted as follows: $\$400,000 \times 1.20 = \$480,000$ (limit available but limited to the loss of \$450,000) – deductible = Loss Settlement. Margins Clauses are looked upon very favorably in the excess surplus lines marketplace. They are a true advantage to insureds that can only purchase coverage on a scheduled basis.

The situation is much different for insureds that have obtained coverage in the standard marketplace and have routinely secured blanket coverage. Going from full blanket to scheduled limits with a margin clause is potentially a significant reduction in insurance coverage in the event of a loss if the values reported by the insured are underinsured.

Coinsurance

In most instances agents securing blanket coverage for their insureds were getting coinsurance waived as well through the Agreed Amount endorsement. Coinsurance could come into play if it was not waived when insuring on a blanket basis. Although blanket coverage offers protection against underinsurance, it does not necessarily prevent a coinsurance penalty because the coinsurance clause usually contains a

provision that specifies the coinsurance clause applies to the total value of all of the property covered by the blanket limit.

Securing coinsurance waivers (along with establishing appropriate scheduled property values) will be very important if the new endorsement applies. Page two of the ISO CP 12 32 06 07 endorsement outlines three examples of how the margin clause will apply in a loss settlement. Example number three is clear how the coinsurance will apply. The coinsurance factor is calculated before the application of the margin clause.

Having the new ISO endorsement attached to a policy with a high (1.20 to 1.50) margin clause will not be detrimental to an insured if the values are adequate as the margin component will provide an allowance for error.

However, having coinsurance apply on a policy is never in the insured's best interest. If the insured has made every effort to value their property correctly, the underwriter generally will have a comfort level with the values and most likely will be willing to provide the agreed amount endorsement eliminating coinsurance issues.

Most agents insuring difficult properties with standard markets or in the surplus lines marketplace are accustomed to providing loss limits and schedule values with margin clauses. However, these agents are careful about waiving coinsurance whenever possible. It is important to remember they are two separate issues. Carriers may be using this new endorsement more and more; therefore waiving coinsurance will be essential to prevent unforeseen loss settlement complications.

Analogous to Protective Safeguards Endorsements/Wording

Protective Safeguard, like the new ISO Limitation on Loss Settlement – Blanket Insurance (Margin Clause), started out as an endorsement. The “Protective Safeguard” name of the endorsement from an insured's perspective may have seemed like a coverage enhancement. However, Protective Safeguard endorsements do not safeguard the insured; they safeguard the insurance company. There are various requirements in the endorsement the insured must comply with or coverage can be voided.

When ISO issued the 2007 filing changes which included the Limitation on Loss Settlement endorsement, this was the introduction, *“An advantage of blanket insurance is that the insured can attain, in effect, full coverage at individual locations without insuring 100% of the total value of all locations. ...The policyholder retains the advantages and convenience of blanket coverage but the maximum loss payable on individual properties is constrained”*. Well, this doesn't sound so bad, but it can be devastating to insureds that have relied on substantial blanket limits that have suddenly disappeared. Initially, Protective Safeguard wording was always added by an endorsement. However, over the years, many insurance carriers have incorporated the wording into their policy forms, making the restrictions much more difficult to detect in the policy. Other carriers routinely add on every policy where an insured has burglar alarms or sprinkler systems, even though there was no mention of this endorsement or wording applying in their quotations. Agents must be diligent in checking quotations and policies to determine whether or not Protective Safeguards endorsements or wording have been added. Every attempt should be made to have it removed from the policy or explain the restriction in detail to their clients. Already agents report seeing the new ISO Limitation on Loss Settlement – Blanket Insurance (Margin Clause) automatically added to the declaration page wording, with some insurance carriers and other carriers adding the endorsement to renewal policies. This is nothing new; insurers routinely add restrictive wording or endorsements and change policy forms which reduce coverage without notifying the agent or policyholder.

Conclusion

As agents, like our insureds, we are concerned about price, a major component in securing and retaining accounts. In some instances this has fueled a silent complicity with our insureds to undervalue property for premium savings when blanket coverage and agreed amount waiver apply. Perhaps a better approach is valuing the property correctly and driving a hard bargain with the insurance carrier underwriter on rate. In other words, let's assume the total values are \$50,000,000 with a .26 rate per \$100 in values (\$130,000 annual premium), but we learn these values are inadequate by 25% and really should be \$62,500,000. If the underwriter was comfortable with the pricing at \$130,000, is it possible for the underwriter to reduce their rate to .205 to keep the premium level yet use the proper values?

With proper values it is easier to get the underwriter on board to continue providing blanket coverage with the agreed amount waiver, as the new ISO endorsement is optional. If the only way you can secure coverage is on a stated value amount, having proper values will almost always convince the underwriter to waive coinsurance and provide a significant margin clause, which is the next best alternative to blanket coverage.

- Explain to your client the need to review their values and insure properly. Assure the insured they should approach this project without worry to premium cost as it is your job to get the rate down so they can insure proper values.
- Secure blanket coverage with agreed amount waivers whenever possible.
- *The only way to be certain about the coverage provided is to require a specimen policy with all the endorsements that will be attached to the policy with the quotation and read them.* The policy form and endorsements should be compared to the prior years to look for changes, limitations, restrictions or exclusions.
- Have a check list for the “red flag” items like Protective Safeguards and Limitation on Loss Settlement or Margin Clause wording. Prior to binding, get as many of the unacceptable terms and conditions amended or eliminated.
- Once you have negotiated the best situation for your client, clearly explain to your client exactly how their policy will respond in the event of a loss.