

# Average Clause (Insurance)

## What does this mean?

The Average Clause is a rule in property insurance that reduces the claim amount if the property is insured for less than its actual value.

It applies when the Sum Insured is lower than the true replacement or reinstatement value of the property. In such cases, the insurer treats the policyholder as sharing part of the risk.

In simple terms, if you insure for less, you get paid less.

## Why is this Important?

### **Prevents underinsurance**

Encourages policyholders to insure property at the correct value.

### **Directly affects claim payout**

If the property is underinsured, the insurer will pay only a proportion of the loss.

### **Protects insurers from partial coverage risk**

Ensures fairness by sharing loss between insurer and policyholder when underinsured.

### **Critical for setting the right Sum Insured**

Incorrect valuation can lead to significant out-of-pocket expenses during claims.

## How does it Work in Insurance?

The insurer compares the Sum Insured with the actual value of the property at the time of loss.

If the Sum Insured is lower than the actual value, the claim is reduced proportionately.

**Formula used:**

Claim Payable = (Sum Insured ÷ Actual Value) × Loss Amount

This means the insurer pays only the insured percentage of the loss.

## When Does the Average Clause Apply?

It applies when:

Property is underinsured

Reinstatement value increases but Sum Insured is not updated

Renovation or additions increase property value

Inflation increases construction costs

It applies even for partial losses, not only total losses.

## Where is it Applicable?

Average clause is commonly used in:

Home and property insurance

Commercial property insurance

Contents insurance

Fire and special perils policies

## Simple Example

A shop's actual value is ₹1 crore.

The owner insures it for ₹50 lakh (50% of actual value).

A fire causes damage worth ₹20 lakh.

Using the average clause:

Claim =  $(50 \text{ lakh} \div 1 \text{ crore}) \times 20 \text{ lakh} = ₹10 \text{ lakh}$

The insurer pays ₹10 lakh, and the owner pays the remaining ₹10 lakh.

## Key Points to Remember

Applies when property is underinsured

Reduces claim proportionately

Encourages correct valuation of property

Applies even for partial losses

Avoided by insuring at full reinstatement value

## Simple Summary

The average clause reduces claim payment when property is insured for less than its actual value, making the policyholder share part of the loss.