FINANCE FORUM

Corporate Exposure: Understanding Your Policy, Part I

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It may seem like an obvious point, but executives must understand their company's insurance coverage and the claims reporting procedure under the policy, for failure to comply with proper reporting of a loss could result in no coverage.

Over the next three months, we will review various aspects of insurance policies and how they work. Specifically, we will focus on the difference between a deductible clause and a self-insured retention; the impact of deductibles on premiums; general policy coverage; court-imposed awards; policy limits; a legal defense issues; what and when to report claim; and the difference between excess and umbrella policies.

Deductible versus Self-Insured Retention

With a deductible provision, the insurance company assumes defense of a claim, settles the loss, subtracts *your deductible* from the payment, and releases a check for the balance. The key point is that the insurance company "assumes the defense" of the claim, thus handling it to conclusion.

With a self-insured retention (SIR) program, *you* assume defense of the claim through your resources; once your retention has been exhausted, the insurance company then assumes the claim. What if the insurance company thinks your cost to defend the action is exorbitant or that your approach was wrong, thus exposing the policy? Welcome to the world of negotiation and, unfortunately, bad faith issues. With a self-insured retention, you pay the defense, so you determine the proper strategy. It's your call on how the defense should be positioned, and you determine the avenue of best recourse. Unfortunately, the insurance company may disagree with your decision afterwards and feel you have adversely affected or even jeopardized the policy. Most policies contain a clause (that you agree to when purchasing the policy) stating you will not interfere, inhibit, or obligate your carrier. In cases in which your insurance carrier does not accept your claims approach, it will usually issue a "reservation of rights" notice. This means the company will investigate your approach, the reasonableness of the claim, and your reporting procedures; only then will it decide whether the loss should be covered by your policy.

As you can no doubt appreciate, in most lawsuits there is no one right or wrong approach. You may, for example, decide to deny liability and fight a claim to preserve your good name and reputation. Yet the carrier may believe that a quick settlement is the proper course of action. This is not an uncommon occurrence. Review carefully who has the right to select legal counsel and when the carrier must be notified.

Reporting a Claim

With a deductible plan, it's probably best to report a claim as soon as possible and let the carrier develop the proper strategy. *Caution:* The carrier is usually attempting to settle the claim as quickly and cheaply as possible. The long-term effects the settlement may have on your business will be afforded little concern. More and more frequently, we are witnessing business opportunities that are affected by the organization's claim experience. So, where it may prove financially sound for the insurance company to settle 1000 claims for $100 apiece, it's evident that the company is not considering the precedent or potential long-term impact this approach may have on *your* product or organization. Suffice it to say that in a deductible program, you should be involved with the carrier's claims approach since it will have a long-term effect on your organization—and keep in mind that your current carrier may not write your coverage next year.

With a self-insured retention plan, it's also a good idea to get your carrier involved as soon as possible. Get the carrier's endorsement to your approach; this will deter the reservation of rights issue we discussed earlier. In addition, we advocate you develop a defense strategy or claims philosophy *before* purchasing insurance. This philosophy should be presented to the carrier for its acceptance and become an intricate element of your risk management plan.

Choosing an Attorney

Before purchasing a policy, develop a list of qualified attorneys you intend to use in the event of a claim and submit it to your carrier for approval. It's important to select attorneys who understand your business. Carriers often select law firms for political or price considerations, not for qualifications or performance. Most carriers will go along with your selections—especially if you have given them a choice or an opportunity to review, comment, select, and endorse your choices. Remember, you must submit this list of attorneys along with your claims philosophy before you buy the policy. Attempting to implement this practice after a loss will not sit well with your insurance carrier.

Next month: Deductibles—their impact on premiums

Harry P. Mirijanian is president of Applied Risk, an independent risk management services firm established to assist the business community in reducing exposure to loss and insurance costs. He is a frequent speaker for AMA.