

UNDERSTANDING CLAIMS MADE LIABILITY INSURANCE

There is considerable confusion on the part of the insurance buying public as well as many insurance agents regarding how a "Claims Made" liability policy works and what, in the end, becomes the actual premium for a claims made policy purchased for any given year.

Claims made liability insurance has been described as the process by which the insurance company transfers the majority of the risk from itself to the policyholder. In order to understand how this is done you have to understand the difference between "occurrence" and "claims made" policies.

The occurrence policy covers the insured for incidents that occur during the specific term of the policy. An example would be an accident that occurred on July 1, 1995. The insurance company that issued the policy in 1995 would be required to pay for a covered incident under an occurrence policy even though the incident was not reported or a claim made against the insured until 2002 or even later.

With an occurrence policy, one (1) premium is paid, the insured has a guaranteed cost for the period the policy was in force, the insurance company has assumed 100% of the risk, and coverage continues indefinitely for any accident that happened during the policy period regardless of when the claim was reported to the insured or the insurance company.

That is not the case with a **claims made policy**. With a claims made policy a claim must actually be made against the insured during the policy period. This seems like a subtle difference but, in fact, it is a huge transfer of risk from the insurance company to the insured.

Why? Because historically well over half of all claims are made after the 12-month period has expired.

If the company issuing the claims made policy does not renew coverage or if the insured does not renew, the insured has no coverage for those claims that have occurred during the policy period, but have not yet been reported. The result is that the insurance company has effectively transferred most of the uncertainty from itself back to the policyholder.

Claims made insurers usually will offer "tail coverage" or an extended reporting period should they or the insured decide not to renew coverage. The offer of tail coverage sounds noble, but keep in mind that the insured has already paid a premium once.

The additional cost for extending the claim reporting period is commonly 100% of the original premium for one year, 200% for two years, 300% for three years.

At the end of just one policy period, the claims made insured can be at the mercy of the insurance company with three tough choices: pay what the current insurer demands, pay another company to provide the same coverage or decide not to pay and become self-insured.

One last thing to think about:

Even if the insured chooses to buy "tail" coverage, when the extended reporting period ends, the claims made insured is, like it or not, now self-insured for any claims that have occurred but have not yet been reported.

That is why there is no guaranteed cost with a claims made policy.



Health Cap

The Health Care Industry Liability Insurance Program