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The Devil Is in the Details, So Know Your Insurance Sublimits

As insurance policies become increasingly complex, it is important for risk management professionals to be aware of the details within the insurance contracts. It is not enough to know the overall limits and the general nature of the insurance coverage. Policyholders need to understand that whether they ultimately will have coverage for a loss, regardless if it is first- or third-party in nature, usually is determined by the details of the contract language. In short, the devil is in the details when it comes to coverage in most instances.

One way in which insurers increasingly look to limit their risk within the insurance policy is the use of sublimits. These limits are monetary limits of the insurance within a particular area of coverage that are less than the policy’s general limits connected to that coverage agreement. The sublimit may be stated as a dollar figure or a percentage of the aggregate limit. For instance, a business owner may have a commercial crime policy to insure against various types of theft. The crime coverage is part of an overall property policy providing various aspects of first-party property coverage to the insured. While damage to buildings may be a $1 million limit, there are sublimits within the crime coverage, such as $10,000 for “Money and Securities – Inside the Premises” and $25,000 for “Employee Theft.” Thus, even within the coverage agreement of a policy there can be various sublimits for the general coverage type as seen in this example.

Often, the policyholder is focused too much on the general type of coverage, such as property coverage, and on its main risk—for example, the loss of its factory. The policyholder fails to zero in on what may be perceived as its lesser risks and those with far lower sublimits. When the insured loses $500,000 to embezzlement, a sublimit of $25,000 is going to really hurt. The pain may be increased when there is a deductible attached as well. A $5,000 deductible now reduces that sublimit to $20,000. Ouch!

A critical area to watch for concerning sublimits is cyber insurance. These policies are new to the marketplace and vary widely between insurers. While many policyholders have a far better understanding of standard CGL and property coverage, it remains critical for them to take extra time to truly understand the nature of a new cyber policy being added into their insurance program. This type of insurance can cover many first- and third-party losses connected to a data breach, but these policies also often carry various sublimits for different aspects of coverage. A low sublimit on a critical component to the coverage, such as computer network restoration costs, may leave the policyholder feeling like it has no coverage at all because it cannot afford to pick up the difference.
One bright side to this vexing concern is that sublimits are listed on the policy’s Declarations Page. Thus, the dollar figure and general coverage area connected to the lower limits is easier to find than the bedeviling details buried in exclusions and definitions that can also reduce or eliminate coverage all together. At the time of each renewal, a policyholder should examine changes to its risk profile and address the need for increased coverage based on that examination. This process is also necessary whenever there is a major change within the organization. For example, if a policyholder merges with another company, its risk of loss likely increases, and its policy limits should increase as well. Returning to the crime coverage example, if a certified public accountant merges and adds 30 new CPAs and assistants who have some type of check writing authority for the company or clients, the risk of loss dramatically increases, and the crime coverage sublimit for employee theft as well as forgery likely needs to increase. The firm would not want to wait until the time of renewal to address this higher level of risk that arose from the merger.

Sublimits can show up in almost any type of insurance policy: homeowners to commercial property, and CGL to health insurance. Policyholders must be active in analyzing their risks and ensuring that they carry the appropriate coverage at the macro as well as micro (i.e. sublimit) levels. Working with an insurance broker and engaging coverage counsel to perform an insurance audit can provide a complete picture to coverage within a company’s insurance program. Once a loss is sustained and a gap in coverage is exposed, it is too late to address the problem through the transfer of risk to the insurer. The problem is catastrophic if that gap is too large for the insured to cover itself. Policyholders always are wise to assess their risk exposure and coverage needs ahead of time.

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