

Manager/Supervisor Risk Management

#101– 10/25/12

A twice weekly e-mail training for YCPARMIA members

TOPIC: INSURANCE LIMITS – DEDUCTIBLES, RETENTIONS AND SELF-INSURANCE

There are two ends to insurance coverage. We have discussed the top end when we talked about insurance limits and aggregates. The bottom end deals with deductibles and retentions; they represent the insured's portion of any payments starting at dollar one, and continuing until insurance coverage kicks in. Contractors assume higher deductibles or retentions to lower their premium. The issue to concentrate on here is the potential danger of a self-insurance retention.

There is a subtle but important distinction between the two. Under a deductible the insurance company's responsibility starts at dollar one; the carrier pays the full amount to conclude the claim, and then gets reimbursement for the deductible from their insured. Under a retention the carrier has no duty until the retention is paid; the carrier would only pay amounts in excess of the retention. Until the retention has been paid, the carrier pays nothing.

That leads to the danger of a self-insured retention. If the insured has a retention that they cannot afford to pay, the entity does not get the benefit of the protection found in the insurance policy. This is why the insurance provisions in a contract require the contractor to declare the amounts of any deductibles or retentions, and reserves the entity's right to address concerns after assessing the contractor's ability to pay their retention. Remember, the insurance requirements are in the contract to ensure that the contractor has the financial capacity to meet their obligation to defend and indemnify; if they can't pay their retention it is more than probable that they will not have the financial capacity to meet their hold harmless promises.

While it is a little different for workers' compensation where the state enforces funding requirements for a business to be permissibly self-insured, self-insurance really means no insurance. The contractor, rather than transferring their risk to a third party insurance company, retains the exposure, and uses their own funds to make claim payments. An entity needs to carefully consider if and when they are willing to accept self-insurance as the guarantee of the defense and indemnification promise found in the contract's hold-harmless clause. The size and reputation of the contractor are important factors to consider when assessing that risk. A retention that appears to be unreasonably high is probably one that should be refused. Maybe the most important question for evaluation is whether the entity would be willing to accept the risk of paying the retention to trigger coverage if the contractor fails to do so.

It should be noted that YCPARMIA is self-insured; there is no insurance. When our members are required to provide proof of their insurance they are submitting proof that they participate in a self-insurance program with deductibles and retentions. Parties in their contracts accept that coverage as adequate because of the financial strength and reputation of YCPARMIA, and that, until recently, California public entities had a history of meeting their financial obligations.

Next topic: Insurance Limits – Rating an insurance carrier