Module 11

Excess and Umbrella Liability Insurance

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Module 11
Chapter 11

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Objectives

- Obj I: Need for Excess or Umbrella Liability Coverage
- Obj II: Basic Differences: Excess and Umbrella Liability Policies
- Obj III: Excess Liability Insurance
- Obj IV: Umbrella Liability Insurance
- Obj V: Structuring a Liability Insurance Program

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Need for Excess or Umbrella Liability Coverage

Objective I

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Excess and Umbrella Coverage

- Excess and umbrella liability insurance are similar types of coverage.
  - Purchased for various reasons, including the need to increase CGL limits.
- Need for coverage is based on:
  - Difficulty in estimating the maximum possible loss for liability loss exposures.
  - Layering of liability coverages.
  - Effect of aggregate limits.

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Estimating Maximum Possible Loss

- Most property loss exposures have a relatively clear maximum possible loss (MPL).
  - No way to estimate MPL for most liability loss exposures.
- Possibility of loss over $1,000,000 exists for almost every organization.
  - Multi-million dollar verdicts have become common.

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Layering of Liability Coverages

- Insurers providing primary liability protection are often unwilling to provide a limit over $1,000,000 per occurrence.
  - A business may need to purchase excess or umbrella policies to achieve desired limits.
- A primary liability policy and excess policy are referred to as layers of insurance.
  - Multiple layers can exist.

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Layering of Liability Coverages

- Underlying insurance is insurance that applies below an excess or umbrella liability policy.
  - Insurance in a lower layer.
- Typically, primary coverage must be exhausted before the next layer makes any payment.
  - Some organizations prefer to retain (self-insure) the first layer.

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Effect of Aggregate Limits

- In addition to an each occurrence limit, one or more aggregate limits often apply to a policy.
  - Insured could have several liability losses during one policy year that exhaust an aggregate limit.
  - Would leave a subsequent claim uninsured or underinsured.

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Practice

- Because of the difficulty in estimating the maximum possible loss for liability claims, many insureds should consider:
  - A. Purchasing an excess or umbrella liability policy.
  - B. Increasing their commercial general liability policy deductible.
  - C. Creation of separate business entities for each service offering.
  - D. Implementing a risk management program designed to eliminate hazardous conditions.

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Basic Differences: Excess and Umbrella Liability Policies

Objective II

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Excess Liability Policy

- An excess liability policy provides excess coverage above limits of underlying coverage.
  - Offers no broader protection than that provided by the underlying coverage.
- Coverage may be even more restrictive than the underlying coverage.
  - Excess liability policy may not provide defense coverage.

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Umbrella Liability Policy

- An umbrella liability policy is a type of excess liability policy.
  - Provides additional limits, as excess liability policies do.
- Also provides coverage not available in the underlying coverages.
  - Subject to insured's assumption of a self-insured retention, or retained limit.
  - Most umbrella liability policies also provide defense coverage.

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Excess vs. Umbrella

- In practice, the difference between excess and umbrella coverage can be unclear.
  - Courts and insurance professionals often use the terms interchangeably.
  - Many insurers providing these coverages do not use standardized policies.

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Practice

- Which one of the following statements is correct regarding excess liability insurance and umbrella liability insurance?
  - A. Almost all insurers writing excess and umbrella liability policies use standardized policies.
  - B. From a practical standpoint, the distinction between excess and umbrella liability policies may be unclear.
  - C. Umbrella liability policies rarely provide coverage for defense costs.
  - D. An excess liability policy offers broader protection than that provided by the underlying coverage.

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Excess Liability Insurance

Objective III

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Excess Liability Insurance

- An excess liability policy covers liability claims in excess of the underlying policy's limits.
- May take any of the following basic forms:
  - Following-form – covers losses only if the loss is covered by the underlying insurance.
  - Self-contained – covers losses per the terms of the excess policy.
  - Combination form.
  - Specific and aggregate – when there is no underlying insurance.

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Following-Form Policies

- A following-form policy covers a claim only if the loss is covered by the underlying insurance.
  - True following-form policy would contain no provisions conflicting with underlying policy.
- In practice, following-form policies differ from underlying policies to an extent.
  - Some losses covered by underlying policy may not be covered by excess policy.

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Self-Contained Policies

- A self-contained policy does not depend on the provisions of the underlying policies.
  - Subject to its own provisions.
  - Applies to a loss only if the loss is covered under the self-contained policy.
  - Coverage gaps between self-contained policy and underlying policy can occur.

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Combination Policies

- An excess policy may combine features of following-form and self-contained policies.
  - May incorporate provisions of underlying policy and modify those provisions.
- Some excess policies provide the broader coverages often found in an umbrella liability.
  - However, do not provide primary coverage when a claim is excluded by primary policy.
  - No self-insured retention.

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Specific and Aggregate Insurance

- Specific excess and aggregate excess are used when there is no underlying primary insurance.
  - Specific policy – insured must retain a specified amount of loss from each occurrence.
  - Aggregate policy – insured must retain a specified amount of loss during a specified period of time, usually one year.
- Often used with self-insured workers compensation arrangements.

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Practice

- Which one of the following statements is correct regarding a self-contained excess liability policy?
  - A. It is typically used in connection with self-insured workers compensation plans.
  - B. It is basically nothing more than an increase in limits to the underlying policy.
  - C. It requires a self-insured retention.
  - D. It generally does not depend on the provisions of the underlying policy.

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Umbrella Liability Insurance

Objective IV

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Umbrella Liability Insurance

- Umbrella liability is an excess policy that is broader than ordinary excess liability policies.
  - Provides limits above each occurrence limit of primary policy.
  - Takes the place of primary insurance when aggregate limits are exhausted.
  - Covers losses that are not covered by primary policy, subject to SIR.
- Almost all umbrella policies contain aggregate limits, similar to primary insurance.

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Drop-Down Coverage

- Drop-down coverage is provided when underlying policies do not provide coverage.
  - Also provided when aggregate limits of underlying policy have been depleted.
- Drop-down coverage is usually subject to a self-insured retention.
  - Similar to a deductible.
  - Only applies when underlying policies do not provide coverage at all for a loss.

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Required Underlying Coverages

- Each insurer has its own requirements for the types and amounts of underlying insurance the insured must have.
  - Umbrella limits apply in full in excess of each for the underlying coverages.
- For example, the insurer may require the following CGL coverage:
  - $1,000,000 each occurrence.
  - $2,000,000 general aggregate.
  - $2,000,000 products/completed op. aggregate.

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Aggregate Umbrella Limits

- Most umbrella policies contain aggregate limits.
  - Operate like primary insurance aggregate limits.
- Aggregate limit can apply to:
  - All umbrella policy claims, or
  - Only to coverages that are subject to an aggregate in the underlying policies.

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Coverage Triggers

- Umbrella policies typically have an occurrence coverage trigger.
  - However, underlying policies could have occurrence or claims-made triggers.
- Some insurers provide both occurrence and claims-made triggers in umbrella policies.
  - Avoids coverage gaps when the umbrella or excess policy has a different coverage trigger than the underlying coverage.

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Exclusions

- Exclusions in umbrella policy are similar to those in underlying policy.
  - Exclusions in umbrella policy may have narrower application than underlying policies.
- Umbrella policy may contain an exclusion that does not exist in the underlying policies.
  - Example – umbrella policy excludes injury due to exposure to lead.

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Conditions

- There are differences between the general conditions of primary and umbrella policies.
  - Maintenance of underlying insurance – obligates insured to maintain all required underlying coverages.
    - If underlying insurance is not maintained, the umbrella policy will apply, but will not drop down.
  - Coverage territory – most umbrella policies provide worldwide coverage.

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Practice

- With respect to a commercial umbrella liability policy, a self-insured retention would apply when:
  - A. Supplementary payments are incurred under the claim.
  - B. The claim is covered under the umbrella policy but not covered under the primary policy.
  - C. The primary policy provides inadequate coverage to satisfy the claim.
  - D. The insured has not satisfied the coinsurance requirement of the primary policy.

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Structuring a Liability Insurance Program

Objective V

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Layering of Coverage

- Liability insurance is often arranged in layers.
  - First layer consists of primary coverage.
    - Includes CGL and business auto coverage.
    - Typically has each occurrence limit ranging from $500,000-$2,000,000.
    - May be self-insured.
  - Second layer is often umbrella or excess layer.
    - May be a buffer layer.

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Working Layers

- The primary and umbrella layers are generally referred to as the working layers.
  - Layers most often called on to pay claims.
  - Many organizations have only one layer in excess of the primary.
- An organization in this category has an umbrella policy above its primary CGL, auto, and employers liability coverage.
  - Organization may also have separate excess liability policies.

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Buffer Layers

- Insured may be required to purchase a buffer layer of excess insurance.
  - Between primary layer and umbrella policy.
- Umbrella insurer requires insured to have underlying coverage limits higher than those the primary insurer is willing to provide.
  - Insureds should try to obtain a policy that follows provisions of the underlying policy.

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Adequacy of Excess Liability Limits

- Layering of coverage allows many insureds the opportunity to secure high levels of protection.
  - However, limits may still be inadequate.
- Risk managers of large corporations commonly purchase the highest limits they can obtain.
  - Organization can get most risk management value from insurance only when it is properly combined with noninsurance techniques.

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Practice

- ABC Company purchased a commercial general liability policy with the following limits:
  - $1,000,000 per occurrence limit.
  - $2,000,000 general aggregate limit.
- The company also carries an umbrella liability policy with the following limits:
  - $2,000,000 per occurrence limit.
  - $2,000,000 general aggregate limit.
  - $25,000 self-insured retention.
- A covered claim arises, resulting in a judgment of $2,400,000 against the company. How much of the judgment will be paid by the umbrella liability policy?
  - A. $1,375,000.
  - B. $1,400,000.
  - C. $2,375,000.
  - D. $2,400,000.

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