AmWINS Group, Inc.

THE VALUE OF A SELF-INSURED RETENTION FOR HABITATIONAL INSUREDS

HELPING INSUREDS TAKE CONTROL OF THEIR LOSS EXPERIENCE

As the market for habitational casualty insurance continues to harden, both primary and excess carriers are being more selective, raising prices and attachment points, and are increasingly unwilling to consider risks with claim-frequency issues. Given these conditions, certain insureds may benefit from moving from a deductible to a self-insured retention (SIR) program.

The distinguishing difference between a deductible and an SIR is how claims are handled. For insureds under a deductible program, the carrier has complete control of how much a claim is settled for, as well as when it is settled. With an SIR, the insured is responsible for hiring a third-party administrator (TPA) to handle the claims that fall within the SIR.

DEDUCTIBLE

In the current marketplace, the vast majority of habitational risks are written with a deductible, or even with a zero-dollar deductible. However, for insureds that own or manage a large schedule of apartments, gone are the days where they can obtain first-dollar coverage, or even small deductibles.

Since each carrier has its own reserving and settlement philosophies, which are often based on the nature and extent of the damages rather than legal liability, claims may be paid which would otherwise be contested. When compared with an SIR, deductible programs have far fewer claims closed for no payment. The resulting impact on frequency and severity can affect premium and retention options at renewal.

SIR

To better understand how an SIR works, let's review an example.

> A large multi-family apartment building typically incurs several liability claims each year. Most claims are small, but the apartment building has incurred a few that exceeded $100,000. The schedule is insured under a general liability policy that has a $1 million each occurrence limit. To reduce the cost of liability insurance, the building owner has elected to retain some losses and has decided to self-insure the first $100,000. If a claim occurs, the building owner must pay damages up to the $100,000 retention amount. If the damages exceed $100,000, the owner's liability insurer will pay the remaining amount, up to the $1 million policy limit.[1]

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CONTACT

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Courtesy of AmWINS Group, Inc.

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As with a deductible, an insured is financially responsible for the retention within an SIR. However, unlike a deductible, the insurance carrier does not participate within the retention, and the insured is responsible for the administrative component of claims up to the amount of the SIR. This administrative burden is generally handled by a third-party administrator (TPA).

When insureds implement an SIR instead of a deductible along with an aggressive TPA, they are better able to impact the reserving and payment process within that retention level. This often results in a better loss experience from a frequency and severity standpoint, and may also afford premium relief at the next renewal.

WHO CAN BENEFIT FROM AN SIR

Insured retentions vary depending on the size of risk, portfolio, frequency of claims, and the amount of risk the insureds are comfortable taking and can financially retain. Attachment points as low as $10,000 are available, but retentions ranging from $25,000 to $100,000 are more common.

There are multiple factors to consider when looking at a self-insured retention, including portfolio growth and composition, which have a direct impact on insurance rates. In the current rate environment, portfolios with more than 5,000 units, class B and C communities, and affordable housing are seeing the most benefit from utilizing an SIR to take control of their claims management.

Claim frequency also has a direct impact on the decision to move to an SIR. When claim frequency on habitational programs exceeds 20-25 claims per policy year, carriers don't always have the capacity or specialization to manage the program effectively. Moving to an SIR and partnering with a TPA that focuses on habitational business can relieve carriers of the frequency burden and illustrates a desire to control costs, which can potentially open an insured to interest from different carriers.

However, simply having claim frequency issues or large portfolios with difficult risks does not mean that an SIR is the right solution for your insured. For an SIR to have a positive impact on an insured's total cost of risk, the insured should have an administrative team that understands the risk inherent in the portfolio and how to mitigate and reduce those risks. Furthermore, this team should be able to manage the claims or work closely with the TPA that is doing so on its behalf. Finally, there are financial implications of an SIR that should be considered, as the insured is responsible for all claim's expenses, including defense, until the SIR is met.

THE VALUE OF A TPA

Many third-party administrators offer industry specialization and most have attorneys to adjust the claims, benefits which can impact frequency and severity. Beyond this expertise, the ability to tell a claimant's attorney that his or her client is self-insured provides leverage when the TPA is negotiating a claim. Finally, through ongoing collaboration, a TPA's approach to when and how to settle a claim can more accurately reflect an insured's philosophy to claims management.

COST-SAVING EXAMPLES

Great Prairie Risk Solutions, a TPA with expertise and specialization in the habitational space, shared the following scenarios that illustrate the potential cost savings of making the switch to an SIR.

- Client A manages mixed-use facilities, which include multi-family housing as well as commercial and retail space, and averages 907 incidents per year. Under a deductible program, their total incurred losses over a three-year period was $4,176,860, and the average cost per incident was $1,535. Under an SIR, their total incurred losses for a three-year period fell to $2,859,351, and the average cost per incident was $1,051 **– a reduction in claims expense of 32%.**

ON YOUR TEAM.

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- Client B has a portfolio of multi-family housing buildings that averages 28 incidents per year. Under a deductible program, their total incurred losses over a three-year period was $537,164, and the average cost per incident was $6,395. Under an SIR, their total incurred losses for a three-year period fell to $256,988, and the average cost per incident was $3,059 – **a reduction in claims expense of 52%.**

CONCLUSION

A self-insured retention is not appropriate for every habitational risk, but it is a viable and cost-saving solution for many. The benefits and savings associated with utilizing an SIR to control loss experience can be material. Taking some level of risk in the claims process and partnering with a third-party administrator that specializes in the insured's line of business and class of risk can help maximize coverage benefits and savings.

SOURCES

[1] The Balance Small Business (January 2019). Protecting Your Business With a Self-Insured Retention. https://www.thebalancesmb.com/protecting-your-business-with-a-self-insured-retention-462557