

Understanding Claims-Made Liability Insurance

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What is *claims-made liability insurance*? Under claims-made liability insurance, coverage is triggered by the date you first became aware of the possibility of a claim and/or a claim is actually made against you, and when you notify the insurer of your knowledge of the claim or potential claim. The insurer's policy that is in force on the date you became aware and give notice is the policy upon which the insurer must defend and settle the claim.

Claims-made coverage is vastly different when compared to so-called "occurrence" coverage (which is the way your auto, homeowners and most other forms of insurance are written). Under an occurrence policy, the policy in force on the date of the event causing the loss must respond with defense costs (principally attorney fees) and settlement expenses. The claim may arise years after the policy has expired and the policy in force at the time of the loss event must still respond.

Generally speaking, up until 2001, both "occurrence" and "claims-made" forms of general liability insurance, including product liability, were available to companies in the dietary supplement industry. About that time, due to the most difficult commercial insurance market in more than 50 years, claims-made coverage became the only available form of coverage. Claims-made coverage has been the only available form of coverage available to the dietary supplement industry for several years.

Many insurance brokers unfamiliar with claims-made coverage will tell you it is "bad" coverage that further "locks you in" to one carrier without the flexibility to bring in competitive carriers to quote or compete for your account. A broker who gives you this advice is wrong.

Virtually all forms of professional liability for doctors, accountants, board directors, real estate and insurance brokers, and many others, are written on claims-made coverage forms. If managed properly over time by a competent, knowledgeable insurance broker, there is nothing undesirable, restrictive or uncompetitive about claims-made coverage.

If there is one negative aspect to claims-made insurance, it is its complexity. Companies visit the subject of their claims-made policy once a year, and in the long interval between renewal periods, it is easy to forget the intricacies of how the coverage works and the requirements to report claims or potential claims to the insurer. Claim denial for "late claim reporting" can be the result. However, these complexities merely underscore the need to retain a competent broker with experience not only in claims-made issues, but also in the dietary supplement industry.

What is the Retroactive Date?

Claims-made policies didn't become common until the 1980s and were written for entities that previously had occurrence coverage. Any losses that occurred prior to the first claims-made policy were insured under the previous occurrence policies. The insurer, to avoid redundant coverage and prior exposures, added a retroactive date to the policy. The claims-made policy doesn't insure any incidents that occur before the retroactive date, which is usually the inception or start date of the first claims-made policy. For example, if you purchased your first claims-made policy on January 1, 2000, making this the retroactive date, the policy wouldn't cover any claims arising from an accident occurring prior to January 1, 2000, even if the claim is presented during the current policy term. The prior occurrence policies would cover that loss.

The rule is: Never change the retroactive date. Sometimes when considering a change in insurance companies, the new carrier wants to advance the retroactive date to the inception date of its policy. This offer may sound attractive as it will reduce the premium. However, if you accept this offer, you forfeit coverage for any losses that occur between the date of its first claims-made policy and the inception date of the new policy. Insurance brokers commonly call this "losing your retroactive date." Most often it is a decision, rather than a loss, made by an unknowing insured in combination with a broker that does not understand the consequences and therefore can't explain it properly.

Losing your retroactive date creates a gap in coverage that could span several years, and effectively means that the entire premium you paid for past policies is completely wasted. Avoid this at all costs.

Applications & Liability Coverage

Most people do not realize with most claims-made insurance, the application becomes part of the policy that is issued, and thus acts as a warranty. This means if there are material misrepresentations in the application, the insurance company can subsequently void coverage. This will happen at the worst possible time—when a claim is submitted, which will cause the insurer to examine the application once again. It is therefore imperative the application be an accurate representation of the company's overall operations.

Underwriters evaluate applications based upon objective and subjective bases. Objectively, they examine projected sales volume, industry category (raw materials, contract manufacturer, etc.), proof of GMP (good manufacturing practice) compliance, and past insured losses, as well as other factors. Subjectively, they review years of experience in the industry, resumes of key players and, if they respect the opinion of the broker, the guidance the broker provides. Based upon these factors, the underwriter will decide what the premium will be for next year.

For a number of reasons, companies may consider reducing the limits of insurance they have historically purchased, most often with the goal of saving money. On the surface this may seem like an easy decision; but, with claims-made coverage, there can be serious consequences. For example, if a company had been purchasing \$5 million of coverage for several years, back to the retroactive date, and is considering dropping coverage to \$2 million, the insurance drops to \$2 million back to the retroactive date. As a practical matter, this means if a loss event happened last week and you find out about it after you have reduced the limits of insurance, the limits of insurance available for that claim when made will be \$2 million, not \$5 million that was in place when the claim actually happened. Most people find out about this the hard way—after a claim is made and the company has reduced the limits of insurance without being fully informed of this pitfall.

In conclusion, claims-made liability insurance can be tricky, but it is easily managed by a knowledgeable business owner, in concert with a knowledgeable insurance broker. With proper expertise, potential pitfalls can be avoided. Important features such as the workings of retroactive dates and the importance of the application must be kept in mind when reviewing coverage annually. Selection of an insurance broker familiar with all of these issues, and one with expertise in the dietary supplement industry, will go a long way toward keeping premium costs' down and coverage as broad as possible.

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