

**Allocation of Coverage
All Sums versus Pro Rata**

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- **Agenda**
 - We will describe the methods of allocation for multiyear policies and their rationale.
 - We will discuss why all of you need to be aware of this in both reserving and underwriting functions
 - We will offer some suggested defensive practices.

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- Asbestos, environmental, construction defects and others – are covered by multiple policies and policy periods, which may have different insurers, or even no insurer, different limits, and different SIR's or deductibles.
- After the court decides the trigger, the next step is allocation.

Allocation of Coverage All Sums versus Pro Rata

- All Sums
 - The 1973 GL policy insuring agreement says "The company will pay on behalf of the insured **all sums** which the insured shall become legally obligated to pay as damages"
 - The 1986 GL policy insuring agreement says "We will pay **those sums** that the insured becomes legally obligated to pay as damages..."

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- The Keene decision (DC circuit 1981)
 - Asbestos case: "all sums" or "joint-and- several" allocation.
 - "the problem of indivisible injury is resolved simply by collapsing the continuous injury into one year. Joint-and-several allocation effectively allows a policyholder to simply select one triggered year and exhaust the coverage provided during that period in satisfaction of its claim ... requiring the insurers to sue each other for contribution."
 - The rationale is that each policy promises indemnification to the insured for "*all sums*" which the insured shall become legally obligated to pay as damages.

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- Under the Keene approach, the insured is entitled to choose, at its discretion, which policy is required to respond to the full liability.
- Naturally, policyholders choose a year with small retention and large limits. In practice, if the loss exceeds the limits for any one year, the policyholder can pick two years.
- If the policyholder was uninsured or self-insured for some years, the insurers go bananas and even the courts which like All Sums get confused.

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- Pro-Rata
 - The 1986 GL policy insuring agreement says "This insurance applies only to "bodily injury" and "property damage" which occurs during the policy period."
 - The 1973 policy is not as specific, but the idea that coverage granted and premium charged both apply to a specific period (usually one year) is pretty clear even to a judge.

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- The Forty-Eight Insulations case (6th circuit 1980)
 - Pro-rata time on the risk allocation places emphasis not on the "all sums language but rather on the fact that the policies provide "indemnification for liability incurred as a result of an accident or occurrence during the policy period, not outside that period."
 - "Each insurer is liable for that period of time it was on the risk compared to the entire period during which damages occurred."
 - Generally, pro rata allocation jurisdictions require an insured "to accept a proportionate share of a risk that it elected to assume, either by declining to purchase available insurance or by purchasing what turned out to be an insufficient amount of insurance."
 - But such assignment to the insured is inappropriate where coverage was unavailable. (2nd circuit 1994)
 - New Jersey allocates by time and limits.

Allocation of Coverage All Sums versus Pro Rata

- There are four big differences
 - All Sums picks one low deductible, pro rata has many. So All Sums is always a bigger claim.
 - Under "All Sums", the insurers have to have a second complicated action to allocate among themselves.
 - Under "pro-rata", self-insurers pay a fair share – but under "All Sums" the reallocation is only among the insurers, because the insured has settled out in the first case.
 - Under "All Sums" there is a spike up into higher layers in the selected year[s]. But in pro rata the amount per year is much less and it is hard to get any contribution from excess carriers, and no chance with reinsurers who attach above the annual share.

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- Reserving – why do you care?
 - If you are the lucky guy who gets picked for “all sums”, you have a large *probable* recovery from other insurers, and lots of notices to give them.
 - If you are not the one, you have a large probable liability but you have not received a claim and are not a party to the litigation until after the all sums judgment.
 - In both all sums reallocation suits and pro-rata initial allocations, what about varying limits, deductibles or SIR's from year to year? Are they ignored, and each year pays the same share. Except in New Jersey, I think so.

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- Underwriting – why do you care?
 - If a previous insurer is bankrupt, you may have to pick up their share. Should you refuse, or price up, an insured because a prior insurer is insolvent, or weak?
 - On OD exposed accounts, low deductibles and high limits might be attractive to the insurer, because you get more premium, but in a multi year loss you probably pay the same share as a high deductible and low limit insurer.
 - Excess Reinsurance and Excess direct policies are *more* attractive in jurisdictions which have supported pro-rata. There may be a huge catastrophic OD loss which costs you nothing.
 - Excess Reinsurance and Excess direct policies are *less* attractive in jurisdictions which have supported pro-rata. The spike in the selected year is a matter of concern.

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- Sympathize with the courts –
 - I prefer pro-rata but it is not perfect:
 - 15 to 30 years are not really equal: there has been a huge change in the value of money, and in awareness and improved risk management
 - The insured can suffer way too much in deductibles if he has to absorb 20 or 30 of them.
 - Excess layers escape even though it is a terribly severe loss

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- **Grand Finale:**
- What you don't know **can** hurt you.
- If you have **ever** insured a policyholder who is claiming an OD type loss against another insurer, get information early and often.
- Remember it can happen in Workers Comp too, not just GL.

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