Cowan
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News & Views

The Cost of Aggregate Limits

When purchasing an insurance policy, municipalities are diligent in examining product and price to find the best solution for their needs. However, there is one area where decision makers may believe their municipality is fully covered when in fact they could end up funding claims.

The key issue here is a special limit of liability known as the "Aggregate Limit". The aggregate limit is separate and distinct from the "per occurance/claim limit", which is the maximum amount an insurer will pay per claim. In contrast, the aggregate limit is the maximum amount a policy will pay out as a result of claims during the policy year. It is an "annual cap" on policy payments.

Aggregate limits may be found in Municipal Liability Policies, Commercial General Liability Policies and Errors & Omissions Policies.

Examples of Aggregate Limits

Fact: You purchase a Public Officials Errors & Omissions Policy with a $5 million per claim limit. The policy also has a $5 million aggregate limit.

Claim #1: In 2005 a developer acquires land and begins construction of condominiums before obtaining title and building permits. You, as the municipality, allow the construction to continue before reviewing the architectural and engineering drawings. Problems with the roof trusses and fire separation walls are discovered and the units are ordered evacuated. In February 2006, the developer claims against your municipality for $2.65 million.

Claim #2: In May, of that same year, a second building inspection claim is presented. A townhouse development that was built in 2003 is found to never have had an inspection by a building inspector. Several code infractions are discovered and all unit holders are evacuated from their units. A claim is presented against the municipality for $3 million.

How will the policy respond?

Claim #1: Since the $2.65 million is within the limit per claim of the policy and it is also within the aggregate limit, it would be paid fully by the insurer.

Claim #2: The policy will not be able to pay the full claim of $3 million. It will only be able to pay $2.35 million because that is all that is left after paying Claim #1. That means the municipality will have to find the funds to pay the remaining $650,000.

How will you finance the remaining amount?

One solution is to look to an Excess Policy. It will be necessary to examine the Excess Policy's terms and conditions. Does the policy have a "drop down feature" or does it require an underlying limit of $5,000,000? If there is no "drop down feature" then the Excess Policy will not respond because the underlying limit has been exhausted.

Therefore the municipality will have to fund the remaining $650,000.

Of more significance in the above examples is the fact these claims have occurred within the first five months of the policy term. That means there is no further protection afforded by this policy for the remaining seven months and leaves the municipality on the hook to pay for this shortfall in coverage. Are aggregate limits really right for your policy?

While policies with an aggregate limit can seem like a good deal, simply because they tend to be less expensive, it may mean paying more in the end.

Frank Cowan Company
4 Cowan Street East
Princeton, ON N0J 1V0
Phone: 519-458-4331 Fax: 519-458-4366
Toll Free: 1-800265-4000
www.frankcowan.com