Self-insurance retention

How to weigh the pros and cons of SIRs vs. deductibles

INTERVIEWED BY ROGER VOZAR

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Saving money on insurance sounds good to any business, particularly one that may be struggling. But going with a policy that includes a self-insurance retention (SIR) can be risky, especially if you become involved in a lawsuit.

"Companies that are struggling to stay in business and accept a larger SIR than they probably should can be put in a very bad position because they may be without insurance protection if they are not able to satisfy the SIR," says Michael T. Ohira, a partner at Ropers Majeski Kohn & Bentley PC.

Smart Business spoke with Ohira, whose practice includes advising insurers in construction defect lawsuits, about how SIRs work and when they make sense for businesses.

What are the key differences between SIRs and deductibles?

The differences are pretty profound. SIRs and deductibles are both forms of risk assumption by the policyholder and are traditionally for a set amount, generally referred to as the retained limit. The policyholder basically agrees to be responsible for paying losses or claims within the retained limit, although there are differences regarding when the insurance company's duties begin.

With an SIR, the insurance company essentially has no duties unless and until the retained limit is paid. Many times SIR endorsements provide that only the insured can satisfy the SIR, and the payment obligation is not excused by the insured's insolvency or bankruptcy. So an insured is at its peril — if it cannot satisfy the condition of paying the SIR, it is not entitled to the benefits provided under the insurance policy.

SIRs are common in construction. Many insurers have left the market because of the proliferation and cost of defending construction defect lawsuits. Subcontractors can be in a difficult situation because general contractors require their subcontractors to have liability insurance and to add the general contractors as additional insureds under the subcontractor's liability policy.

Typically, the reasons to have an SIR are about cost and the availability of insurance. A large corporation that is financially strong can reduce its insurance costs by electing to purchase a policy with an SIR, which commands a lower premium.

What are the benefits of deductibles over SIRs?

The biggest benefit of a deductible is that, unlike an SIR, the deductible does not need to be paid upfront and is not a condition to receiving insurance benefits. That's important when you have a liability policy, get sued and need a lawyer. With a deductible, the insurance company will provide a lawyer and provide a defense immediately, as opposed to requiring the insured to pay its own attorneys' fees until the amount of the retained limit is satisfied.

Where do companies make mistakes in deciding which route to go?

Some companies will assume an imprudently large SIR. If the business is in decline and gets hit with a liability claim, then paying for a defense lawyer on top of normal operating expenses can push the company into a precarious financial condition. I've seen retained limits as high as $250,000. Businesses that assume a large SIR, that they cannot later pay, can find themselves without insurance coverage.

That can be an issue for general contractors. If a subcontractor has an SIR that allows only the subcontractor to pay the SIR, then the general contractor would be without coverage as an additional insured under that subcontractor's policy, if the subcontractor fails or is unable to pay the SIR. This is because the insurance company's obligations are not triggered until the subcontractor pays. So, general contractors and developers need to carefully review the insurance policies of the subcontractors they hire to ensure that the subcontractor either doesn't have an SIR or that the policy allows the developer or general contractor to pay the retention if the subcontractor is unable.

When deciding whether to have an SIR, take a hard look at your financial situation. Do you have the financial wherewithal to comfortably absorb that initial share of risk? It's a business decision — weigh the cost savings against the benefit of being able to get insurance benefits more immediately, and from dollar one. ●