



Costs and Expenses Solution Claims Scenarios

AIG's Costs and Expenses Solution

In December 2013, the Supreme Court ruled that where a statutory charge exists over a policy with a single monetary limit, the insurance fund cannot be used for defence costs.

AIG has created a single policy solution to address this situation that ring-fences defence costs through a separate "Costs & Expenses only tower" ("tower" meaning limit of indemnity) that will respond only in the event that a section 9 charge prevents payments from the existing insurance tower.

This Costs & Expenses tower will be a new section within the insured's existing policy.

The solution is a single insurance policy with three sections:

- Section A – includes all coverage available under an existing policy. This is the only section that has the potential for a section 9 charge to apply.
- Section B – a new Costs & Expenses section that responds only if there is a charge over all of Section A.
- Section C – the General Terms & Conditions and governing language of the policy.

If defence costs are advanced under the new Costs & Expenses tower (section B), but could ultimately have been taken from Section A, Section A can reimburse Section B. This "wash up" clause allows for separate defence costs cover to be reinstated that may be accessed in the event of a second claim provided that some funds remain available under section A following the settlement of the previous claim.

Possible Scenarios

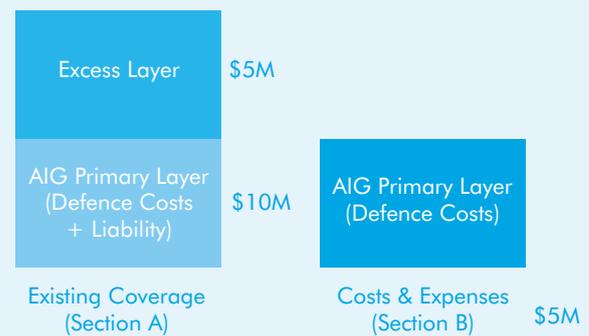
We consider three scenarios based on the limits in Figure 1 (above right).

Scenario 1: Section B is not required.

A company faces a third party claim with potential damages payable of \$6m plus \$1m likely adverse costs award. Defence costs are estimated to be \$1m. The claim is ultimately determined to be \$5m, including adverse costs awards.

- In this scenario, Section B is not required as it responds only in the event that a Section 9 charge prevents payments from the Section A Primary Layer
- The potential damages, adverse costs awards and defence costs can all be paid from the primary layer of Section A.
- The net payment is \$6m from Section A primary layer, \$0 under section B and \$0 from the Section A excess layer.

Fig 1. Policy Structure under AIG Solution



Scenario 2: Using the Wash Up Clause

A company faces a third party claim with potential damages and adverse costs awards of \$20m. The claim is ultimately determined to be \$11m, including adverse costs awards. Defence costs are \$3m.

- In this scenario, a Section 9 charge exists over all of the primary section A layer as well as the \$5m excess layer.
- Section B is made available to insured and incurs the \$3m defence costs.
- When the claim is settled for the lower amount of \$11m, AIG pays \$10m from section A and the section A excess layer pays \$1m.
- Section A excess layer reimburses Section B for the \$3m incurred.
- The net payment by insurers is \$10m under the section A primary layer, \$4m from the Section A excess layer, and \$0 from section B (following reimbursement from the section A excess layer)
- As there are still funds available in Section A (\$1m), Section B remains available for a second claim.



Scenario 3: A claim exhausts section A and B

An insured is the subject of an investigation by a regulator who seeks to freeze their assets. A civil claim on a related matter is brought for \$20m by a third party, but is ultimately determined to be \$15m including adverse costs awards. Defence costs are \$4m. Investigation costs are \$1m.

- In this scenario, a Section 9 charge exists over all of the primary section A layer as well as the \$5m excess layer.
- Section B is made available to the insured and incurs \$5m comprising the \$4m defence costs and \$1m investigation costs.
- When the civil claim is settled for \$15m, AIG pays \$10m from Section A and the Section A excess layer pays \$5m.
- Section A is exhausted and no funds are available to reimburse Section B.
- The net payment by insurers is \$10m under the Section A primary layer, \$5 from the Section A excess layer and \$5m under section B.
- Section B now ceases as there are no funds available under section A (primary or excess) to reimburse section B.

Implementing the solution for your clients

AIG will adopt this new approach for all renewals that aggregate cover for liability and defence costs. If you wish to implement this Costs & Expenses solution into an existing policy before renewal, please speak to AIG. We would welcome the opportunity to speak to you, your staff or any clients as required. We pride ourselves on understanding and dealing with these complex issues and are always available to discuss your needs.

IMPORTANT: This is not financial advice. Please refer to the policy wording for full details of the cover and to ensure a full understanding of the scope of cover offered, and that it is suitable for your purposes and requirements and/or those of your client.

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