COVERAGE INSIGHTS

Cybercriminals increasingly use sophisticated methods to infiltrate businesses' computer systems and networks, putting sensitive data and personally identifiable information at risk. With cyberthreats evolving in scope and complexity, businesses of all sizes and industries face potentially devastating financial and reputational damages. To manage these risks, leaders should adopt robust cyber defenses and follow cyber hygiene best practices.

In addition, they must obtain cyber insurance as a critical layer of financial protection. Understanding the nuances of coinsurance and sublimits in cyber policies is essential, as these clauses affect coverage, cost and risk-sharing responsibilities.

Coinsurance provisions are increasingly included in cyber policies, often applied to high-cost risks like ransomware. These clauses help distribute financial responsibility between insurers and insureds, ensuring both parties share the cost burden for specific losses. Typically, coinsurance is expressed as a percentage split in the policy, such as 75/25, where the insurer agrees to cover 75% of certain claims, and the insured is responsible for the remaining 25%. For example, in a ransomware incident, a 75/25 coinsurance clause would require the insured to pay 25% of the claim cost out-of-pocket, with the insurer covering the rest. By sharing risks for high-cost, high-frequency incidents, insurers can offer policies that are affordable and sustainable.

A sublimit is the maximum amount of coverage an insurer will pay for a specific type of claim within the broader policy limit. Cyber insurance policies frequently contain sublimit clauses for defined losses that are relatively common and have substantial financial impacts (e.g., wire transfer fraud due to social engineering). It is important to note that a sublimit is a part of the overall policy limit, not an additional amount of coverage, meaning claims for losses within a sublimit will be capped at a specific amount.

Coinsurance and sublimits may appear to disadvantage policyholders by increasing out-of-pocket expenses. For example, coinsurance can lead to substantial out-of-pocket expenses for the insured if the underlying claim is large, while sublimits may limit coverage to a point where the insured must pay additional costs beyond the set limit.

However, coinsurance and sublimits allow insurers to manage costs by sharing risks with insureds. This approach not only helps control premiums but may also encourage policyholders to strengthen their cybersecurity measures. Therefore, by capping exposure through sublimits and sharing responsibility through coinsurance, insurers can offer policies at lower premiums, incentivizing stronger cybersecurity practices that can mitigate the financial impact of a cyber incident.

When evaluating cyber insurance, business leaders need to review the coinsurance and sublimit clauses within their policies, especially at renewal when terms may change. This can help them determine if they have sufficient coverage to protect the finances of their operations in the event of a cyber incident. Business leaders should also evaluate their cybersecurity measures, as insurers may require specific safeguards (e.g., multifactor authentication, segregation of backup data) as part of the policy requirements.

Additionally, business leaders should carefully balance their risk tolerance with premium costs. For example, selecting a policy with lower sublimits and lower coinsurance may reduce out-of-pocket exposure but will likely come with higher premiums. Conversely, higher sublimits and coinsurance percentages may lower premiums but increase the insured's financial responsibility in the event of a claim. These considerations require a careful assessment of cyber exposures, potential financial impacts and budget constraints. Strengthening cyber defenses can also improve a business's overall insurability, reduce claim frequency and help manage premium costs.

As cyber risks continue to grow and businesses increasingly rely on digital tools to store and transfer data, cyber insurance has become a crucial safeguard. However, business leaders need to understand coinsurance clauses and sublimits in these policies and work with an insurance professional to secure adequate coverage aligned with their risk tolerance and budget. Consulting a professional can ensure businesses have the right protections in place and maximize their cybersecurity investments.

Contact us today for more information.