

An E&O Claim - 360° View

Objectives:

- *Understand what an E&O claims is*
- *Use claims statistics to identify areas to focus risk management efforts*
- *Review the specific types of errors made*

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INTRODUCTION

Often it takes an uncovered loss to create an E&O claim. Generally speaking, an uncovered loss would be caused by:

1. A lack of appropriate type of coverage, or
2. Inadequate values or limits to cover the full loss.

E&O claims don't discriminate by the size or location of agencies. All agencies, regardless of staff size, must proactively address E&O risk management!

Statistics show that annually one (1) in seven (7) insurance agencies and brokerages will report a potential E&O claim. Statistics also indicate that approximately 50% of those reported claims are closed with no defense reserves or indemnity payment made.

E&O claims statistics have fluctuated over the years and are often influenced by market cycles which drive changing behavior of insurance buyers, carriers, and agents. Catastrophic events such as tornados, hurricanes, flooding, earthquakes, and wildfires can be the catalyst for the discovery of uncovered losses that lead to E&O claims against agents.

In those cases where the claim goes forward, the agency may or may not have actually made a mistake. Just because an E&O claim was made against you doesn't mean that the agency staff did anything wrong or breached your legal duty. It may simply be that the agency finds itself in the uncomfortable situation of an allegation being made against them because of their inability to prove that they are not responsible. Unfortunately, many E&O claims allegations are "he said, she said" and **this is where documentation, combined with good E&O risk management procedures that are invariably followed, is a key defense mechanism.**

ERRORS AND OMISSIONS DEFINED

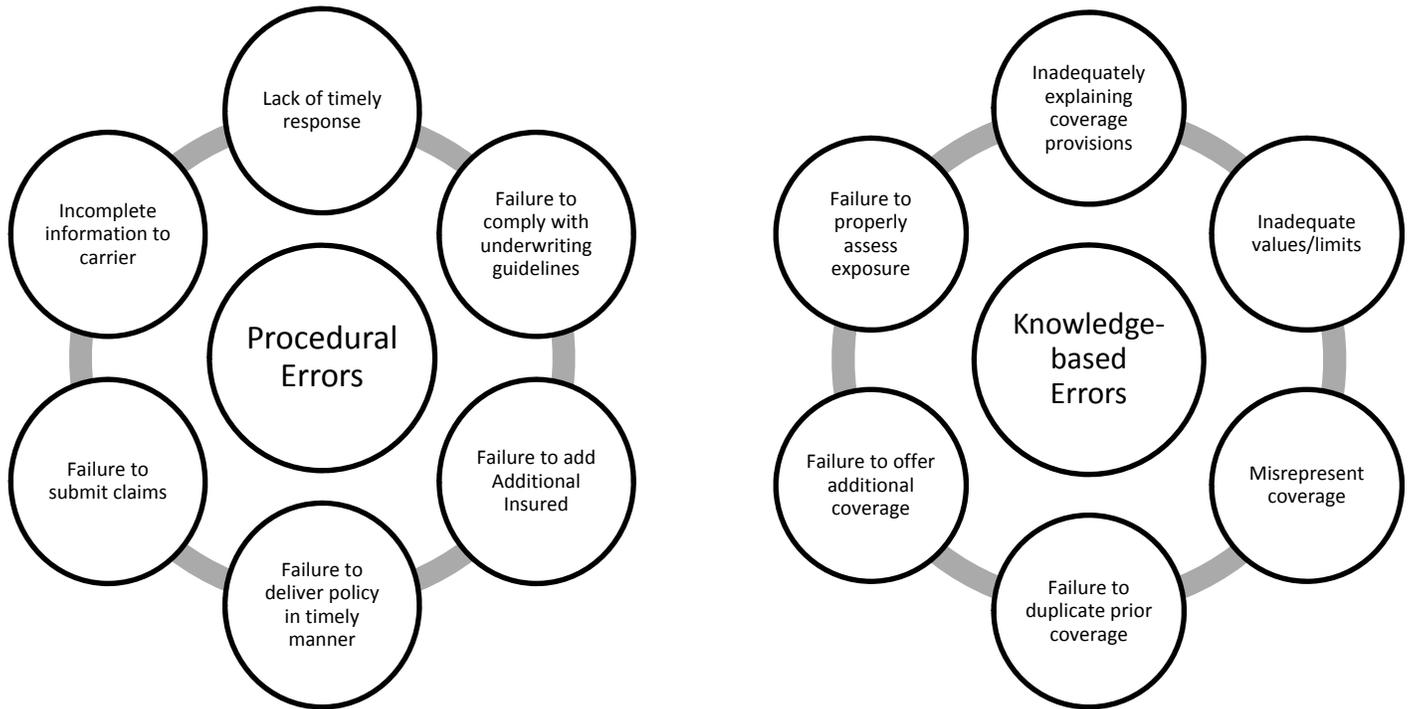
Errors and omissions can simplistically be described as "I made a mistake" (error) or "gosh I missed that" (omissions). When we look at E&O in this way, the mystique of "wrongful acts" can be described as human failings. An agency that has good E&O risk management procedures in place, that are enforced and monitored, can reduce their E&O exposure. This is especially true for those claims that could result from an omission.

Section 1: Procedural vs. Knowledge Based Errors

E&O claims can generally be broken down into two categories: procedural errors and knowledge-based errors. The spread of claims between these two categories is about 50/50 and in some cases there is overlap between the two. So, to truly reduce E&O exposure both error types need to be addressed. It is worth noting that knowledge-based types of errors

could include a lack of product understanding or technical coverage knowledge as well as giving bad advice to customers.

What are examples of procedural and knowledge-based claims?



Section 2: Agency E&O Culture - Staff Awareness

Making sure the agency staff follows agency procedures is one thing, but making sure they understand the concept of how errors and omissions may occur in the agency is also important, especially how it applies to them. The actions or lack of action of agency staff (including: owners, producers, CSRs, account managers, accounting staff, clerical personnel) ultimately affects the agency's E&O exposure. Employees may lose sight of this. A culture of E&O awareness can keep it top of mind and is the first step in successfully avoiding claims. Open discussions will create an environment where agency staff is more comfortable making managers aware of potential E&O claims. This will facilitate better claims reporting and meeting your E&O policy's reporting requirements to ensure coverage. If employees fear discipline or reprisal they may delay bringing a situation to management's attention until it is too late for either the agency or its E&O insurer to resolve the problem.

FACT CHECK:

Swiss Re Corporate Solutions data reveals that agencies that attend an E&O risk management seminar have fewer claims. The more agency employees that attend a seminar, the better. Consider having an in-house seminar for all employees.

Class Discussion

- *What are some of the reasons why a customer might have an uncovered claim from a lack of coverage?*
- *What are some things agency staff can do to avoid claims from inadequate limits?*
- *What factors may cause an increase in E&O claims when the insurance marketplace experiences a hardening?*

E&O CLAIMS STATISTICS

The E&O claims frequency statistics provided by Swiss Re Corporate Solutions provide guidance for an agency to determine their E&O exposures. They not only give you an understanding of the types of errors being made, they provide your agency with direction on where to focus your risk management efforts including:

- On whom to focus in reinforcing the importance of risk management,
- Areas of potential weakness in agency operations creating exposures and,
- Product education and training needs.

Section 1: Who is suing agents?

It is not only insureds that can and do bring claims against insurance agencies. Past claims experience shows that claims come from the following sources:

1. **Customers** – The vast majority of the time it is the customer bringing claims against the agent for failing to procure or recommend the coverage to protect them.

2. **Carriers** – In the past decade there has been a visible trend in the number of E&O claims involving the carrier against the agent. These types of claims can be a result of agents:

- Exceeding their binding authority

Example: An agency may be granted binding authority by the carrier to bind policies up to specified limits, e.g., \$250,000, without first submitting the application to the carrier for approval. When the agent binds a policy containing limits in excess of \$250,000 and a large loss occurs, the carrier is likely to deny on the basis that the agent exceeded his authority -- or will cross-claim against the agent, seeking indemnity.*

- Not adequately explaining policy provisions

Example: The agent obtains a policy for her customer's newly acquired property that contains a '60 day vacancy' clause. When the new owner fails to occupy the new property for over 60 days a water leak occurs and substantial damage occurs to the building while it is unoccupied. Both the customer and the carrier that denies coverage based on the vacancy clause will argue that the agency failed to properly explain the policy provisions.*

- Failing to comply with underwriting guidelines

Example: An agent has binding authority with a carrier that insures boats, subject to the carrier's underwriting guidelines, which restrict coverage to pleasure crafts under a specified horsepower and length. After a serious loss occurs, the carrier investigates and determines that the boat in question slightly exceeds both limitations -- and denies coverage. If forced to pay the loss, the carrier will file suit against the agency for failing to comply with its guidelines.

- Providing inaccurate or incomplete information to carrier

Example: An agent remarkets an account to a new carrier, but fails to include information regarding prior losses. When a new loss occurs the carrier takes the position that a material misrepresentation occurred and, had the information about the prior losses been known, then it would not have insured the customer. The carrier pays the loss and files suit against the agency to recoup its claim payment.

- Failing to provide timely notice of a claim to the carrier

Example: *If an agent fails to provide the carrier with notice of a claim, timely notice to the agent could be deemed timely notice to the carrier. In that case, the carrier could pay the claim and then file suit against the agency, arguing its investigation of the loss was prejudiced by the delay in receiving notice of the loss. One such example would be an auto loss wherein the car was repaired before the carrier had a chance to inspect it.*

3. **Third parties** – Sometimes agents can be sued by third parties. These claims often involve:

- Failure to add an Additional Insured or Loss Payee

Example: *Agency customers frequently are obliged to add a party with whom they contract to the policy as an 'additional insured,' or in the case of a lender, to be named as an 'additional loss payee.' If the broker fails to make that change to the policy, the uninsured third party or lender will attempt to hold the agency responsible.*

- Misrepresentation or inaccurate information on Certificates of Insurance

Example: *Many COI claims occur when an overworked (or undertrained) staff member issues a COI, as requested by the customer, without first checking to confirm that the coverage being certified actually does exist as represented. In some cases, the customer was not even obliged to provide the coverage in question -- that is, until it represented to a third-party via COI that the coverage was in place.*

- Failing to procure coverage that was relied on by a third party

Example: *Landlords often require tenants to obtain insurance for the leased premises to cover damage caused by the tenant or others. If the agent is aware of that requirement but neglects to obtain the required coverage, the landlord may pursue a claim against the agent.*

4. **Regulatory/governmental entity** – In responding to complaints, regulatory bodies can investigate the insurance operations of agencies. Some E&O policies offer some amount of coverage for expenses in defending these investigations. These allegations may include:

- Fraud or intentional misconduct

Example: *In the event it is discovered that an employee has been embezzling premium monies, the state Department of Insurance may initiate a regulatory proceeding against the agency for failing to supervise an employee.*

- Failure to return premiums

Example: *If an agency agrees to handle a customer's account on an agency bill basis and holds premium monies in a trust account, but fails to return any premium refunds, the Department of Insurance could initiate a proceeding against the agency. This could be the case even if the agency applied the return premiums to the customer's other policies.*

- Unfair claims practices

Example: *If an agency has claim-handling authority, acts that violate state law might include: failure to respond to the claim promptly; misrepresenting significant facts or insurance policy provisions; or denying claims without a reasonable investigation.*

Section 2: Who in an agency is most likely to be involved in an E&O claim?

9 out of 10 claims involve the following categories of staff. They are listed below in descending order of frequency:

1. Producers – The types of errors where producers are most frequently involved include: coverage type and limit recommendations, policy interpretation, application and policy issuance errors. They are also involved in a surprisingly high number of claims involving failure to provide timely notice of a claim to the carrier.

Here are more specific errors involving producers:

- Not explaining policy provisions

Example: A broker's failure to explain the definition of "vacant" in a homeowner's policy may lead to uncovered losses, most notably for vandalism or water damage. Vacancy is defined by courts and in individual policies based on the amount of furniture/personal property that is left in the home, or the length of time it is left unoccupied, e.g., when a home that is for sale remains unsold for an extended period of time.

- Recommending inadequate value/limit

Example: This often occurs when an agent relies on documents that are provided by the customer, but were prepared by a third party. Relying on inaccurate square footage or age of a structure can lead to inadequate coverage. In addition, claims can occur when the customer requests only minimum required limits and the agent does not have process for always offering higher limit options.

- Failure to recommend coverage type

Example: Excess flood and wind coverages in coastal areas are examples of coverages that a broker should recommend to a customer based on his knowledge of the customer's location and the nature of the property.

- Inaccurate information to the carrier

Example: This can occur when an agent fills out an application without asking the customer each question individually, e.g., whether he has been charged with a DUI, or if the premises has a monitored alarm. Although the agent may ask the customer to review the application before signing it, errors often are not noticed because "I just signed where my agent told me to sign..." If the question is answered incorrectly, the carrier may declare its policy void.

- Inadequate identification of exposures

Example: Home businesses and non-owned auto usage for business purposes can cause coverage gaps when agents fail to familiarize themselves with the customer's business.

- Failing to duplicate prior coverage

Example: Failure to obtain a copy of the prior policy or dec sheet when replacing coverage which leads to gaps in coverage such as a hurricane deductible or a sublimit on the new policy.

2. Licensed customer service representatives – CSRs are most frequently involved in errors involving the claims process, handling applications, certificates of insurance, and policy cancellation.

Here are some specific errors involving CSRs:

- Failing to provide timely notice of a claim

Example: A commercial customer reported an auto claim to the agency to report to the carrier. The CSR reported to the primary carrier but not the excess carrier. The agency faces exposure if the claim exceeds the primary limits because the claim was not sent to the excess carrier in a timely fashion.

- Mishandling application resulting in failing to procure coverage

Example: A customer sent in several renewal applications for multiple properties, along with the renewal premiums. The CSR failed to submit one of the applications and the error was not discovered until months later when a fire loss at the missed location was reported.

- Not notifying the customer of policy cancellation

Example: A customer's fire policy cancelled six times due to non-payment of premium, and each time the CSR would contact the customer to advise that the premium needed to be paid. A year later the customer suffered a fire loss and the carrier denied coverage because the policy cancelled for unpaid premium. The customer alleged the agency failed to contact him as they had in the past regarding the payment of the premium.

- Failing to add Additional Insured or Loss Payee

Example: A customer asked the agency to add the auto lender as a loss payee to his auto policy. The vehicle was totaled in an accident and the carrier paid the proceeds to the named insured only. The lender is looking to the agency for payment of the loan balance.

3. Account Managers – The error profile for account managers is very similar to that of producers. They are most frequently involved in errors relating to the recommendation of coverage and limits and assessing customer risks. The data also shows that account managers do a little better when it comes to explaining coverage to customers than producers.
4. Owner/Partner/Sole Proprietor/Principal – Looking at the claims data it seems that owner/principals are “jacks of all trades”. Claims involving them are spread pretty evenly across the different processes. This is likely because they are involved in so many facets of the agency, especially when it comes to important accounts. In smaller agencies the term “cook, bottle-washer, and waiter” may apply. Interestingly, owners have the highest percentage of recommendation errors such as failing to recommend coverage or adequate limits.

Class Discussion

- *Why are producers and CSRs most frequent involved in E&O claims?*
- *Does your agency have staff meetings that specifically address the importance of agency E&O risk management?*
- *Of the types of errors described above which do you think are the easiest to avoid? The most difficult?*

Section 3: What transactions are driving claims frequency?

The two transaction areas that make up agency’s largest profit margins also drive claims frequency. Not surprisingly, 40% of all claims frequency arises from new business followed by renewals at approximately 25%. When it comes to new and renewal transactions the following process steps drive frequency:

- Risk assessment and recommendation errors

Example: An agent's failure to ask probing questions of his customer and, where possible, visit the property insured, can lead to errors regarding such matters as: geographic location, activities undertaken, hazardous chemicals/processes utilized, supply chain disrupts, and jurisdictions where employees live/work.

- Policy issuance errors

Example: The failure to accurately identify the persons and property insured. Also, failing to forward policy in a timely basis so the customer can review it for accuracy.

- Application errors

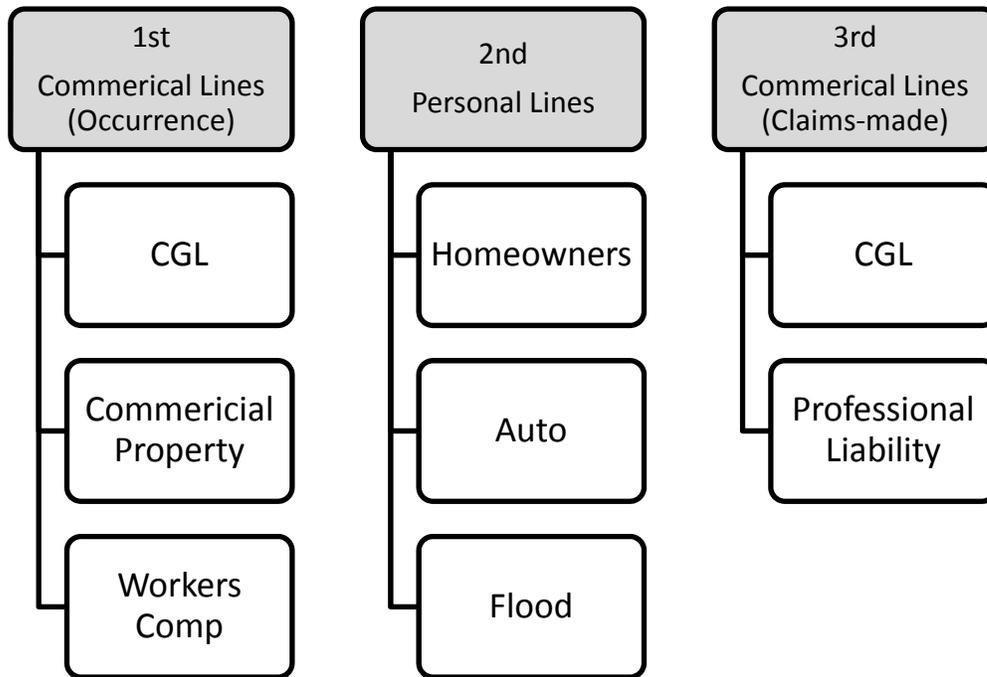
Example: Common application errors include missing medical history on life & health policies, and errors regarding the value and/or square footage of the property insured. If there are misstatements in the application, both the customer and the carrier are likely to blame the agent who prepared and submitted the application -- particularly if it was filled out by the agent -- when the carrier denies coverage, or pays less than the entire loss.

- Failure to duplicate prior coverage

Example: Both with renewals and new or remarketed coverages, agents often fail to compare the policy issued to the quote to ensure that the coverages requested are in place. Carriers often add sub-limits or remove small coverages. Certain perils are frequently excluded, such as pollution and snowplowing coverages. Oftentimes, these are changes that the carrier was willing to reverse by endorsement for a nominal fee which the customer readily confirms he would have paid.

Section 4: What types of policies are driving claims frequency?

Any policy not properly written could generate a claim. It is no surprise to any agency to find that commercial lines forms make up about 60% of the claims frequency by type of coverage. Commercial lines frequency of E&O claims is double that of personal lines. Below are the underlying coverages most frequently involved in E&O claims:



Class Discussion

- *Why do you think twice the amount of claims come from commercial lines versus personal lines?*
- *At what point in their process of working with customers are a producer and CSR most vulnerable or likely to make an error?*
- *Why do 1 in 5 errors involve the CGL policy? What makes it so prone to be involved in E&O claims?*

Section 5: What type of error/omission are others alleging an agency has made?

An agency can be accused of making any type of error or omission. Just because a claim is made doesn't mean you did anything wrong. However, below are the errors/omissions that have been alleged by customers, carriers and others in descending order of frequency:

- Failure to procure coverage

Example: A customer tells his agent that he plans to make an acquisition of new property, but the broker never follows up to determine whether the purchase was completed. Meanwhile, the newly acquired property sustains a loss and the customer expresses surprise that coverage was not obtained.

- Failure to adequately explain policy provisions

Example: A common complaint in the wake of commercial property losses is that the agent failed to explain the policy's 'coinsurance' provision, as a result of which the insured is underinsured.

- Failure to adequately identify exposures

Example: Because the agent is not entirely familiar with the customer's business and property and isn't using risk assessment questionnaires, a new provision on a policy that excludes coverage for a particular peril -- one for which the customer requires coverage -- is overlooked by the agency at renewal.

- Failure to recommend coverage type

Example: The agent, through lack of familiarity with his customer's operations, never learns that the customer's officers and employees routinely use their own automobiles on the job. As a result, when one of the employees is involved in a serious at-fault auto accident on the job, coverage is denied by the customer's business auto carrier because the agent failed to recommend and procure 'non-owned auto' coverage.

- Inaccurate/incomplete information provided to the carrier

Example: Agents placing coverage on commercial property routinely rely upon the customer to provide information regarding the building's square footage and present value. The carrier relies on that information and common estimates of construction costs to conclude that the limits requested offer adequate 'replacement cost' coverage. When the building burns to the ground, and it is discovered that the actual square footage was substantially more than represented, the customer likely is substantially underinsured -- especially if a coinsurance penalty is assessed.

- Failure to provide timely notice of a claim to the carrier

Example: The agent reports a workplace injury for his customer, and tenders it to his customer's workers compensation carrier. He neglects to consider that the general contractor has 'additional insured' status on the customer's GL and excess policies. As a result, when the employee sues the general contractor months later and the claim is turned in to those carriers, they deny for late notice.

- Negligent misrepresentation

Example: An agency issues a COI showing 'additional insured' status for a third party, e.g., a contractor, where none exists. This can occur in situations where there was no obligation on the part of customer to provide such coverage, but the COI recipient claims to have relied on the COI to its detriment.

- Failure to add an Additional Insured/Loss Payee

Example: The customer provides its agent with a copy of its contract with a general contractor, which contains a provision requiring that the other party to the contract be named as an 'additional insured' on the customer's policy. The agent does not carefully review the contract and does not ask the carrier for an 'additional insured' endorsement.

- Failure to duplicate prior coverage

Example: The agency fails to note that particular activities, e.g., snowplowing, which were covered on an expiring policy, are now excluded on the replacement policy. Policies placed with a new carrier upon expiration of an old policy often have new exclusions or other limitations on coverage that avoid notice -- until a claim occurs.

- Alleged failure to pay claim

Examples: Decisions regarding the payment of claims typically are within the discretion of the carrier, but some E&O claims occur because the claim report is made late, or is not made to all carriers with possible coverage, e.g., workers compensation, CGL and excess/umbrella.

- Failure to recommend adequate value/limit

Example: Agents open themselves up to claims when they (1) fail to verify the exposure characteristics of the property to be insured, e.g., square footage, (2) fail to recommend an appraisal to an unsophisticated customer, and/or (3) fail to recommend periodic increases in limits to keep pace with inflation in replacement costs. Even if the property is not a complete loss, inadequate limits may lead to the carrier's imposition of a coinsurance penalty, for which the broker will be blamed.

- Failure to notify customer (re: policy cancellation)

Example: Customers who suffer an uncovered loss following the untimely cancellation of their policy routinely insist that they received no notice of the cancellation (while the broker usually has a copy in its file) and counted on their broker to provide notice and procure replacement coverage.

** Note: Claims examples were provided courtesy of Swiss Re Corporate Solutions.