



E&O Loss Prevention Guide for Property & Casualty Agents

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Chapter 1 - Introduction to E&O

A. What is E&O?

Errors & Omissions Insurance (or E&O) provides protection for professionals in the event a claim is made against the professional, or his/her staff, by a customer. Errors & Omissions is also called Professional Liability Insurance or sometimes malpractice insurance. As litigation has increased in the United States, E&O insurance has been used to protect professionals in almost every line of work where an individual has to acquire special knowledge or training to provide a service. It has been used to insure Insurance Agents for decades.

The type of claims that are covered by Insurance Agents E&O are those that are brought for damages caused (or allegedly caused) by any act, error or omission of the agent, or a staff member, during the course of providing professional services to the customer. The E&O insurance pays for the cost of the damages incurred by the claimant and the expenses associated with defending the claim.

B. What is "Claims Made and Reported" coverage?

"Claims Made and Reported" coverage sets time based boundaries which establish when a claim is covered by an E&O policy. Unlike the types of liability insurance that you may be familiar with, such as general liability and umbrella policies, which are written on an "occurrence" basis, nearly all errors and omissions insurance policies are written on a "claims made and reported" basis. In a claims made and reported policy, you must report claims made against you during the policy period in order for the coverage to apply. An "occurrence" form does not have a required time frame for when a claim must be "made and reported".

For a claim to be eligible for coverage under a typical E&O policy, the following two things must happen:

1. The claim must be made against the agent, or other insured under the policy, during the policy period,
2. The act, error or omission in question must have occurred during the policy period or on an earlier date which in no event precedes the retroactive date (please see paragraph C for an explanation of retroactive date) and;

Your E&O policy may have a specific deadline for reporting claims to the insurer. Or it may state, that a claim made against an Insured must be reported to the insurer "as soon as practicable".

Some insurance agents E&O policies are written on a "claims made and reported" basis which means that in addition to the two requirements discussed above, you must also report the claim to the E&O insurance company during the policy period.

If a summons and complaint has been issued, it should be immediately forwarded to your E&O carrier.

C. What is a retroactive date and how does it apply?

A retroactive date (or "retro-date") is the date that defines the earliest date for which coverage will be provided by the E&O policy for acts, errors or omissions occurring **prior** to the inception date of the policy period. This is sometimes called the "prior acts" date. The coverage provided for errors and omissions occurring during the time frame between the retroactive date and the effective date of the E&O policy is often called "prior acts" coverage.

Example of how a retro-date works: if a claims made E&O policy began on January 1, 1997, with a retroactive date of January 1, 1997, only claims arising from acts that occurred after January 1, 1997 would be eligible for coverage under the policy. On the other hand, if that same policy had a retro-date of January 1, 1992 (i.e. giving five years of prior acts coverage), claims that arise from acts that occurred within that five years between January 1, 1992 and January 1, 1997 would be eligible for coverage.

Alternatively, you could think of your retroactive date as the date that you first became liable for your actions as an Independent Agent. Be sure your policy retroactive date matches your history with your business.

D. What is an Extended Reporting Period and why is it used?

An Extended Reporting Period (commonly referred to as an "ERP" or "tail" coverage) extends the time an agent has to report a claim after the last claims made E&O policy purchased by the agent expires. By electing an ERP option, and paying a one time premium for this feature, the agent is able to continue to report claims to the carrier without maintaining on-going claims made E&O coverage.

It is important to note that the ERP only applies to acts, errors or omissions which occur on or prior to the expiration date of the last claims made policy (and on or after the retroactive date). In other words, the ERP does not provide you with coverage for errors you might make in the future.

You should also be aware that the ERP does not increase the limits of liability of the last claims made E&O policy. And the ERP could be voided if you obtain similar E&O coverage with another insurance company. In spite of these limitations, the ERP is very valuable, especially if you are going to retire or change to another profession. For example, an agent retires (or discontinues services as an insurance agent) and a claim is made four years later for a product sold while the agent had maintained continuous E&O coverage. If the agent had purchased a ten year ERP option at the time of retirement (or at the time services were discontinued), the claim could be reported and be eligible for coverage. If the agent did not buy tail coverage, or selected an ERP option length of less than four years, the claim would not be covered and the agent would be personally liable for any damages and defense costs incurred to defend the claim.

E. How do gaps in coverage occur and why should I be concerned about it?

Gaps in coverage can occur when using Claims Made policies. Many times when an agent moves his E&O coverage from one carrier to another, the new carrier will move up the retro-date, limiting coverage for prior acts. If you accept a policy with a retroactive date that is later than the retroactive date on the policy that you are replacing, you will have a gap in coverage for claims that arise out of errors made between the old retro-date and the new retro-date. The most significant gap that can occur in this regard is when the new policy provides no prior acts coverage at all and you do not purchase an ERP under the expiring policy.

Some E&O carriers have an underwriting policy of only providing prior acts coverage back to the date of the first continuous date of claims made E&O coverage. A gap in coverage can then occur if you were to fail to purchase E&O coverage for a period of time. The next time you purchased an E&O policy your retro-date might be equal to the (later) effective date of this new policy.

To avoid exposing your personal assets to cover claims that arise from gaps in coverage it is important to make sure the retroactive date stays the same from year to year and that you maintain E&O coverage continuously.

F. Who is typically included for coverage in an insurance agents E&O policy?

A *typical* E&O policy provides coverage to the Named Insured (the person or entity named on the policy Declarations) as well as others specifically identified as Insureds or Additional Insureds. This usually includes officers, directors and employees but *generally* does not include independent contractors. You should review the definitions section of the E&O policy to make sure that anyone acting on your behalf will be included.

G. What is meant by “Professional Services”?

As mentioned earlier, E&O insurance covers claims that arise out of the rendering of Professional Services. Each E&O policy defines the type of professional services that are included for coverage. Generally, the definition will be limited to one type of business. An insurance agents E&O policy will typically define professional services as those services related to the insurance business of the Named Insured. If you are also a real estate agent, for example, not only will the definition of professional services not extend to the real estate profession but the policy will contain an exclusion relating to claims arising out of services rendered as a real estate agent.

H. What are the advantages to being in a group program versus an individually underwritten program?

Purchasing power = broad coverage - Given the number of agents participating in the group program, you have a large amount of clout in getting broad coverage that you would not have as an individual procuring an individual policy. The group policy provides an advantage to the carrier through lower administrative costs and they therefore are generally willing to provide coverage features to a group that they would not ordinarily provide to an individual.

Law of large numbers = rate stability - With many agents insured under one program also comes the advantage of having actuarially sound loss and pricing information. The group rates for agents E&O will generally be stable and move up or down gradually because they are based on the loss numbers of **ALL** the insured agents in each program. In contrast, an agent purchasing an individual policy could be subject to wide variability in premiums from year to year if he or she reports a claim, especially if the E&O carrier has a large payout on that claim.

Customized claim information and loss control - A group program also has the advantage of being able to provide very specific information as to what kind of claims agents are susceptible to and how they may be prevented.



Chapter 2 - What is an E&O Claim?

A. What are the elements of an E&O claim?

There are generally three key elements that make a customer complaint a claim.

1. The customer alleges that the agent has made a "mistake" (usually deemed a negligent act, error or omission) while providing a service to him/her.
Mistakes do happen. For example, a vehicle was erroneously taken off a policy. An accident occurs later and the carrier refuses to cover the underlying claim. Claims that arise out of errors like this are one reason why agents buy E&O.

Also, an agent doesn't actually have to make a mistake to have a claim made against him! Many times customers have a misunderstanding as to what a policy was to cover even after their agent has explained it to them thoroughly. When a customer has an uncovered loss, memories often get hazy. Nothing can stop a customer from making a claim or suing, even if the agent has performed the services well. This is why the E&O policy covers acts "allegedly" committed by an agent and will assume the agents defense.

2. The customer demands money or services be provided to pay for the damages caused by the "mistake".

The customer makes a demand upon the agent for monies or services. This demand may come in many different forms, all of which can trigger coverage under the E&O policy. A customer may make a phone call or write a letter to the agent. The customer may also notify the agent through the service of a lawsuit or by asking for an arbitration hearing. Or, the customer may report the claim to the insurance company and tell the claims adjuster of the alleged agent error. The key in the determination whether the customer's request is a demand is whether or not the customer is seeking money or services to be made whole.

3. The customer incurs an uncovered loss ("damages") that was the result of the agent's (or other Insured such as a member of the agent's staff) "mistake".

For a complaint to be an E&O claim, the customer has to have incurred a (financial or economic) loss that he or she did not expect and for which the agent is legally liable.

If a claim is made, the customer will have to prove that the agent's mistake resulted in the uncovered loss incurred by the customer. If a claim goes to court, which only a small portion of the claims actually do, the policy will cover defense costs and any judgments that must be paid (up to the policy limits of liability) if the agent is found liable by the judge or jury. Many claims that are paid are done so through settlements before going to court. Settlements usually save both time and money for everyone involved.

As we just noted, damages include all sums that the agent is legally obligated to pay. It includes all judgments and settlements. It also includes taxes, fines or penalties paid by a third party in connection with the damages. An E&O policy will not pay fines or penalties imposed by law, or that are deemed uninsurable by law.

B. What are some examples of E&O claims against insurance agents?

E&O claims can be grouped into major categories of the cause of loss (i.e. nature of agent error). The majority (over 80%) of E&O claims against personal lines agents fall into the following categories:

- Failure to place or provide coverage
- Failure to provide adequate coverage
- Misrepresentation by advising coverage when there actually was none
- Failure to advise, review and explain coverage
- Failure to renew coverage

Some of the cause of loss categories sound very similar. In fact, in all of these categories, the customer thought that he or she had procured an insurance policy that would cover them for the type of loss sustained.

In the examples which follow, you will see the differences between these general cause of loss categories.

The first category, failure to place or provide coverage, involves the complete absence of coverage for the underlying claim by the agent's customer. These claims usually involve an existing policy but can also occur with new business. A typical example involving an existing policy is the failure to add a vehicle to an auto policy.

Failure to provide adequate coverage on the other hand involves a policy that included some coverage for the underlying loss but not enough to cover the entire amount of the loss. This might involve a limits issue on an auto policy or the failure to add an endorsement to a Homeowner's policy. We see many claims which involve auto policies issued at the statutory minimum limits where the customers thought they had, or had requested, greater coverage.

Statements like "don't worry, you will be covered for all claims" or "this is an all-risk policy" or "you have full coverage" lead to claims in the third category, misrepresentation by advising coverage when there was actually none. Another potentially dangerous comment that agents make to customers who are moving their insurance business from one carrier to another is "you will have the same coverage under this policy as you currently do."

This latter generalization can also lead to claims falling under the failure to advise, review and explain coverage cause of loss category. Some E&O claims could have been avoided if only the agent had prepared a side by side comparison of the terms and conditions of the old and new policies and reviewed it with the customer.

These are just a few brief examples of E&O claims that are made against insurance agents. In subsequent sections of this Loss Prevention Guide you will be provided with case studies of actual E&O claims. We urge you and your staff to review them carefully and refer to them from time to time as a way to refresh your memory about what can go wrong in the course of providing services to prospects and customers.

C. What types of requests from customers aren't E&O claims?

Following are some examples of the types of communication from customers that do not need to be reported as a claim or potential E&O claim:

Routine Inquiries

- What are my limits/deductibles?
- What are my exclusions?
- What's my premium?
- When is my next payment due?
- Explanation of Coverage or Benefits
- Waivers
- Who are covered parties?
- Inquires about new vehicle coverage
- Requests for change in coverage against the advise of the agent [Note: Many agents fear making such a change because it will come back to haunt them in the form of an E&O claim at a later date. The key to preventing a claim in such cases is to document the request (preferably have the customer request the change in writing) and explain the ramifications of the change and why it is not recommended in writing.]

D. What is a potential claim and why do I need to be concerned about reporting it to the E&O carrier?

A potential claim is an act, error or omission that you are aware of that could become a claim in the future. Most E&O policies include an "awareness provision" that allows you to report the details of a potential claim; if the incident becomes a claim in the future, the policy under which the incident was provided will provide coverage for it. It is especially important that you report any known incidents when you change E&O carriers because the new carrier will not provide coverage for any prior or pending litigation or claims where you had awareness prior to the beginning of the policy period.

Here are some examples of potential claims:

- A complaint letter is received by the agent from a customer requesting clarification of a misunderstanding.
- A complaint letter is received by the agent from the Department of Insurance or other regulatory agency.
- A complaint letter is received by an underlying carrier and forwarded to the agent for response or explanation.
- Verbal complaints with a specific demand (refer to Demand Letters in Section F below).
- Dissatisfaction is expressed by the customer ("I'm not happy with the policy you sold me").

E. What Happens When A Potential Claim Is Reported?

- The agent is requested to provide the E&O carrier with a copy of the subject policy file.
- The agent is also requested to provide the E&O carrier with a statement and chronology of events leading up to the demand letter or conversation.
- The E&O carrier may ask the agent to draft a letter to the customer (or Department of Insurance or Insurance Company) and will provide the agent with suggestions.
- The E&O carrier will not contact the agent's customer unless it appears the matter is a claim demanding immediate action and/or negotiation.
- E&O carriers do not pay complainants damages to make potential claims "go away." It is not their policy or objective to "make something out of nothing." Payment of damages to complainants is based upon an evaluation of the agent's potential liability and the economics of settling versus defending a claim.
- The file will be monitored for a period of 60 to 180 days at which time the file will be closed if it appears the potential claim will not become a claim. If there is future activity on the matter, the file can be reopened. Reporting potential claims protects the agent by avoiding potential denial of coverage due to "prior knowledge."

F. What is the difference between a potential claim and a "real" claim?

The difference between a potential claim and an actual claim can best be described by providing you with examples of claims that need to be reported to your E&O carrier immediately.

1. Litigation Proceedings - Must be reported immediately (within 24 hours of being served). This includes:
 - Suits - The E&O carrier needs to assign defense counsel for the agent
 - Cases to be heard in Small Claims Court - Generally, the defendant is not permitted to bring an attorney or other legal representation but the E&O carrier can assist the agent in preparation for the hearing.
 - Arbitration.

2. Demand Letters must also be reported immediately, such as:

A written request, by the customer or an attorney, for compensation or for a payment of cash to rectify a "perceived loss."

- Disputes over a premium adjustment
- Disputes regarding an unpaid claim
- Disputes over a deductible amount
- Requests for refund or recession of a policy
- Requests for remedy of error ("fix this")

G. What are some of the Do's and Don'ts when dealing with an E&O claim or potential E&O claim?

- Report all claims and potential claims promptly while events and facts are fresh in your mind.
- When in doubt, call your E&O carrier and discuss with an E&O claim professional the matter at hand.

- Be factual and honest (don't call to discuss a "hypothetical" situation).
- Call the claim handler assigned to your claim or potential claim after any subsequent communication with the customer.
- Don't admit liability or wrongdoing to any party until you have spoken to someone at the E&O carrier or its third party administrator. This could jeopardize your coverage under the E&O policy or create a claim that is not your responsibility.
- Don't call a customer regarding a complaint letter without first reporting a potential claim to the E&O carrier and obtaining advice on how to proceed. Matters could be made worse.
- Don't try to handle a "small" claim because the amount of damages are within your deductible. "Small" items have a tendency to ignite larger issues and by handling the matter yourself you could prejudice the E&O carrier's position and jeopardize your coverage.
- Don't delay the reporting of a potential claim or claim because you think the customer will "go away." Dissatisfied customers don't go away and furthermore, your E&O policy has conditions which require you to report claims promptly.
- Don't retain the services of an attorney on your own.
- Remember, a quick response to customer complaints and potential claims is good for your customer and you. (Over 50% of all claims are closed with no payment of damages.)



Chapter 3 - Auto E&O Claims

Claims resulting from the sale or servicing of auto policies represent a majority of the E&O claims for personal lines Property and Casualty agents. The average cost per claim when damages are paid is \$4,100.

Most of these claims result from a failure to implement changes requested over the telephone by customers. Claims are then denied by the underlying carrier because coverage has not been placed. Typically there are no written records of the customer's request or conversation, so this gives weight to the customer's recollection of past events.

Another frequent E&O claim stems from improperly executing binding procedures by either the agent or agent's staff. (Watch out for these with car dealerships and follow up on new car purchases.) Once again, at the time the loss occurs to the customer, the underlying carrier does not have a policy in force. The examples which follow will give you specific suggestions to prevent E&O claims involving auto policies.

Description of Claim:

The customer called the agent's office on or about 4-8-97 requesting to add another vehicle to his policy. It wasn't done right away because the customer didn't have the VIN number handy; he was to fax it to the agent. The agent never followed up on it and when the customer's son was involved in a traffic accident on 7-9-97, the car had not yet been added to the policy. Estimated Claim Cost: \$7,500.

E&O Prevention Tip:

Document all telephone requests and changes immediately in your computer, on a log, or in your day planner. Follow up to be sure the transaction was completed.

Description of Claim:

The agent allegedly misrepresented to the customer the coverage available under an auto policy. The agent sold an auto policy to a customer for a modified, "pro street" legal 1966 auto. The customer states that the agent told him the policy was for replacement cost of the vehicle, as modified. During modifications the auto was stolen. The carrier would not pay replacement for the vehicle, as modified; instead, they paid replacement cost on a '66 same make auto. Estimated Claim Cost: \$9,500.

E&O Prevention Tip:

Unusual transactions are a "Red Flag" to clarify in writing your quote and customer's expectations.

Description of Claim:

The customer called the agent on 4-15-98 to add a vehicle and delete another vehicle from his existing auto policy. The agent inadvertently deleted both former vehicles, while leaving only the new car on the policy. When the customer's vehicle was stolen 5-2-98, the fact that it had been removed from the policy was discovered. Estimated Claim Cost: \$14,200.

E&O Prevention Tip:

Verify change endorsement with customer's request; confirm in writing any reduction in coverage.



Chapter 4 - Homeowners E&O Claims

E&O claims resulting from the sale or servicing of Homeowner's policies are 25% of the E&O claims for personal lines Property and Casualty agents. The average cost per claim when damages are paid is \$5,300.

A customer request to make a change to their homeowner's policy should prompt the agent to perform a thorough policy review. Oftentimes, major changes such as relocation, renovation or the purchase of high value items or collectibles require special amendments to a homeowner's policy. Additionally, customers are not always accurate in their description of changes. As a result, agents and their staff have been held liable for failure to recognize the need for coverage or to process requested changes.

The examples which follow will give you specific suggestions to prevent E&O claims involving Homeowner's policies.

Description of Claim:

An agent wrote a Homeowner's policy for a customer. The customer later called to advise that the property was now being rented out (which would require a policy contract change). The agent did not rewrite the policy. A liability loss occurred involving the tenant. There was no coverage under the Homeowner's policy however there would have been under the Landlord policy. Estimated Claim Cost: \$5,000.

E&O Prevention Tip:

Upon being advised of a change in exposure, rewrite or replace with appropriate coverage immediately. Be sure to explain to the customer any limitations in coverage that result from the change in policy forms.

Description of Claim:

In 1992 the agent wrote a Homeowners policy that included replacement cost, (best possible coverage at the time) for the customer. In 1995, due to financial reasons, the customer requested the policy to be rewritten to a less expensive form which did not include replacement cost. The customer called the office in 1997 to upgrade the policy as "things were better". The agent completed the application, however, did not mark the box for "replacement cost". The customer sustained a major water loss to both the structure and contents and was paid on an Actual Cash Value basis. Estimated Claim Cost: \$12,800.

E&O Prevention Tip:

Review completed applications with your customer before submitting them to the insurance company

Description of Claim:

The customer had an Auto policy with the agent for a number of years. The agent solicited the customer's Homeowners which was with another carrier under a "Deluxe" Homeowners Policy. The agent indicated to the customer that they would save money by switching because they would have a multi-line policy discount. The agent claims he advised them at the time of the new policy submission that there would be no coverage for water damage. The customer later sustained a water damage loss and claims that the difference in coverage was not explained. Estimated Claim Cost: \$7,511.

E&O Prevention Tip:

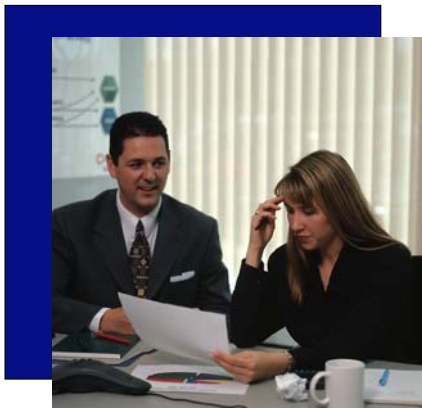
Confirm to your customers, in writing, any reduction in coverage.

Description of Claim:

An agent wrote a new Homeowners policy with Scheduled Jewelry coverage from an expiring policy back in 1993. A ring on the schedule was insured for \$2,411. The ring was stolen from a suitcase in 1998 and the value of the ring was set at \$5,400. Estimated Claim Cost: \$2,000.

E&O Prevention Tip:

Regularly remind your customers with Scheduled Personal Property to review values and obtain current appraisals.



Chapter 5

Commercial/Specialty E&O Claims

E&O claims arising from the sale and servicing of commercial or specialty lines of insurance occur for many of the same reasons that were discussed in the prior chapters. While selling and servicing commercial or specialty lines of insurance problems frequently occur when agents try to expand their area of expertise by selling products that they do not normally sell, are not as informed about, and do not spend the time required to become knowledgeable about the product.

Professionalism is a popular catchword in the industry and is a wonderful attribute; however, it can be a two edged sword. On the one hand, offering your services as a professional sells and attracts customers. On the other hand, it commits the agent to a higher standard of care than that expected from an average agent or broker. It is often difficult, then, for a success driven salesperson who is viewed as a "professional" to learn to say the words, "I don't know" to a prospective or current client when asked about a product or coverage that the agent may not be familiar with. However, you can bet that your customer will remember if incorrect advice is given- especially if it is pointed out by another salesperson, a claims adjuster or an attorney.

Know your realm of expertise and expand your knowledge in the areas where you feel you need it. The process of developing real expertise requires acquiring detailed technical knowledge and keeping it current through continuing education, seminars, workshops, reading, independent study and research. You can become very knowledgeable across a wide range of insurance subjects through intensive studies, such as those offered by industry trade associations or professional institutes. By increasing your expertise, you will be able to offer your customers better technical advice while improving your odds against having an E&O claim.

The examples which follow should help identify some potential problem areas and give you specific suggestions for preventing E&O claims.

Description of Claim:

The customer started a new moving/delivery company and obtained a Commercial Auto Policy from the agent. This is the only policy that was purchased from the agent. A delivery to an elderly woman was made in which the woman helped the employee carry the item. In the process of helping, the elderly woman hurt her wrist and fell down the stairs. A claim was submitted under the Commercial Auto Policy however it was denied as there was no General Liability provisions. Estimated Claim Cost: \$10,000.

E&O Prevention Tip:

Make recommendations to customer for needed coverage if coverage is not provided elsewhere. Have the customer sign-off on any coverage recommended but not taken.

Description of Claim:

An inexperienced customer service representative told a long-term insured of an agency that there was no market for unique coverage that he had requested to be endorsed onto a small commercial policy. Not only was she incorrect in representing that the type of coverage was not available, her agency had written this type of coverage for other insureds within the same general time period. When a loss occurred, the insurance carrier denied the claim and provided a written statement that the coverage would have been offered for a very reasonable premium. Estimated claim Cost: \$28,000.

E&O Prevention Tip:

Do not tell a client that a market does not exist for certain coverage. You may not have a market, but don't assume that another agent could not place the risk. Establish a practice of open and frequent communication between agents and staff regarding customer requests.

Description of Claim:

The customer purchased inland marine coverage for his business. The customer was transporting ice cream when the refrigeration unit broke down during transit. The claim was submitted to the insurance company who denied it, as the customer did not have coverage for spoilage. The customer alleged that the agent failed to obtain like coverage from a prior policy and filed a claim in small claims court seeking compensation for the loss. Estimated Claim Cost: \$8,500.

E&O Prevention Tip: Always compare proposed commercial coverage to customer's expiring policy. Identify the differences in a coverage comparison and review them with the customer at the time the coverage is purchased.

Description of Claim:

A customer contacted his insurance agency on 2-6-96 to advise that the home they insured would no longer be his primary residence but instead would now be a rental home. He also requested that flood coverage be added. A secretary took all the information and placed it in the customer's file where it stayed. The agent was contacted by the customer on 1-6-97 to make a claim for a flood loss which occurred on 1-3-97. Estimated Claim Cost: \$4,500.

E&O Prevention Tip: Document and implement telephone requests immediately or suspense them in one common file for future follow-up.

Description of Claim:

A producer in the agency sold the customer a policy for his business. The producer was aware that the customer kept merchandise in his van. The customer's commercial van was broken into and \$16,000 worth of merchandise was stolen. The policy limit was \$2,500 for coverage on merchandise while in a vehicle. The customer contends the producer advised him that the policy would cover the full value of all merchandise in a vehicle owned by his business. Claim Cost: \$13,500

E&O Prevention Tip: Know policy limits. Have the customer sign a waiver referencing any policy limitations that are applicable to specific areas of risk.



Chapter 6 - Financial Products E&O Claims

A review of the claims arising from the sale of financial products reveals a pattern of frequently recurring allegations. A registered representative who is aware of and understands the pitfalls of selling these products, can sharpen their business practices, avoid costly claims and better satisfy their customers' needs.

Following are brief synopsis of potential danger areas in the sale of service of financial products.

- **Delay in Processing:** A delay between the date of the order for a transaction and the actual processing of that transaction can cause an economic loss to a customer.
- **Misrepresentation:** Often a registered representative will be so enthusiastic about an investment that indicates about the performance of a product are perceived to be guarantees by the customer.
- **Investing a Windfall:** Many of those making claims are people of modest means and little financial experience who suddenly have a need to manage a substantial amount of money due to inheritance, insurance settlement or retirement distribution. While they know they should probably invest, they really have no investment experience and thus, do not understand investment risk. If this once-in-a-lifetime windfall is lost through bad investments, the claimants are not philosophical; they are traumatized and they go to see a lawyer determined to get their money back.
- **Suitability Issues:** By far, the most common allegation by unhappy customers is that the recommended investment was not suitable for them. Claimants frequently allege that they told their registered representative that their objectives were capital preservation and reliable income and were advised to invest in securities which they later discovered were not suitable for these objectives.

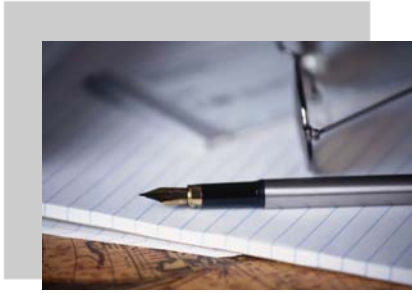
A broker who makes a recommendation should have a reasonable basis for believing that the customer has such knowledge and experience in financial matters that he may be reasonably expected to be capable of evaluating the risks of the recommended transaction and financially able to bear risks. Often customers do not understand that an investment can go down in value or that they possibly cannot get their money out anytime they need it.

Description of Claim

A woman who was recently widowed met with a financial planner to seek advice on handling a \$400,000 portfolio left to her by her late husband. Her husband had been an extremely conservative investor and the money was invested entirely in short-term government securities. The widow needed to decide how to reinvest the money as the securities matured and since she had no prior investment experience, she hired the financial planner. The widow took an instant liking to the financial planner and said she would do whatever he recommended. The financial planner recommended a number of high-quality growth and income mutual funds. Within a few months, market conditions had caused the total value of the portfolio to decline by \$12,000. The widow reacted with panic. She liquidated her funds and hired a lawyer who filed an arbitration claim against the financial planner for recommending unsuitable investments. In arbitration, the widow was awarded the full amount of her loss. Estimated Claim Cost: \$400,000.

E&O Prevention Tip:

Get to know your customer and understand their tolerance for risk. Always complete the Broker/Dealer's required financial profile or New Account Form completely and truthfully.



Chapter 7

Underwriting and Binding Procedure

E&O Claims can occur as the result of an agent not being familiar with or overstepping an insurance company's underwriting guidelines and/or failing to properly follow binding procedures. Losses arising from violations of underwriting/binding procedures are most prevalent when an agent places a risk with a company where he/she does not place a high volume of business.

Agents who operate within the scope of their express authority will, in most cases, avoid liability for their errors and omissions. There are several steps which should be taken to avoid errors and omissions arising from underwriting and binding procedures.

- It may seem obvious, but every agent must KNOW their scope of authority with every company they do business with. Carriers do sue agents when it appears that their agency contract has been breached.
- When in doubt, check with the carrier regarding proper procedures.
- If an underwriter makes an exception regarding a risk, be sure to have the underwriter document his agreement in writing and maintain a copy in your file. If the underwriter does not provide you with such a letter, confirm your understanding in writing to the underwriter requesting an immediate reply if your understanding is not correct.

Other simple procedures can go a long way to preventing these types of losses.

- Always fully disclose the nature of a risk to the insurance company. For instance, if a carrier requires an inspection of a property as part of the application process, be sure to completely inspect the property to be perfectly clear about the nature of the risk. Incomplete inspections often lead carriers into writing risks they may not have written had all the facts been known. Sometimes it is not so much what is said about a risk but what is NOT said. While the carrier may end up paying a claim in the event of a loss, the carrier may turn around and sue the agent later.
- If you lack binding authority for a risk, be sure your customer understands that. Confirm in a letter that no coverage exists and copy the underwriter. Provide the customer with a realistic expectation of how long it will take to obtain a quote or authorization to bind from the carrier. If the customer needs an immediate answer, call the underwriter and get the answer in writing.
- Bind ONLY those risks you know the insurer will accept.
- Know your state's statutes regarding the issuance of binders. In some states, a written binder must be sent to the insured and to the insurer within three business days of the issuance of the oral binder. Reduce all oral binders to written binders and send a copy to the insurance company as well as to the customer.

- When possible, use a particular insurance company's application rather than a standard ACORD form application. The form provided by the insurer is typically tailored to capture information related to its own underwriting rules.
- For hard to place coverages or when a customer delays in choosing an insurer or coverages, send the customer a follow up letter emphasizing that no coverage has been bound.

The following are examples of claims which could have been prevented if proper underwriting or binding procedures had been followed.

Description of Claim:

The carrier's underwriting guidelines required submission of a photograph of all rental properties included for coverage. The agent failed to obtain a photograph of the rental property for which a customer desired coverage; a binder was provided to the customer. A fire occurred and due to the issuance of the binder, the insurance company was required to pay the claim but later sought reimbursement from the agent. Had the agent visited the property to obtain a photograph, it would have been clear that the property was boarded up and vacant and therefore an unacceptable risk. Estimated Claim Cost: \$150,000.

E&O Prevention Tip:

Always follow an insurance carrier's underwriting requirements for binding coverage.

Description of Claim:

An agent issued an auto insurance binder to an insured who was twenty (20) years old. The insured had an accident; the agent was held liable because the underwriting guidelines of the carrier clearly stated that the minimum age requirement was twenty-five (25). Estimated Claim Cost: \$12,000.

E&O Prevention Tip:

Review and follow the underwriting guidelines of every company that you place business with.

Description of Claim:

An agent bound coverage on a homeowner's policy for a large home which was actually a bed and breakfast establishment. The agent knew that the home was actually a bed and breakfast but failed to disclose this to the insurance carrier. A fire damaged the bed and breakfast area of the home. There were losses not covered under the homeowners' policy. Estimated Claim Cost: \$60,000.

E&O Prevention Tip:

Do not mislead an insurance carrier regarding the nature of a risk.

Description of Claim:

A customer requested flood insurance through the National Flood Insurance Program. An application was completed and the premium paid for the coverage. The agent advised the customer that he had no binding authority for the flood coverage but that he would process the paperwork right away. The Flood Program allows the effective date of the policy to be calculated from the date of the application if the application is received at their offices within ten days. Otherwise, the policy effective date will be 30 days from the date of receipt of the application at the Flood Insurance Offices. The application had been mailed by regular mail during the Christmas season and did not arrive at the Flood Insurance offices until 12 days after the date the agent wrote the application. A flood occurred in early January and due to the fact that the application had not been received within 10 days, the loss was not covered. Estimated Claim Cost: \$8,000.

E&O Prevention Tip:

Although the agent told his customer that he did not have binding authority, the customer was led to believe that there would be no problem in getting coverage from the date of the application. Sending the application and premium payment by certified and/or express mail would have prevented this claim.



Chapter 8

Telephone & Documentation Procedures

Over half of all errors and omissions claims filed against agents include allegations that the agent failed to provide adequate coverage. The majority of these claims involve additions or deletions to existing policies. No discussion of E&O prevention would be complete without discussion of the role that documentation plays in defending agents against E&O claims.

As professionals, insurance agents and brokers are held to certain standards in running their business. While documentation procedures cannot completely relieve agents of their professional responsibilities or guarantee that E&O claims will be settled in their favor, an established loss control procedure which address all areas of documentation will provide a better defense when an E&O claim arises.

Documentation can take many forms. One valuable piece of documentation is the follow up letter. Whenever a client inquires about any aspect of their policy, an agent should send a follow-up letter confirming the issues discussed (with a copy of the letter retained in the file). Instances where a client requests a reduction in coverage should always be followed up with a letter. The agent should consider sending such a letter by certified mail. Often an agent will go one more step and have the client “sign off” on coverages that were either reduced or refused. This is especially important when a client refuses or eliminates coverage against an agent’s recommendation. A customer who won’t follow a recommendation is, unfortunately, the first to hold the agent responsible when a loss occurs. Requesting that the customer sign off on refused coverage often prompts that customer to reconsider the importance of the issue and purchase the coverage after all.

The telephone is often the primary method of communication between agents and customers. Proper telephone procedures for both incoming and outgoing calls should be established. Whether an agency has a receptionist or whether everyone answers their own phone, proper telephone documentation begins with a telephone log. Consider using two part message pads so that a historical record of all incoming phone calls is maintained. The log should include the date and time the call was received, the name of the caller and the individual called.

It is important to document a summary of every client/agent conversation, including calls from the agent to the client. Additionally, phone conversations with insurance company personnel such as claims adjusters and underwriters should also be documented and kept in the file. The following information should be included when documenting these conversations:

- Date and time of call
- Names of parties involved in call
- Synopsis of conversation
- Action to be taken by agent, client or other party as a result of conversation
- Follow-up measures to be taken-i.e. Confirming letter, returning phone call etc

Remember to apply these procedures to mobile telephone calls as well. A phone call placed or received over a cellular phone poses a unique problem for an agent who wishes to document the conversation rather than relying on memory at a later time. One solution might be to carry a small, inexpensive recording device to dictate required actions for later follow-up.

When developing documentation procedures for your office, address other forms of communication such as fax, answering machines and e-mail. When using faxes, remember to immediately deliver faxes to the appropriate person. Never fax confidential information without your client's permission. Many fax machines have automatic date and time stamp- be sure yours is set to the correct date and time.

If your office uses an answering machine when the office is closed, be sure the outgoing announcement indicates that leaving a message does not constitute an agreement to bind or write any type of coverage. You may also wish to consider a message that simply states the office hours and does not allow messages to be left.

E-mail is a quick way to communicate and more and more people are using it. While most systems allow the user to store a message, it is recommended that messages be printed out and hard copies be placed in the client's file.

Description of Claim:

An agent in a small town handles the insurance needs for many acquaintances, friends and neighbors. One of the agent's friends calls the agent at home one day to confirm their golf date on the following afternoon. In the middle of the conversation, the friend tells the agent that he finally bought a new car for his daughter and needs to add it to his policy. The agent and his friend proceed to talk about their upcoming golf game and other personal matters. By the time the agent hangs up the phone, he is only thinking about his game the next day and completely forgets about the new car. An accident occurs and because the other cars on the policy only had liability coverage, there is no physical damage coverage on the new auto. Estimated Claim Cost \$4,000.

E&O Prevention Tip:

Always document every conversation. Whether at home or in the office, be sure you have message pads beside each phone.

Description of Claim:

A father called the agent to advise that he had taken over his son's mobile home and needed to have the policy changed to his name. The agent took down the information but failed to submit the information to the insurance carrier. The son stopped paying the premiums but because the policy change had never been processed, the father never got any notices of cancellation. The mobile home was subsequently damaged due to a tornado. When the claim was reported, the father was told the policy had canceled several months back. Estimated Claim Cost \$5,000.

E&O Prevention Tip:

It is not enough to simply write down that a call was received. Forms used for documenting requests should also include a place to record what action is required as a result of the phone call.

Description of Claim:

An agent took an application for auto coverage that was to be an assigned risk policy. The agent prepared the quote which included collision coverage. The client stated that the car would just be parked and therefore he would not need collision coverage. Shortly thereafter, the client had an accident. The client claims that he had requested full coverage on the car. Claim Cost: \$8,500.

E&O Prevention Tip:

A follow up letter confirming the insured's desire to have minimal coverage since "the car would just be parked" would have provided a defense of the claim. Or, if the quote had been presented in person, the agent could have had the insured initial and date the refusal of the collision coverage.

Description of Claim:

An agent insured a prior owner of a building. That owner sold the building and completed the appropriate paperwork to have the existing policy transferred to the new owner's name and then faxed it to the title company. The title company then paid the amount due on the policy and sent it to the agent who deposited the money in his trust account. Thereafter, the agent did not remember whether or not he paid the premium. A fire loss occurred to the building and the insurance company denied the claim stating that there was no policy in force. The agent kept all his records on his computer but his computer crashed and he did not have access to prior records that could confirm that the premium had been paid. Claim Cost: \$12,500.

E&O Prevention Tip:

Establish procedures for regular back up of computer records.



Chapter 9 - Standard Office Procedures

Insurance agents are expected to be knowledgeable about their client's insurance needs and to be able to recommend the appropriate coverages. Agents sometimes focus on the business of insurance while overlooking the liability that may arise from the business itself.

The time to develop a set course of conduct and custom for the running of the business is before an E&O claim arises. The agency, including all of its employees, is considered a professional firm and therefore will be held to certain expectations and legal obligations. Not only do the actions of employees reflect upon the image of the firm but, in some instances, may give rise to an errors and omissions claim against the firm itself. In view of this, it is essential that agencies establish office procedures and that all agency personnel have a thorough knowledge of the procedures to be followed.

A first step in establishing office procedures is to set up a manual which describes systematized office routines which are used by everyone all of the time. Each employee should have a copy of the manual and the manual should be updated regularly.

Suggested items to be addressed in the manual include:

PERSONNEL STANDARDS

- Scope of authority for each employee
- Attendance at regular staff meetings
- Agency philosophy regarding professionalism, teamwork and the need for ongoing professional education

AGENCY STANDARDS

- Telephone procedures including standardized memo and message forms
- Cash management & check handling procedures
- Mail handling procedures (which should include date stamping incoming mail)
- Forms manual with instructions outlining when to use standard letters, memos, meeting reports, etc.
- Complaint handling procedures including how to deal with negative comments from clients

FILE MAINTENANCE PROCEDURES

- Standard filing procedures that define how documents are to be maintained. A multi-part file folder is recommended to separate the correspondence, policy, application etc.
- Record retention standards. Check your state requirements.

EFFECTIVE SUSPENSE SYSTEM

- An effective suspense system should facilitate follow-up as well as to document and verify the completion of an item.
- Each day the items which are diared to be reviewed for that day should be documented with the following issues being addressed:

- Pending new business
- Renewal processing
- Changes pending on existing business & status thereof
- Expiration dates
- Correspondence requiring a reply

The claims examples which follow illustrate how incomplete or inadequate office procedures contributed to an E&O claim being filed against an agent.

Description of Claim:

A long time client of the agent had a large family with several children of driving age. This client made frequent changes to his auto policy to add or remove vehicles and drivers. On one occasion, the client called the agent to discuss two changes. First, he wanted to add a daughter and her new car. Second, he thought he might be removing a pickup truck that he was selling because a potential buyer was coming back in a day or two with the money. The agent made notes to his file and told him to call back as soon as he knew the truck was sold. The agent then put the file aside, figuring he would handle both changes at the same time. Three months later, the client called to report that his daughter had totaled her new car. The agent pulled the file and realized he had failed to act on the customer's request to add coverage. Estimated Claim Cost: \$15,000.

E&O Prevention Tip:

Act on coverage requests immediately. Establish a diary/suspense system to follow up on potential changes.

Description of Claim:

A new customer contacted an agent and requested an immediate binder for coverage on a car he was buying. The agent asked the client if he had a valid driver's license. The client said that he did so the agent quoted a 6 month premium, collected a cash deposit and issued a binder. Two days later, the agent received a motor vehicle report showing the client's license was suspended. The agent attempted unsuccessfully to contact the client by phone for several days. The agent then sent letters to the client and to the bank rescinding the binder explaining that the client's license had been suspended. The agent forgot to refund the premium deposit. Four months later, the client called to report that the car had been totaled. The agent reminded him that he had no coverage. Both the bank and the client denied receiving the agent's letter. Estimate Claim Cost: 10,000.

E&O Prevention Tip:

Establish clearly defined procedures for notifying clients of cancellation. Utilize a cancellation checklist which includes a step to refund any unearned premium. Consider using certified mail.

Description of Claim:

An agent's assistant printed an automated policy summary from the agency's computer system for a BOP policy and sent it to the client. In the haste to deliver the summary, no one checked to be sure it matched the actual coverages purchased by this particular customer. As a result, the customer received a generic summary that showed three specific coverages that were not included on his specific policy. In addition, the summary failed to mention the reduced sub-limits of third-party coverage. When a claim occurred involving coverage that the customer did not have, the customer pulled out the policy summary page showing that coverage was to be included. Estimated Claim Cost: \$7,300.

E&O Prevention Tip:

Be sure your office has procedures in place to address double-checking templated documents against actual insurance company quotations and/or in force coverage.

Description of Claim:

A woman purchased a house and requested that the agent obtain a policy. The agent accepted a down payment premium of \$100. The application was misfiled and never processed. The woman called the office several times to inquire as to the status of the policy and the agent told her that the application had been sent to the insurance carrier. Two months later, the woman's house was destroyed by fire. The agent did not realize that the application had not been processed until the woman called to make the claim report. Estimated Claim Cost: \$50,000.

E&O Prevention Tip:

Do not rely on memory when responding to client inquiries regarding policy status. Pull the physical file or look up the information on the computer and call the client back if necessary.