

# Changing Professional Liability Insurance Providers

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## SUMMARY

Before a firm changes liability insurance providers, it is important to understand the firm's current policy and to be aware of the complexities of the insurance market. Insurance premiums are affected by several factors, including, but not limited to market conditions, the limit of liability, the deductible, scope of coverage, and more. Talking with a credible professional liability insurance broker, conferring with colleagues, and conducting research on various insurers can provide helpful information that a firm needs before changing insurance providers.

## MARKET CONDITIONS AND INSURANCE PREMIUMS

The professional liability insurance market can be volatile. When premium rates are low and competition among insurers is high, the market is said to be "soft." When premium rates are high and competition is scarce, the market is said to be "hard." Note that the degree of "hardness" is measured from the perspective of the policyholders—a soft insurance market is advantageous to consumers, while a hard market is tough on them.

While the volume of claims made against policyholders is a significant factor in premium rates, other, macro-economic factors can have an equal or greater impact on how much you pay for professional liability insurance. Such factors as the performance of the stock market, prevailing interest rates, and the availability of credit in the financial markets can cause insurance premium rates to rise or fall regardless of dollars insurance companies pay out for claims.

When the professional liability insurance market hardens, many policyholders find that, despite their good claims history, their insurance premiums rise dramatically and/or their coverage is reduced. Many insurance companies will try to limit their financial liabilities by eliminating valuable (to the policyholder) and costly (to the insurer) policy provisions such as "first dollar defense" or multiyear policy terms. In the

hardest markets, some design professionals may find it difficult to obtain insurance at all.

## EFFECTS ON POLICYHOLDERS

A hardening insurance market prompts many policyholders who have previously been content to remain with the same insurance company year after year to consider switching to a different company. But changing insurance companies carries its own set of risks, which must be carefully considered if a firm is not to find itself exposed to financial liabilities for which it has always assumed it was properly insured. Thoughtful planning of the transition can help minimize these risks.

## UNDERSTANDING YOUR CURRENT POLICY

Most professional liability insurance policies are written on a "claims-made" policy basis. That means, quite simply, that the policy coverage is limited to claims made *while the policy is in force*. Unless you notify your insurance company of a potential claim before the policy ends, you have no protection for that claim after the policy has been canceled or has expired—even if the claim or the alleged design error occurred during the term of the policy.

Most policies will provide coverage for professional services that were rendered before the start of the policy period, extending back to a specified date, known as the "retroactive date." But again, in order to be eligible for coverage, claims pertaining to such prior acts must be made while the policy is in force.

Another way to think about claims-made coverage is that while the policy coverage can reach back in time to cover acts performed before the start of the policy period, coverage never extends forward in time—when the policy expires, the coverage stops.

The terms of insurance policies vary from one company to another. Similarly, insurance requirements vary from state to state. But generally a professional liability claim needs to meet three criteria to be eligible for coverage.

- There must be an active policy.

- The policyholder must not have had knowledge of the claim before the start of the policy period.
- The professional services that led to the claim must have been rendered after the retroactive date of the policy.

The claims-made provision of professional liability insurance policies places an additional burden on you when you decide to change insurance companies. You must carefully consider the retroactive date of the new policy and any claims that might fall between the two policies. Make certain you are continuously covered. Do not allow a lapse in coverage to occur.

### **PLAN AHEAD**

Allow yourself enough time to shop the market, evaluate your options, and effect the transition to a new policy. Begin at least 60 to 90 days in advance of the expiration of your current policy.

### **AWARENESS OF CLAIMS AND INCIDENTS**

A claim is a demand for money or services. An incident (also known as a circumstance or a potential claim) is an issue that a reasonable and prudent person could expect to result in a claim. New policies will not provide coverage for claims or incidents that the policyholder is aware of on the day coverage begins. Before you change insurance companies, confirm—double-check and triple-check, if necessary—that there are no claims against you and that there are no incidents that might lead to claims. If any are revealed, report them to your current professional liability insurance company *before* you change companies.

### **DISCLOSURE REQUIREMENTS**

Your new insurance company relies on the information you provide to make an offer of coverage to you. It is common practice for brokers to assist policyholders in completing one application, which they then submit to several insurance companies for price quotes. If you elect to change insurance companies, the new company may ask you to complete its own application before it issues the policy.

This may result in a risky sequence of events. If the second application discloses new information, the insurer may increase the premium, require reductions in coverage, or refuse to issue the policy altogether.

For example, your new insurance company may consider multifamily projects to be risky. The first application might not have required that you disclose

the percentage of your services performed for condominium projects, whereas the second application does. If you decide to change insurance companies, ask your broker to complete and submit the new company's application form before you make the final decision to switch. And always maintain your existing policy until you are certain that the new policy is in force.

### **RETROACTIVE COVERAGE**

Insist that the retroactive date of any new policy that replaces an existing policy be the same as or earlier than the retroactive date of the existing policy. When one is continuously insured, the retroactive date should remain the same. This is analogous to retaining health insurance coverage for preexisting conditions when one is continuously insured but changes health insurance policies.

### **POSSIBLE INCREASES IN FINANCIAL RISK**

A hardening insurance market may leave you no choice but to reduce your coverage in order to maintain affordable premium rates. Carefully weigh the financial risk of every change in coverage, and determine whether you can assume that risk.

### **FIRST DOLLAR DEFENSE**

"First dollar defense" coverage is among the first provisions eliminated by insurance companies in a hardening market. This provision simply means that if a claim is made against you, your insurance company will pay your defense costs beginning with the "first dollar"—meaning that the defense costs are not charged against your deductible. If you work in an environment or on building types that are particularly prone to claims of errors and omissions regardless of the quality of your professional services, the value of this coverage may be significant to you. If, on the other hand, claims made against you are rare, you may be willing to assume the financial risk of eliminating "first dollar defense" coverage.

### **HAMMER CLAUSES**

Beware of "hammer clauses," provisions in insurance policies that may reduce the limit of liability (coverage) for a particular claim if the policyholder and the insurance company disagree on the settlement of the claim. The provision is best explained by the following example. Let's say you have a policy with a limit of liability of \$2 million per year. A claim is made against you in which your insurance company is prepared to settle with the plaintiff for \$500,000. You disagree that you are at

fault, believe that you have a reasonable chance of prevailing, and wish to defend yourself against the claim in court. If your policy contains a "hammer clause," your insurance company informs you that as a result of your refusal to accept the terms of the proposed settlement, the limit of liability for that particular claim is now \$500,000. A policy for which you have paid premiums to secure \$2 million in coverage is now worth, with respect to that claim, only \$500,000. If possible, refuse to accept such clauses in any insurance policy.

### **LIMIT OF LIABILITY**

Lowering your limit of liability will reduce your premium rate, but may dramatically increase the exposure for which you buy insurance in the first place. It is also unlikely that the reduction in premium will be proportional to the reduction in limit. Reducing your limit by 50 percent, for example, may lower your premium by only 20 percent. If you must consider reducing your limit of liability to reduce your insurance costs, you must also weigh the premium savings against the value of (and risk of losing) any assets—including personal assets—that could be seized to satisfy a judgment against you if the lower insurance coverage is insufficient.

Be mindful of the "claims-made" provision of most policies. If your previous policy had a limit of liability of \$2 million per year and your new policy has only \$1 million, then the insurance coverage for projects you completed while that previous policy was in force has effectively been cut in half.

### **INCREASING YOUR DEDUCTIBLE**

Increasing your deductible may be one of the least risky and most cost-effective ways of holding the line on insurance premiums without assuming substantial additional risk—provided you have set aside the cash needed to satisfy any claims to which the deductible might have to be applied. As unpleasant as the idea of money sitting idly in the bank may seem, it is far preferable to have the money in an interest-bearing account in your firm's name, than paying it to an insurance company as premiums. The cash set aside for that purpose has the added benefit of improving your balance sheet, which may improve your prospects for obtaining a line of credit at favorable interest rates. It may also provide a financial safety net for your business, which is a form of risk reduction in and of itself.

### **REDUCTIONS IN COVERAGE**

Be alert to changes in coverage that affect previous exposures. For example, even though you no longer

work on projects that pose a high risk for water infiltration claims, if you provided professional services on such projects in the past, you should be concerned about a new policy that would exclude coverage for claims due to mold.

### **THE POLICY TERM**

In a volatile market, most insurance companies are reluctant to issue multiyear policies; the term for most policies will be one year. If you have or are being offered a multiyear policy, examine carefully the language with respect to the policy term and the limit of liability. A two-year policy with a limit of liability of \$2 million for the term of the policy is not the same as a two-year policy with a limit of liability of \$2 million per year; the latter provides twice as much coverage.

### **OTHER TERMS AND CONDITIONS**

Other factors affect your insurance premium in addition to the limit of liability, the deductible, first-dollar defense, and scope of coverage. Policies may pay you for the time you spend attending claim proceedings, cut your deductible in half if you participate in mediation, have fewer exclusions than others, or provide risk management services, contract review, and/or continuing education programs at no additional cost. These provisions have value, and should be considered in comparison with the premium rate.

### **DUE DILIGENCE CHECKLIST**

Ask your broker to provide you with a side-by-side comparative analysis of different policies. If the change of insurance company also means a change of broker, develop your own checklist from the features in your current policy and the policies being offered to you. At a minimum, your list should include the following:

- The retroactive date
- Deductible options and their cost
- Persons/entities covered
- Management and financial ratings of the company
- A clear definition of "professional services"
- Differences in exclusions
- The coverage territory

- Provisions that may reduce the deductible, including the amount and under what circumstances
- Payment to the policyholder for attendance at claim proceedings, including the amount and under what circumstances
- Number of years the insurance company has offered policies to design firms
- Included benefits, such as risk management support services, contract review, and professional development seminars
- Whether the policy includes a hammer clause. What happens if the policyholder disagrees with the insurance company's desire to settle a claim? Does the policyholder have an unequivocal right to withhold consent to a settlement without risking a reduction in coverage?

### EDUCATE YOURSELF

Many sources are available to help you gather and process information. Most professional liability insurance companies publish abundant information on their Web sites, and much of it is available to the public.

The AIA Risk Management Committee, together with its counterparts at the National Society of Professional Engineers (NSPE) and the American Council of Engineering Companies (ACEC), conduct an annual survey of and in-depth interviews with the major underwriters, program administrators, and brokers in the A/E professional liability insurance markets. The results are usually published on the Web sites of the three organizations.

Talk to your colleagues. Surf the Internet. And, most important, remember that a portion of your premium is paid to your insurance broker and that you are entitled to expect service. Don't be timid about asking your broker to perform.

### ABOUT THE CONTRIBUTOR

Melissa Roberts is a vice president with Euclid Insurance Agencies, Itasca, Illinois. She has specialized in providing insurance, loss control, and risk management services to design professionals since 1984. Melissa received the 2000 AIA Northeast Illinois Outstanding Affiliate Member Service Award.

### LESSONS LEARNED

Educate yourself, understand your policy, understand its limits, strengths, holes, if any, and deductibles. Do not be shy to ask your broker questions when deciding which insurance provider to choose.

### RESOURCES

#### More Best Practices

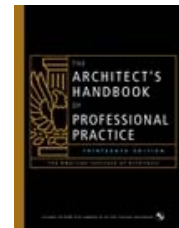
The following AIA Best Practices provide additional information related to this topic

- 12.02.01 Selecting a Professional Liability Insurance Broker
- 12.02.02 How to Minimize Your Insurance Premiums
- 12.02.04 Design-Build Insurance Considerations

#### For More Information on This Topic

See also "Insurance Coverage" by Lorna Parsons and Ann Marie Boyden, Hon. AIA, *The Architect's Handbook of Professional Practice*, 13th edition, Chapter 12, page 331.

The *Handbook* can be ordered from the AIA Bookstore by calling 800-242-3837 (option 4) or by sending an e-mail to [bookstore@aia.org](mailto:bookstore@aia.org)



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#### Key Terms

- Practice
- Insurance management
- Liability insurance
- Professional liability insurance