

The Uncertainties of the 'Claims Made' Form of Insurance

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In 1979, the Lloyd's of London insurance syndicates created a new form of liability insurance named "the Claims Made form," to offset the long-term risk and uncertainties created when unexpected huge losses from Liability Insurance occurred many years after a small premium was paid for the risk. Prior to 1979, liability risks were covered under the "occurrence" form of insurance, which simply stated that the insurance company was obligated to pay for claims arising from occurrences that arose during the policy year for which premium was paid, regardless of when the claim arising from the negligence is reported to the company, even 20 years later. Thus, the occurrence form led to uncertainties for insurance companies because the risk could not be measured. Uncertainty was also created for the insured, because the insurance company might not exist when the claim is filed many years later.

Most professional liability insurance contracts written now use the "Claims Made" form policy, which enhances the importance of understanding the differences between the "Occurrence" form of liability insurance and the now predominate "Claims Made" form.

- "Occurrence" policies protect policy holders for alleged acts of malpractice that occur while the policy was in force, no matter when a claim against the professional is reported to the insurance carrier. "Occurrence" insurance policies are no longer available to most professionals, with a few exceptions.
- "Claims Made" Policies protect policyholders for alleged acts of malpractice that both occur and are reported to the insurance company while the "Claims Made" policy is in continuous force and includes coverage back to a "prior acts date." Coverage for prior acts under a current liability insurance contract should be detailed in the current policy for both the individual attorney and the firm.

Lawyers Professional Liability is especially vulnerable to uncertainties because of the "long tail" exposure of services provided in the areas of Collection and Bankruptcy; Construction Law; Environmental Law; Estate/Trust & Probate; Plaintiff Personal Injury (including class action); Patent/Trademark; Real Estate/Foreclosures and Securities.

Since 1979, most insurance companies abandoned the occurrence form for liability insurance and have created further uncertainties in liability insurance, by constantly changing important policy provision in current policies. Each subsequent year's claims made policy covers all prior acts liability of the previous years back to a beginning date of coverage known as the "retroactive" date.

The "retro date" of a claim made policy is the starting date in the current policy for a firm's liability policy. The individual attorney's start date in a multiple attorney firm is referred to as the individual attorney's "prior acts" coverage date.

This retroactive (or prior acts) date should be maintained when changing insurance companies or changing employment. However, when the claims made policy terminates without some continuation of coverage, it's as if the policy never existed and prior acts coverage is also terminated.

If an insurance company cancels an individual or firm's liability policy, most policies offer some extension of coverage, referred to as "tail coverage" and known formerly as an "Extended Reporting Period Endorsement." When an Extended Reporting Period Endorsement is purchased, the terms and conditions of the terminating policy may extend, in some admitted policies, up to an unlimited period for reporting claims back to the original prior acts date. If a claims made policy is continuously renewed, the prior acts or retro date should remain constant, even when changing insurance carriers or employment. Caution is advised if a carrier offers a renewal policy with no prior acts (retro inception), at a much lower premium, which means acts prior to the current policy's effective date are excluded. Because there may be a significant lag time between when a legal service was provided and the filing of a claim, Claims Made premiums are relatively low for the first few years and are structured to increase each year, up to five years, (mature claims premium), that the coverage is in force.

The terms of a current renewed policy apply to all previous years of coverage, back to the retroactive date. However, the policy terms may change, and often do change, over the life of subsequent policies, thereby changing the terms back to a retro or prior acts date. Each year, renewal terms of a claims made form should be reviewed and compared to the terminating policy.

The Insurance industry has over the past 20 years essentially diminished coverage and increased premiums as losses have increased. Examples of diminished coverage are:

A) introduction of deductibles; B) requiring that deductibles be paid up front in the event of a claim and C) introduction of the "Pac Man," concept wherein the defense costs diminish the limit.

The irony is that the current claims made form's conditions and terms apply to all claims presented under the existing policy, even if the claim is from an error or omission from years ago. In other words, the liability insurance coverage that applies is the policy that exists when the claim is made, thus the title, "Claims Made Policy."

Therefore, if you decide to cancel your Claims Made Policy because you are changing jobs, retiring, moving, etc., you should consider the options available to extend coverage for past acts back to your individual retroactive date. Your new firm or new insurance carrier should provide "prior acts" coverage under the new firm's policy, or included in your new individual policy. The purchase of "tail" coverage may be necessary to insure you for incidents that occurred while the policy was in force, but reported after the policy was cancelled or terminated.

"Tail" coverage, also called an "Extended Reporting Period" (ERP) provides protection for claims that are filed after a claims made policy has been non-renewed, cancelled or terminated. The terms and pricing for tail coverage should be defined in the current policy. The purchase of tail coverage is unusually expensive, as the cost may be 200% to 300% of the expiring premium. Some admitted insurance companies' claims made policies may include a free unlimited tail after three to five years of continuous coverage.

In conclusion, professionals covered by a claims made form of liability insurance should be very conscious of the uncertainties and the changing characteristics of the form. The consequences of unwise choices only become apparent when a claim arises.