

The ABC's of E & O Insurance

by John J. Matternas

Author's Note: This article is written to help real estate appraisers better understand errors and omissions insurance. It should not be used as a substitute for reading the particular provisions of their policy.

Claims made coverage. Prior acts coverage. Retroactive dates. Minimum earned premium. A.M. Best Ratings. And so on...

The technical jargon of the insurance industry can be confusing to lay people. When it comes to purchasing professional liability insurance or errors & omissions insurance, real estate appraisers are no exception. And they must have a basic working knowledge of common terms and coverages, in order to make informed decisions and wise choices.

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Professional liability insurance is designed to cover organizations or persons that render professional services for the liability exposure they face for a failure to use due care and the degree of skill expected of a person in that particular profession.

In medical fields, this coverage is generally referred to as *malpractice insurance*. In non-medical professions such as accounting, real estate, and architecture, it is usually called *errors and omissions insurance*.

Liability insurance is written on either an *occurrence basis* or a *claims-made basis*. An occurrence policy would generally apply to an act or omission of the insured which occurs *during* the policy period. On the other hand, a claims-made policy covers acts or omissions of the insured which occurred during the policy period or *after* the retroactive date, for which claim is first made against the insured, and reported to the company during the policy period.

General liability coverages, such as those found in a typical business owner's policy, are usually written on an *occurrence basis*. Professional liability insurance, in contrast, is usually written on a *claims-made basis*.

This is because professional liability insurance is not restricted to liability for injury caused by an occurrence—that is, caused by an accident. In most cases, the professional did exactly what they intended to do, but the outcome was faulty or deficient in some way, resulting in injury to a third party. This injury may not be caused by an *occurrence*, but it can be — and often is — the basis of liability. In the case of professional liability, it may be referred to as a *wrongful act*.

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The following examples underscore the difference between the occurrence and claims-made forms.

If you are involved in a vehicle accident, you can pinpoint the date and time. It is an *occurrence*. However, let's look at a hypothetical example related to the real estate field.

An appraisal is done in January of 1997. It does not indicate that the subject is in a flood plain. In August of 1998, the property owner discovers that this is the case, and files an action against the appraiser for failing to disclose this information. As you can see, there is *no occurrence* or accident that you can pinpoint precisely.

Take this hypothetical example one step further. The appraiser purchased an Errors and Omissions policy from *Company A* that was effective from January 1, 1997 to January 1, 1998. It had a retroactive date of 1/1/97. On January 1, 1998, he purchased a policy from *Company B* for the period from January 1, 1998 to January 1, 1999. This policy has a retroactive date of 1/1/97 as well. The claim is made in August of 1998. Which insurance provider responds to the claim? Under a claims-made form, the response would lie with *Company B*, since the claim was made during the second policy period, and involved an act or omission that occurred after the retroactive date.

This is one reason why it is so important for persons purchasing liability coverage to be certain that they maintain *continuous coverage*, with a retroactive date that generally goes back to the date the insured first purchased this coverage.

Prior acts coverage — for acts or omissions prior to the effective date

of the policy—is generally *not* available to persons purchasing this insurance for the first time.

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The other important point to note about a claims-made policy is that when the policy terminates, there is no further coverage unless the insured purchased an *extended reporting endorsement*. In the insurance world this is often referred to as *tail coverage*, since an extended reporting endorsement allows a period of time, anywhere from six months to several years, for claims to be reported.

Another difference between professional liability and other liability policies is that professional liability policies are not framed in terms of bodily injury or property damage. A typical policy for real estate appraisers, for example, covers damages arising out of wrongful acts

rendered or which should have been rendered by the insured. The term *wrongful acts* is defined as: *any actual or alleged breach of duty, neglect, error, misstatement, misleading statement, or omission committed solely in the conduct of the insured's profession*. A comparison of costs, benefits and details of each policy will help you make the right decision. Also, how do you feel about the service you receive, how quickly are your questions answered, and do you feel comfortable with your insurance provider? This is an important business relationship which you should approach with care.

There are various other terms and definitions you may encounter as you navigate the path to finding the right E & O policy:

MINIMUM EARNED PREMIUM

The minimum policy premium that is due if the policy is cancelled after the inception date.

A.M. BEST RATINGS

Ratings on the financial strength of insurance companies prepared

by the leading insurance rating organization. Standard and Poors also issue ratings on the companies.

FIRST DOLLAR DEFENSE

This refers to whether the insured's deductible applies to the defense costs and any damages or judgment or whether the deductible applies only to damages.

In this article we hoped to provide some deeper understanding of issues to consider in purchasing errors and omissions insurance for real estate appraisal professionals. Of course, each individual's policy is the final authority on all matters relating to their coverage. Therefore, if you do not understand something, be sure to get clarification from your provider. Your insurance is there to protect you and your business. Choosing it carefully should be an important priority. ♦

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