

British Insurance Brokers' Association



Professional Indemnity Initiative

An introductory guide to professional
indemnity policy wordings



- 03 Foreword
- 04 Introduction
- 05 Why use the BIBA PI facility?
- 06 The principal issues
- 09 Assessing the risk
- 10 Claims
- 13 Checklist summary
- 14 Professional indemnity buyer's checklist





There is no requirement that an insurance policy is reasonably intelligible in terms of content and there is no requirement that it be especially legible.

Birds' Modern Insurance Law, 6th edition, 2004



This statement may appear at first sight to contradict the FSA regulatory position but was, of course, written before the introduction of FSA regulations, and contract certainty.

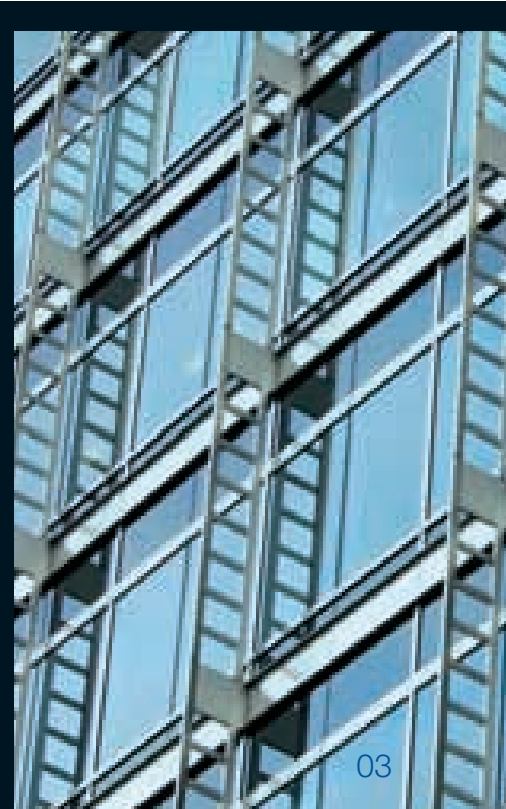
Nevertheless, I believe there remains an element of truth in the warning. Insurance companies are competing for business and they are free to choose their own style of policy and the words, phrases, and expressions they use to define their offering. These can differ immeasurably and I believe insurance intermediaries should be aware of the differences and how they could impact the very important protection they expect from a professional indemnity (PI) policy.

This is the second phase of our PI initiative, which attempts to move the industry to clearer definitions/ understanding of the wordings and consider the advantages and disadvantages of a minimum standard.

We are also publishing a more comprehensive guide to members' PI on our website. This is an extensive guide to the interpretation of policy wordings and I hope you find both this introductory guide and the website guide useful.

The next phase of the PI initiative will look at a minimum wording, claims handling and risk management.

Eric Galbraith
BIBA Chief Executive



This guide is a summary point of reference for BIBA members with responsibility for buying the firm's PI insurance

This introductory guide is designed to create awareness of:

- the necessity to ensure the PI policy meets the firm's needs and expectations
- contractual obligations of the policyholder
- acts or omissions that can cause the policy to fail.

PI insurance is complex and contains strict obligations on the policyholder which, if breached, can result in loss of cover. In today's heavily-regulated trading environment that is a risk that no BIBA member can afford to take.

Recommended reading

Those responsible for buying their firm's PI insurance or for the recognition and notification of potential claims are recommended to read the *BIBA Guide to Professional Indemnity Insurance* where matters described in this introductory guide are dealt with in greater detail.

This is available exclusively to members on the BIBA website at www.biba.org.uk and includes:

- useful tips
- examples of key policy clauses
- explanation of claims obligations
- common exclusions to cover
- a buyer's checklist.

WHY USE THE BIBA PI FACILITY?

The benefits of choosing a BIBA-accredited broker

A specialist skill


PI insurance is a specialist class of business. It requires many years of experience to fully understand how it works in practice.

Negotiating effective PI policies is a skill which requires an understanding of how the policy will respond in the event of a claim. Handling claims also requires specialist skills because both market practice and the prevailing case law can influence how claims are best managed.

Only those who handle such matters day in and day out know how best to deal with them.

BIBA-accredited brokers have these skills and BIBA strongly recommends that members take advantage of their specialist knowledge and experience.

Key points:

- BIBA has reviewed the PI cover available in the market in conjunction with the accredited brokers and has raised the standard of cover available
- the BIBA PI initiative has already increased the competitiveness of PI cover for members
- the accredited brokers have a special knowledge of PI insurance and the skills required to negotiate the best available cover for BIBA members
- the relationship between the accredited brokers and the selected insurers can avail you of the best available resources and negotiating skills in the event of a claim
- BIBA has identified a panel of experts to handle disputes or conflicts for members. 



BIBA-accredited brokers have a special knowledge of PI insurance and the skills required to negotiate the best available cover for BIBA members.



The key issues associated with purchasing PI insurance

BIBA members are encouraged not to buy their own PI insurance but to use the services of one of the accredited brokers. The reason for this is that BIBA believes that brokers need the independent support and representation of a specialist in the field of PI insurance.

Brokers are dependent upon their PI insurance in the event of a claim; it is a requirement of FSA regulation that PI is in force and maintained. However, the cost of PI insurance is a considerable annual overhead and so there is a natural tendency to buy on price alone.

BIBA is concerned for members that buying on price alone can lead to a failure to obtain the most effective and secure cover and this can lead to a dispute with insurers at the time of a claim.

Please be aware:

- that no insurance intermediary is immune from a complaint or claim
- that a common pitfall is a gap in cover
- of how insurers assess your risk and your obligations for materiality and disclosure
- of claims notification obligations. These are often misunderstood and lead to disputes with insurers at a time when the firm can least afford it.

These issues and many more described in this summary, are dealt with in detail in the full *Guide to Professional Indemnity Insurance* available exclusively to BIBA members on the BIBA website, www.biba.org.uk

This guide is designed to help the BIBA member make informed choices when presented with the various options available in the market.

BIBA is intent upon helping its members to identify the “elephant traps” associated with PI insurance because it is essential for the protection of the business and reputation of members that the cover is effective and fair when called upon.



Top tip: Always compare the cover offered by two or more policies currently available from the market.

No immunity

No insurance intermediary is immune from a complaint or claim.

In any business, however well run, things will go wrong. Insurance intermediaries, however well run, will sometimes make mistakes and communications can break down both between the insurer and the insurance intermediary and the insurance intermediary and their client. This can lead to a claim.

Consumers' expectations of insurance often exceed what is reasonable and it is this that can lead to complaints and claims. They are facts of modern business life.

Cost – without liability

Whether or not the allegation or claim is justified is of no consequence. Once an allegation or claim has been made, there is no option for the insurance intermediary but to enter a defence. Defence costs, even for misconceived or unmeritorious claims, can be far beyond the financial reach of most small businesses.

It is a common misconception that all costs are covered by PI insurance. They are not.

The cost of the policyholder's time in compiling records, attending meetings and preparing statements, combined with the resulting loss of business opportunity, is not covered by insurance. This is often overlooked until cash flow difficulties come to light.

Common policy pitfalls

Unless care is taken to understand what is covered, restrictions and exclusions will only become apparent for the first time when underwriters repudiate a claim.

What is required of your PI policy?

The most important feature is the practical defence it provides against the allegation or claim. If this fails it has serious consequences for the eventual negotiation and settlement of any claim.

The insurers should:

- accept notification of a genuine “circumstance” without demur
- provide competent and timely advice and support from their solicitors
- wherever possible, use dispute resolution/mediation to avoid litigation
- keep you informed of progress at all times
- have due regard to your reputation when settling a claim.

Does your policy meet your needs?

The first and prime requirement of a PI policy is to provide the legal expertise of insurer's solicitors and the insurer's financial support in defending an allegation or claim.

In a recent case, insurance brokers had misunderstood their policy coverage. They had not reviewed their cover against their activities and needs, and failed to recognise the obligations imposed upon them by the policy wording. This exposed the firm to several million pounds of uninsured loss.

Cover – words, phrases, expressions and definitions

There are several PI policies available at any one time containing widely differing terms and conditions. At first glance one policy wording looks very similar to

▶ THE PRINCIPAL ISSUES

another, but in fact they can be very different. Words, phrases, expressions and definitions can have materially different meanings as between one insurer's policy and another. The devil, as always, is in the detail.

Policy wordings are regularly changed and updated. The changes are influenced by market practice and claims experience. It is important to appreciate what is a sound PI policy for your purposes and what is not.

Selection by price

There is a significant risk in selection of cover by price alone. Deficient cover cannot be rectified at the time of a claim.

Damage to reputation

Your firm's reputation can be easily damaged if the claim is not handled sensitively. Insurers will take over the conduct of the claim and may want to settle a claim for 'commercial' reasons which may not suit your commercial needs. This possibility needs to be anticipated and taken into account when deciding upon choice of insurer.

BIBA members experiencing difficulties of this kind can now obtain expert advice from BIBA's special advisers. Full details are available from BIBA.

Value for money?

The value of PI insurance is directly proportional to the cover, assistance and reinsurance given by the insurers when you most need help. This defines its fitness for purpose.

Usually, value for money is only calculable when the policyholder needs help, but with the assistance of the BIBA *Guide to Professional Indemnity Insurance* it is now possible to assess the true value of the policy at the time of purchase.

Key tests of fitness for purpose include:

At time of purchase:

- a policy that properly covers the activities of the policyholder
- clarity of the definitions, exclusions and conditions
- clear and practical claims notification conditions.

At the time of notification of circumstance or claim:

- acceptance of, and a positive response to, first notification
- full support of the insurer and their lawyers in defending the allegation or claim
- dealing with the claim sensitively, such as by using mediation or other similar forms of dispute resolution to avoid litigation, if possible. ▼



Top tip: Make enquiries of the BIBA accredited brokers about the insurer's reputation in the market for fairness, support and paying claims.

How risk is assessed by a PI insurer

It is important to appreciate the insurer's considerations when assessing your risk. It will assist you in understanding what is material to your insurer and what needs to be disclosed beyond the questions in the proposal form.

Insurers will consider the proposer's:

- claims record
- commission/fee income (turnover)
- classes of insurance placed
- territories and jurisdiction
- size and nature of clients
- limit of indemnity
- excess
- other special information.

Proposal forms – the basis of the contract

Proposal forms play a more important part in PI than in many other classes of insurance. They must be completed in full every year. They are relied upon absolutely by insurers as a true representation of the facts upon which they offer their terms.

The law relating to non-disclosure is harsh. Developed at a time when the law played a less prominent part in the commercial decisions of underwriters, it has been relentlessly tightened to a pitch that is now a significant peril for every policyholder.

Whilst there have been calls from the judiciary for this aspect of the law to be reformed, as things currently stand experience has shown that the courts will assume that an insurer is entitled to rely upon the information disclosed in proposing for insurance (in whatever form it is disclosed) as being accurate

and given in utmost good faith. Furthermore, it is generally accepted practice that a proposer knows more about his business than an insurer and this creates a heavy burden upon the proposer to ensure that anything unusual about the business is disclosed to the insurer, even if no specific question is asked about it in the course of negotiations for insurance. This is especially true for authorised insurance intermediaries, because they could reasonably be regarded by insurers as experts in the subject and so should know the rules of disclosure. Failure to disclose material information can result in the policy being voided back to inception.

Because the proposal form is the basis of the contract and insurers may refer back to it at the time of a claim to establish if the representations made are in fact true. It is easy to overlook a material fact.

Invariably, proposal forms will not ask questions that cover every aspect of the proposer's business.

If there is any doubt that an aspect of your business is not covered by a question in the proposal form then you should make reference to it in an addendum to the form and give underwriters the opportunity to ask further questions. Failure to do this can lead to cover being denied. ▣



The problems associated with making a PI claim

Frequently encountered difficulties

The most frequently encountered difficulties concern:

- late notification or non-disclosure of circumstances or claims
- non-acceptance of a notification of circumstances
- reservation of rights and acting as “prudent uninsured”
- inadvertent breach of policy conditions
- non-disclosure of material information
- the solicitor representing the best interests of the insurer but not the insured.

Notification of circumstances and claims

Every PI policy will require you to notify “circumstances” within a specified period of time. The terms concerning notification of circumstances can vary considerably and the expressions used can affect the insurer’s entitlement to deny liability.

Notification is a strict obligation and insurers can immediately deny liability if the obligation is breached. This issue is described in detail in *The BIBA Guide to Professional Indemnity Insurance*.

There may be a temptation to leave notification to the last minute in the hope that the “circumstance” will come to nothing. This often leads to a dispute with the insurer. It is a grave mistake to fail to notify insurers at the earliest moment. BIBA-accredited brokers can help to advise what, when, and how to notify a circumstance or claim.

Duty to understand

Unsurprisingly, insurers expect insurance intermediaries to better understand risk and insurance than any other insured and to:

- observe the duty of disclosure and the nature of material information
- understand and comply with policy terms and conditions
- fulfil all regulatory and legal obligations.

Caution – There are strict notification obligations in insurance intermediaries’ PI policies. Experience has shown that many insurance intermediaries are unaware of just how strict these are. In particular, employees are often unaware of the obligation to notify circumstances to their directors. Failure to adhere to these obligations can result in loss of cover and increased future premiums.

Non-acceptance of notified circumstances

Insurers should never reject a notification made properly and in good faith.

This is a problem from time to time. Some insurers are reluctant to accept notified circumstances even when notified in compliance with the policy terms and conditions, because they do not consider them to be sufficiently specific. They are persuaded that they have the right to make a judgement about what constitutes a notifiable circumstance. Whilst there are several reasons why an insurer may do this, it is contrary to good insurance practice and members finding difficulty in notifying a circumstance should seek specialist advice. This is now available to members through BIBA.

Inadvertent breach of policy conditions – no excuse

A typical PI policy contains several conditions that have more impact than may at first be apparent. The conditions



Top tip: Brokers sometimes try to use their business relationship with an insurer to negotiate their way out of a potential claim. This can be dangerous as it can invalidate the PI insurance. If you intend to do this, always obtain permission from your PI insurer, first.



impose obligations upon the policyholder which, if not met, may entitle insurers to rebut the claim. Often the extent of the obligations were not appreciated by the policyholder until they were pointed out at the time of claim. Some of these concern the interpretation of words, phrases, expressions or definitions, but more often than not there is evidence that the policyholder has simply not read the policy and not understood what is required of them.

Who is the insurer's solicitor representing?

The policyholder is entitled to expect that the solicitor appointed by the insurers is representing the best

interests of the policyholder. Where the solicitor is obliged to represent the interests of the insurer before those of the policyholder there are well established conventions for the management of the conflicting interests.

In brief, the solicitor is representing the insurer when advising whether the claim is covered by the policy and representing the policyholder when negotiating the defence of the allegation or claim.

Specialist legal skills are needed to:

- know when to defend or negotiate
- conduct a full investigation of the facts and issues
- gather and analyse relevant evidence
- liaise between insurer and policyholder. ▣



Insurers should never reject a notification made properly and in good faith.

Here's a checklist of the key areas to consider in a professional indemnity insurance policy

A detailed checklist is available to members on the BIBA website.

The checklist includes:

- the completion of the proposal form – what is required of the proposer
- understanding the insured's contractual obligations which, if not met, may result in loss of cover
- comparing the cover available from current typical policy wordings with the firm's demands and needs.

Proposal form

The proposal form is the basis of the contract of insurance and may be scrutinised by insurers for accuracy and disclosure of material facts at the time of a claim. Omissions from or errors in the proposal form can result in policy cover disputes and may result in loss of cover.

Insured's contractual obligations

Experience shows that insureds rarely read the policy document until they have a claim to defend. By this time, there may have been a breach of policy conditions which immediately puts the insured into a dispute with insurers. The most common breach is late notification of circumstances or non-disclosure of a previous claim.

Conditions and definitions

There are two particularly important parts of the policy that should be understood from the moment the policy comes into effect:

- the conditions imposing the contractual obligations
- the definitions by which the conditions will be interpreted.

The policy's definitions qualify the nature and scope of cover. They are frequently overlooked but their impact can determine the cover available to defend the claim.

Demands, needs and coverage

The broker's demands and needs are known only to themselves and their broker. It is essential that these are compared with the cover available from the policy. The insuring clause is the cornerstone of the policy. Insuring clauses vary from policy to policy. Do not assume that they all provide identical cover.

Exclusions and definitions

The policy's exclusions restrict the cover. They can be further influenced by the policy's definitions and they too are frequently overlooked when choosing the insurance. Their impact may only be discovered at the time of a claim.

Self-insured excess

The self-insured excess can operate in a variety of ways and it is important to be clear how it will be applied in practice. This is particularly important when there are a series of claims arising from one event. ▼



Questions to ask when buying professional indemnity insurance

The following questions are a selection only from the full checklist on the BIBA website available to members.

Insuring clauses

- does the insuring clause clearly describe what is insured?
- does the cover you understand you have bought meet the cover you need? Set out your demands and needs and make a careful comparison.

Definitions

- do any of the definitions change the meaning of words or expressions in the insuring clause/s or exclusions?
- do any of the definitions relate to the claims notification clause? If so do they affect your understanding of what you must do to comply with the claims notification obligations?

Conditions

- are there any procedures that you must follow?
- are there any extensions of the insurers' rights under the contract?
- are there any conditions that appear to change the cover from your expectations and needs?

Exclusions

- do any of the exclusions remove cover for any activities necessary to conduct your core business?
- do any of the exclusions remove cover for any activities necessary to conduct your non-core business?
- do any of the definitions change the meaning of words in the exclusions?

Excess and related clauses

- do you understand how the excess operates in practice?
- do insurers pay the costs and expenses incurred in defence of the claim (or do these fall within the excess)?
- if the excess is "in the aggregate" do you have a means of monitoring the erosion of the excess to know when it has been exhausted?

- do you understand the implications of an excess which includes the phrase "each and every claimant"?

Claims conditions

- what are the time limits concerning notification? Are they reasonable and practicable?
- do you understand exactly what obligations the claims conditions impose on you?
- does your office/business run in a way that can accommodate the obligations of prompt notification and the requirements of the policy to comply with the claims conditions?

Schedule

The schedule to the policy contains the features (monetary limits, names of insured, etc.) that are specific to your insurance. If something important is omitted from the schedule it may imply that this was not intended to be covered. It is not uncommon for errors to be made in the schedule of a policy and they can lead to disputes over coverage at the time of a claim. It is essential that you carefully check the schedule for accuracy.

The example, shown right, demonstrates what is typically included in the schedule.

Example

1. Policy number: 867SY391
2. Insured: Smith and Smithe Insurance Brokers Ltd.
And others as listed in Appendix A attached.
3. Premium: £2,765.00 + IPT £138.25
£2,903.25
4. Period of Insurance:
From 30th November 2007
To 29th November 2008
(both dates inclusive)
5. Limit of Indemnity:
£2,000,000 any one claim and in all, including costs and expenses
6. Excess: £25,000 each and every claim excluding costs and expenses
7. Excluded persons: None
8. Other activities: None
9. Proposal dated: 20th September 2007

Points to consider

- do the details set out in the policy schedule agree with the terms of the contract that you negotiated?
- are there any typing errors in the schedule; especially those that may change the meanings of expressions or definitions?
- check dates
- check numeric values
- check names and addresses.



Top tips: It is not uncommon for errors to be made in the schedule of a policy and they can lead to disputes over coverage at the time of a claim. It is essential to carefully check the schedule for accuracy so that you match your expectations and needs.



HUGH JAMES

Flaxman
PARTNERS

FirstCity

PREMIUM



CREDIT

towergate
partnership



LOCKTON™



B | I | B | A

British Insurance Brokers' Association

BIBA House, 14 Bevis Marks, London EC3A 7NT

www.biba.org.uk