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It's Just a Name Change and Other 'ERPS'

By Frederick Fisher

Claims made insurance policies have existed for a long time. For specialty line insurance policies, such as directors and officers liability, professional liability, cyber liability etc., they are the most common type of policy issued. They are complex, and depending on the definition of claim, as well as whether or not it's a claims made and reported form, the policies can be extremely dangerous.

What follows is the first installment of a three-part series on the complexities involved in securing extended reporting coverage in conjunction with claims made policies. I have written numerous articles on claims made trigger problems, prior act problems, prior pending claim exclusions, etc. These only make the problems more dangerous for insureds and for insurance producers. However, and unfortunately, one important aspect of the policy that I've somewhat been lax to review in depth is the complexity of the extended reporting provision (ERP) and the ability to buy optional extended reporting period coverage, also known as runoff coverage and/or retirement coverage. Even my own article, The Dangers that May Lurk in All Claims Made Policies, raises extended reporting provisions, but not in depth.

Many policies guarantee one year, but may not offer more. It does not mean that an underwriter might not be willing to quote additional years should the insured be a clean risk. However, if there have been claims it is unlikely. Equally true is the fact that the trigger for an ERP is not limited to cancellation or non-renewal. A sale of assets, stock, or an acquisition can too, yet often that provision is found in another condition in the policy.

Contributing to the problem are the implications that selling or buying a company or its assets present, and dealing with the existing insurance portfolio is typically overlooked, except as to the need to buy an extended reporting term. All too often, insurance brokers are the last to know about any such events and thus cannot advise as to what options may exist. There often is little time to implement approaches and solutions that follow.

Initial Concerns

Consider a "name change." Producers are often faced with the common problem of "it's just a name change." As a wholesale producer, we would often get requests from producers for an endorsement because it is simply a "name change." Sometimes it turned out to be true, and sometimes it didn't.

The real question is, what name change are we talking about? Often, it was more than a name change. It's one thing to be Joe Smith, and then become Joe Smith DBA "Make Money with Us." That would be a name change. However, if it was Joe Smith, and now it's "Make Money with Us Inc." or "Make Money with Us LLC" — that's not a name change. It's a new entity and therefore an organizational change. To simply get an endorsement with a name change would mean you cover an entity that does not exist, while not covering the entity that does.

The key to determining whether it is the name change, is whether the FEIN number has changed. For instance, a sole proprietor could use their Social Security number for all business issues, or could apply for and obtain an FEIN number to distinguish between personal and business pursuits.

However, if one incorporates, or forms an LLC, or any other organizational entity, they must get an FEIN number to do so. How to insure the entity becomes a quandary because it is a new one, even though it may conduct the same operations as before. Sometimes the policy will remain in the name of the proprietorship, and an endorsement will be added to pick up the new entity so all prior act dates of the proprietorship are protected, as well as go-forward coverage for the entity that could not have committed a wrongful act before inception. That way, all prior acts are preserved as the policy continues in the name of the proprietorship, even though all business is now being conducted by the additional named insured entity.

Another danger, however, is equally ever present and involves "extended reporting periods." Some policies provide neither a pre-set extended reporting time nor what the premium might be. Such provisions simply state that an underwriter will consider how many years may be granted together with the premium based on "underwriting and pricing guidelines in effect at that point in time."

That could place an insured in a dangerous position should they have serious problems with the business, in which case an underwriter may not be inclined to give more than one year and not at the usual "clean account" pricing. I've seen situations where the pricing was 800% of the expiring premium!

This is something to be avoided, as many policies come with language that automatically grants one year and others up to three years at a specific price. However, this is not always true. In addition, an underwriter may also have the option to quote more than what is stated in the policy, especially if the risk is low and has had a good "track record" as to profitability and claims history. The obvious point being the fact an underwriter can always endorse a policy beyond what the form provides as to any provision, let alone the extended reporting provision(s).

'The key to determining whether it is the name change, is whether the FEIN number has changed.'

Common Events That Trigger the ERP

The most common trigger of an extended reporting provision, a.k.a. runoff provision or "tail" provision, is a cancellation or nonrenewal of the policy.

Usually that provision is bilateral, yet some policies still may limit the cancellation or nonrenewal as to when the insurance company cancels or non-renews. Such a cancellation or nonrenewal often arises due to claims experience, or a significant change in the members of the board and/or corporate officers. These changes signal something is wrong with the company, either its direction, profitability or other difficulties that could significantly and adversely change the risk and hazards. Thus, the insurer could decide to non-renew the coverage. The insured might also consider going "public" or the reverse, considering going "private," both of which could adversely change the probability of future claims taking place.

The foregoing follows a concept I've espoused for years. A claims made policy insures only one risk, which is the probability of a claim being first made during

continued on page 40

continued from page 39

the policy term. The hazard(s) insured are a different matter and may or may not inherently affect the "risk."

Another provision is commonly called a change of control provision. This is where either the insured acquires another entity, or the insured has either sold many of its assets (usually over 50%), or over 50% of the stock of the company is sold to a new buyer. This also triggers the ERP. Typically, the policy, as of the transaction, automatically goes into "runoff mode" until the normal anniversary/expiration date of the policy. For instance, if the policy has been in force only six months, and then there is a change in control by the sale of assets, of the sale of the stock of the company, the policy mutely goes into "runoff," but the policy does not expire for another six months.

Thus, only those claims first made during the remaining six months of the policy term will be covered if the wrongful acts as alleged took place before the date of the "triggering" transaction. In addition, when the policy expires on its anniversary date, the insured may still purchase an ERP based on what the policy states is available. Often, this may be limited to one year, but many policies offer one-, three-, five-year options with pre-set pricing for each option, etc. Usually, the premium itself is also so stated. Yet there is always that dangerous provision where the insurance company will determine what terms they will offer based on their underwriting guidelines as they exist at that point.

There are additional complexities, as well, because an ERP traditionally has been triggered by either cancellation or nonrenewal or a change in control of assets, operations, or sale of the stock of the company.

There are inherent dangers when a company is acquired, not only for the selling company but for the acquiring company, as well. It is not uncommon for the buyer to require the seller to purchase several years of ERP coverage. This is because the buyer, when either acquiring the assets or the stock transaction, wants no exposure to any known or unknown liabilities created by activities that occurred before the acquisition. The buyer will only want to be protected on a go-forward basis, whether the acquisition is asset-based or stock-based. There is an inherent problem with this traditional thinking, but more on that follows in subsequent articles on this subject. IJ

Note: The above is the first article in a three-part series on problems that may arise with claims made policies involving extended reporting provision (ERP) coverages.

Fisher J.D., is currently the president of Fisher Consulting Group Inc. and was the founder of E.L.M. Insurance Brokers, a wholesale and managing general agency facility specializing in professional liability and specialty line risks. He is a member of the editorial board for Agents of America; a faculty member of the Claims College, and member of the Executive Council, School of Professional Lines sponsored by the Claims & Litigation Management Association and an instructor for the Academy of Insurance, an Insurance Journal company.