Professional Indemnity Initiative
Volume 5

An Essential Guide to Professional Indemnity Risk for General Insurance Broker Staff

The best insurance is a BIBA broker
Find a broker at:
www.biba.org.uk
0870 950 1790
Foreword

This is BIBA’s fifth Professional Indemnity Initiative publication for members.

It is to be used as either an introductory tool for new starters in an insurance brokerage or as a helpful refresher for all staff on avoiding common errors and omissions claims. I hope you can use this as an everyday guide in your offices to the benefit of your staff and company.

Eric Galbraith
BIBA Chief Executive

Autumn 2011

Contents

Reasons to enhance good practice and reduce the risk of negligence 3
Ten top tips 4
What are the most usual causes of claims against brokers? 5
What are the prime Must do’s? 6
What can I do to prevent E&O/PI Claims? 8
Unachievable demands and needs 10
How to enhance good practice and reduce the risk of negligence 11
Listing of claim types against brokers 12
Underinsurance case study 13
Claims made policy 14
Notification of PI claims and circumstances 15
A general insurance broker or intermediary will almost certainly, at some time, attract some criticism that could develop into an Errors and Omissions (E&O) / Professional Indemnity (PI) claim. The reasons for this stem from the fact that:

a) Mistakes can be made in even the best regulated business and
b) Clients’ expectations of insurance are often greater than we realise.

There are three good reasons for a broking firm to take care to avoid E&O / PI claims:

1. They are time consuming, expensive to deal with and damaging to your reputation.
2. They imply fault with the firm’s FSA regulatory compliance standards.
3. They cost the business money: the policy excess, unrecoverable costs in defending the claim and increased PI insurance premium following the notification – all of which hit the bottom line.

1“Client/s” in this text refers to proposers for insurance or policyholders or Insureds, as may be relevant in the context in each case.
1. Know what your professional duties and legal responsibilities are as a broker and as an agent of the parties you represent at any given time.

2. Be aware of what can cause a complaint or claim and what constitutes a “circumstance that could give rise to a claim”.

3. Know how to create a complete and accurate written record of all your advice, recommendations and communication. This will provide essential defensive evidence.

4. Understand the relevance of Demands and Needs Statements and how they create a liability if you have not actually assessed the risk.

5. Know when (and how) to ask for guidance or advice from peers or managers.

6. Beware of the traps that lead to underinsurance, especially in valuations of property and in business interruption insurance calculations.

7. Never rely upon your client to know what an underwriter would consider to be material information. You must tell them.

8. Never send an email giving insurance terms or advice without checking it thoroughly. Preferably, send terms and advice in a formal letter, checked by a peer before it is sent. [A thorough check is best achieved by checking it yourself and then asking a competent peer to check it again.]

9. Never write something in an email (or anywhere else) that you would not want read out in public, to your employer, or in court.

10. If you don’t actually know something for certain, say so; don’t guess and don’t make it up to get a sale.
What are the most common causes of claims against brokers?

Today, 25% to 30% are caused by failure of a policy to meet the claim (in whole or on part).

This can be for a variety of reasons including:
- Breach of warranty
- Breach of claims notification conditions
- Non-disclosure and misrepresentation
- Gaps in term of coverage (e.g. failure to renew on time)
- Under insurance
- Errors in Business Interruption assessments/calculations

What is the most common root cause of E&O/PI Claims?

Failure of Communication
This can be in the written, spoken or unspoken (implied/assumed) form, published or not, conveyed in any permanent or transient form and may or may not have originated from the broker but has nevertheless been relied upon by the Insured (or someone to whom the broker owes a duty of care).

Over 75% of E&O/PI claims are the result of a breakdown in communication.

Emails
The convenience of e-mails and the unsupervised privacy in which they are written has given rise to an unprecedented commercial risk. Modern email culture is counter to best practice in which clarity and certainty of communication are essential.

Inadequate record keeping
The failure to appreciate that, in a modern working environment there is a complex mixture of evidence to be recorded. It includes email, paper documents, online communications and downloads, the spoken word on telephone and at meetings and video conferences. The task of collating records from different media and creating a complete audit trail is, admittedly, burdensome. Consequently, it often fails to be done. This severely damages the prospects of a successful defence of a broker where contemporary evidence is absent.

Poor communication skills
Insurance is a complex technical commodity that still relies upon jargon, phrases and expressions unique to the industry. They may be unintelligible to the average lay person and are a communication barrier. Ineffective communication frequently leads to the broker being found liable for negligence. Time and commitment to precise communication is a prime responsibility of the broker.

Reports
Broker reports should be written to a standard formula and format (i.e. house style) agreed by senior management and there should be a peer review process before they are published to a prospect or client, to ensure they do not contain misrepresentations or misleading facts or recommendations. Where a warning of any kind is given in a report it is essential to explain the consequences of non-compliance.
What are the prime MUST do-s?

**Acknowledging Instructions**
All instructions from clients, whether in writing, by telephone or at a meeting, should be acknowledged, in writing.

Write a short, concise communication to the client stating exactly what you have understood their instructions to be and confirming what you intend to do as a consequence. Say also that if this is not in accordance with the client’s understanding or intention they must advise you in writing without delay. Check! – that they have received and understood this communication. Do this within three to four working days of sending it, or earlier, if time is of the essence. Don’t just assume they have read it – make sure.

**Record the critical facts**
Record in your file/ attendance note and refer to in your confirmation:-

1. Specific information imparted by the client,
2. The timescale for action,
3. Whether time is of the essence,
4. Any reliance you have upon something that the client (or someone they rely upon) must do as a result of the instructions,
5. Any other conditions, impediments to action or restrictions that may prevent the instructions being carried out.

**Always explain the consequence of non-compliance with warranties, exclusions and conditions**
Cover may be offered / given subject to warranties, exclusions and/or provisos such as, for example:-

- Theft precautions
- Survey
- Alarm warranties
- Improvements in security, management of processes or procedures
- Confirmation of something to be done or not done, installed or removed
- Time limits given for compliance with specific requirements

**Be aware that the client may be:-**

- Unwilling to comply
- Unable to comply for reasons of lack of authority in the business
- Unable to comply for financial reasons
- Apathetic and reckless as to whether they comply or not
- Relying upon the belief they can always sue the broker if there is a coverage problem
Warranties, exclusions and conditions must be spelt out to the client in such a clear way that there can be no reasonable doubt about:-

1. The scope and limitations of cover actually given, and
2. The consequences of non-compliance.

It is essential that the client should have a clear understanding of the requirements of the warranties and the consequences of not complying with them; not only at the inception of the policy but also through its term. Clients should be encouraged to read warranties carefully and ensure they understand what is required and tell the broker if there is any doubt that they can comply with them.

The client should be asked to confirm in writing:-

1. That they understand what you have said,
2. What they must do or not do (as required by insurers),
3. The consequences for the insured of non-compliance.

This is best achieved by a clear and simple written communication (or series of communications) properly recorded on the broker’s file

It is the broker’s sole responsibility to chase the client until the broker is satisfied that compliance has been effected

It is NOT enough to rely upon them signing a duplicate copy of the broker’s letter. A court may now not regard that as effective communication

NB
An insurer will often not bother to check that precautions have been carried out. They have no duty to do so. However, they will seek to rely on warranties, exclusions and provisos and cover can be at risk by non-compliance. The broker is at great risk if they have not taken all reasonable steps to ensure that:

1. The insured understands that the warranties, exclusions and provisos exist.
2. The intentions and meanings of the warranties, exclusions and provisos are understood.
3. The essential importance that the warranties, exclusions and provisos are complied with, precisely.
We cannot prevent someone making a claim against us but, we can avoid giving them a reason to do so.

Professionalism – know how you are seen and judged by others

A modern broker is a professional adviser. The standards by which a broker will be judged are those of a professionally skilled adviser owing a professional duty of care. The modern law concerning insurance brokers is governed by:
- The Law of Agency
- Common Law Duty of Care
- Law of Contract
- Statute/Legislation
- FSA Regulations

The primary role of the broker is generally to act as agent of the insured, acting as expert in respect of insurance and offering services to those seeking the benefit of insurance. The role is wide and includes not only effecting the policy, but also the giving of advice on the policy/ies and in making claims.

The primary duty of care owed by the broker is to the insured. The broker/intermediary must be aware that it may assume a duty to persons who may not be its client. The broker may also have separate obligations in law to underwriters and underwriting agents, concurrently with its obligations to the insured. This brings about conflicts of interest that must be properly managed and recorded. Conflicts of interest are an ever-present danger to the modern broker/intermediary. They are always closely examined in E&O claim situations.

Generally, it is for the Court to decide what a reasonably competent broker should do or not do. The generally held view is that brokers should achieve such standard which, in the opinion of the Court, members of a "profession" (of brokers) ought to achieve. This means that the Court is not bound by the fact that the "broking profession" itself allows a low threshold of competence or operates poor practice.

A broker cannot rely upon the simple defence of: “I carried out the instructions of my client”. So, simply reacting to a client’s instructions is no longer adequate. An insurance professional is required to give its clients unprompted proactive advice (and where necessary, warnings) about their insurance arrangements and, specifically their demands & needs.

What can I do to prevent E&O/PI Claims?

BIBA Professional Indemnity Initiative
Regulation – A practical application of a Principle.
ICOBS 5.2.2

1. Prior to the conclusion of a contract, a firm must specify, in particular on the basis of information provided by the customer, the demands and the needs of that customer as well as the underlying reasons for any advice given to the customer on that policy.

2. The details must be modulated according to the complexity of the policy proposed.

At the time of writing ICOBS 5.2.2 prevails. In the event that the ICOBS are overtaken by FCA the principles of the ICOBS will doubtless remain the same.

It is precisely because ICOBS 5.2.2 refers to a broad principle that insurance practitioners have to understand the breadth and depth of the implications it carries, beyond FSA regulation itself. It has significant implications for the broker’s common law duty of care and for the broker’s Terms of Business Agreements (Tobas).

It is important that senior management of broking firms fully understand the implications of the complexities arising from the coexisting inter-relationship of regulation and the common law relating to modern day insurance broking / intermediation.

It is even more important to understand that the gathering of information from potential policyholders has to be accurate and effective to enable the broker to assess the demands and needs (requirements) in the context of the products available and, thereafter, either (a) produce a bespoke demands and needs statement (which may follow an established structure or format); or (b) use a generic demands and needs statement.

The broker must assess, in each case, whether that statement is relevant to the potential policyholder. This requires an understanding of the practical effects and implications of the complex law and obligations and how to tackle them in practice. (A Demands and Needs Statement is a summary of the customer’s Demands and Needs, it demonstrates that the agent understood the client’s request for cover and confirms a meeting of minds).

It is not possible to give a generic Demands and Needs Statement that will be certain to stand up to the test/s applied by the FSA or by the law. The ICOB requires “the underlying reasons for any advice given to the customer on that policy” and for that to be achieved the agent must have first made an assessment of the customer’s demands and needs. This rarely happens in practice and is becoming an elephant trap for brokers/agents in E&O litigation.

Youell v Bland Welch (no 2) [1990] 2 Lloyd’s Rep 431
Unachievable Demands and Needs

An inability to place insurance on terms required by the client does not entitle an intermediary to just place a policy on any terms, without any reference to the client.

Clients’ needs and expectations are sometimes beyond what can reasonably be achieved. Brokers are often reluctant to admit this for fear of losing a client. It is a dangerous practice.

The broker’s role is to ensure that the insurance obtained properly meets the client’s requirements and this necessitates the broker actively considering whether the insurance could or should have particular clauses and whether the wording in the policy actually provides the extent of cover that the insured requires for its particular circumstances.

A broker faced with this situation should discuss the inability to exactly meet the expressed demands and needs. They should explain the consequences of not being able to obtain the insurance to meet them.

Equally a broker must ensure that if cover is available that is wider or more beneficial than what is asked for, then this also must be made known to the proposer/client. The broker must also explain the consequences of being without it.
How to enhance good practice and reduce the risk of negligence

1. Know whether you are making an Advised or Non Advised Sale. Don’t give advice or recommendation or opinion in a non-advised sale. Do give proactive and complete advice in an Advised sale. See FSA Full Handbook / PERG / 5 / 8

2. Remember that you are a professional adviser and will be judged by a. the quality and completeness of your advice and b. your ability to prove that your advice was consistent with the standards expected in law, of a professional adviser.

3. Assessing the customer’s demands and needs is your first duty as a broker. The client is relying upon your knowledge, skill and expertise to obtain the right cover and you will be making a statement that says that you have assessed their demands and needs. If you haven’t made an assessment you cannot justify making that statement!

4. Always record your actions, advice and opinions in such a complete manner that your audit trail will provide a sound and complete record if ever it is needed in evidence.

5. Be aware that the legal duty of care of the modern broker is not discharged by standardised warnings and demands and needs statements. The broker must actively and specifically explain to the client their obligations and duties relating to insurance and, specifically, disclosure of material information. The recent case known as ‘Environcom’ demonstrated the importance of ensuring that your client understands its duty of disclosure and this cannot be achieved by warning notes in brokers’ placement or renewal documentation alone. The immediate implications of Environcom for general insurance broker intermediaries can be summed up as spoken by the judge, David Steel J.:-

   “In short, a broker:
   a. must advise his client of the duty to disclose all material circumstances;
   b. must explain the consequences of failing to do so;
   c. must indicate the sort of matters which ought to be disclosed as being material (or at least arguably material); must take reasonable care to elicit matters which ought to be disclosed but which the client might not think it necessary to mention. All this flows from the requirement that the broker should take reasonable steps to ensure that the proposed policy is suitable for the client’s needs.”
1. Failure to place or renew an insurance.
2. Failure to execute client instructions.
3. Failure to present information as provided by the proposer.
4. Failure to record client instructions.
5. Failure to effect insurance cover appropriate to the insured’s needs.
6. Failure to understand a clients’ needs and expectations.
7. Failure to properly advise particularly in relation to:-
   a. Limit of indemnity/ Sums insured.
   b. Assessment and calculation of Business Interruption sums insured.
   c. The application and meaning of Average.
   d. The obligations of claims notification.
8. Failure to bring matters to the attention of appropriate officers of the Insured organisation.
9. Failure to ensure that the insured has properly understood the advice and warnings brought to their attention.
10. Failure to properly advise about obligations of disclosure of material information.
11. Failure to issue policy documentation correctly.
12. Failure to comply with ICOB/TCF regulations.
13. Failure to disclose conflicts of interest.
14. Failure to convey the meaning and implication/s of warranties or special terms and conditions to the insured.
15. Failure to clarify ambiguities in policy terms and conditions.
16. Failure to advise where clients’ contracts, promises or undertakings can conflict with and/or potentially negate insurance cover.
17. Failure to advise client of options and choices in selection of insurance terms and conditions.
18. Failure to advise implications of insurer (in)security.
19. Failure to advise client of the consequences of non-compliance with warranties, terms and conditions.
20. Failure to communicate information between client and insurer – both ways.
21. Failure to notify claims or circumstances on behalf of the insured.(including excess layers)
22. Failure to communicate material information to insurers on behalf of the insured.
23. Failure to advise, proactively.
24. Giving incorrect or incomplete advice.
25. Errors in terms and conditions quoted prior to inception of contract.
27. Unreasonable delay in provision of terms and quotations.
29. Breach of fiduciary duty.
31. Inadvertent mis-selling; Reckless mis-selling; Deliberate mis-selling.
32. Mis-description or misleading-promotion of insurance products/services.
Underinsurance – Case Study

**Example**
A broker was instructed by its client (the insured) to reduce the sum insured on the Buildings and Contents policy and also on the Business Interruption policy.

The broker advised the client, in writing, on three occasions, that it was “not advisable to reduce the sums insured” because, by the calculations and experience of the broker, the business would be under-insured.

The insured insisted, telling the broker that their accountant had advised that they were over-insured and that significant premium could be saved.

The broker carried out the instruction, “because it was in writing”.

A claim occurred in the same policy period and insurers denied liability on several grounds including:

- Misrepresentation of material information by the broker – who knew/believed the insured was underinsured and did not tell the insurer!
- Misrepresentation of material facts concerning the nature and profitability of the business - the accountant’s figures were later proved (by loss adjusters) to be factually wrong

The claim against the broker succeeded and was settled out of court for an undisclosed sum equalling the full limit of indemnity of the broker’s E&O policy.
PI insurances are always written on a “Claims Made” basis. This means that the policy only covers claims made during the period of the policy irrespective of when the act, error or omission alleged to have given rise to the claim was actually committed or occasioned. In other words it is the policy in force when the claim is first made by the claimant (or circumstance first notified by the insured) which will cover the claim under the policy.

It is absolutely essential that a claim is notified to insurers as quickly as possible when it is made AND in full compliance with the claims notification provisions of the policy. These vary from insurer to insurer.Whilst they all are intended to have a similar effect the wording of each of them differs and it is in the insured’s (and the brokers’) best interest to have read and fully understood what these require of the insured.

Some claims conditions are Conditions Precedent to liability. For example it is a condition precedent to liability that the insured will notify a circumstance or claim within seven days of discovery. If it is notified on the 8th day it is a breach. A Condition Precedent must be complied with unconditionally and absolutely. If it is not the policy can be voided “ab initio” and therefore there will be no insurance protection, period.

Every broker should be aware of the notification requirements of their own firm’s PI policy.

The Claims Made policy brings with it the requirement to notify “Circumstances that [might/could/may/is likely to] give rise to a claim.
The question “what is a circumstance?” is probably one of the most vexing, controversial questions associated with professional indemnity insurance.

A “circumstance” means a circumstance that [might/could/may/is likely to] give rise to a claim. The words “might/could/may/is likely to” are variously used by different insurers and have different practical meanings but there is no uniformity of practice in the PI insurance market.

Overview
Every broker needs a clearly defined procedure for identifying, assessing and controlling claims and circumstances that may give rise to a claim.

The chosen procedure must be able to detect and identify potential claims and circumstances as early as possible. It must also determine exactly what when and how the matter is reported to insurers. This is essential. If it fails to achieve this the broker will be in serious trouble.

Why is it important?
Firstly, the earlier a problem is identified and brought under control, the greater will be the chance of minimising its impact and cost.

Secondly, insurers insist upon prompt notification and reporting to avoid being prejudiced by the actions of the Insured who tries to deal with the matter themselves. Brokers are particularly prone to this in the belief that they can “do a deal” with the parties. Very often they can’t and in trying to do so they have caused prejudice to the insurer, thus entitling them to avoid paying the claim.

Professional Indemnity Insurers will be less tolerant with members of their own industry than with almost any other Insured, especially of circumstances that are not notified but come to light later.

When should you notify claims?
As soon as possible after you become aware.

Every policy of PI insurance required the insured to give notice as soon as possible of any claim or circumstance which may / might / could / is likely to give rise to a claim; the expressions differ from policy to policy but the intent is similar. Failure to do so can nullify the policy cover.
What should you report?
As a rule of thumb, if you have to ask yourself whether a matter should be reported, then consider that it should be.

You should report:

- any actual allegation or claim made against you, whether verbally or in writing
- any suggestion, intimation or indication that a claim against you is being considered; however remote you believe this to be NOTIFY it
- any circumstances/situations/problems which you recognise to be a potential difficulty for you or your client or any third party with whom you are dealing which could result in dissatisfaction, a complaint, refusal to pay fees or other monies due a casual conversation indicating dissatisfaction or a gripe or any other matter that has the potential for becoming a claim, however remote you believe that possibility may be

If it is your case / client that is concerned you are not the best person to make the judgment so refer it to a manager.

What about claims which fall within the excess?
All claims should be reported, even those which are likely to fall within your excess.

Failure to do so can invalidate the policy.

Will this affect the premium?
That is not a matter that should influence your decision as to whether to notify.

Insurers tend to increase premiums after a claim but good brokers can negotiate these things at renewal.

Anything else I should know?
Never, ever take a chance with notification of claims or circumstances. Insurers and their lawyers have seen all the excuses and believe none of them.

Brokers who think they know better than the insurers and lawyers usually come off worse. If your firm’s PI is cancelled you are in breach of FSA regulation and must cease trading immediately. That happens.

If in doubt, spell it out – and notify it.
The BIBA PI Initiative offers members help with Professional Indemnity Insurance related risk and claims management.

BIBA has appointed three accredited brokers to provide access to PI cover which meets the specific requirements of brokers at competitive rates. A team of PI experts has additionally been appointed to provide members with specialist services including risk management, claims mediation and legal assistance.

The BIBA PI Initiative will enable members to:

1. Obtain optimum protection for its professional liability risks.
2. Fully appreciate the risks associated with being an insurance Broker.
3. Avoid breaches of regulation and claims of negligence.
4. Access specialist support in notifying, managing and negotiating complaints and claims.
5. Benefit from an effective approach to liability risk management.

The BIBA PI Initiative has been created in response to feedback from our members and following wide consultation with stakeholders including PI underwriters, brokers, the FSA and the FOS. BIBA is committed to supporting its members in all aspects of broker practice and compliance and welcomes your comments.

For enquiries please contact
Graeme Trudgill
Head of Corporate Affairs
Tel: 020 7397 0218
Email: trudgillg@biba.org.uk

The BIBA PI initiative was a winner of a prestigious Trade Association Forum Award in 2009.
BIBA has appointed accredited brokers to provide a competitive, specialist resource for members. Each broker is selected for their proven knowledge of professional indemnity insurance and the markets available. The brokers represent both London and regional interests and, between them, a wide range of insurers representing a full cross section of the market.

There is no attempt by BIBA to promise the lowest premium and terms. This is a matter for each member to negotiate with the market but we are confident that the Accredited Brokers have the skill and incentive to serve our members well.

**BIBA – accredited PI broker**

**Lockton LLP**

Lockton has been providing the insurance broking profession with professional indemnity insurance (PII) and risk management services for the last 40 years.

We have a wealth of talented professional indemnity specialists dedicated to serving this sector.

Our commitment to the broking community is evidenced by our 25 year relationship with the British Insurance Brokers’ Association (BIBA) and their members as a scheme provider.

Key Features of our EXCLUSIVE products:

- Unique coverage
- Innocent non disclosure
- £250,000 FSA or other professional bodies investigation costs
- Automatic 12 months free run-off provision
- Compensation for court attendance
- Acquisition Cover
- Claims advocacy support

Premiums start from £550

Contact: Brian Boehmer
Tel: 0207 933 2083
Fax: 0207 933 0739
brian.boehmer@uk.lockton.com
The St Botolph Building
138 Houndsditch
London
EC3A 7AG
www.locktonaffinity.com
Contact BIBA

Eric Galbraith
Chief Executive
020 7397 0201
galbraithe@biba.org.uk

Graeme Trudgill
Head of Corporate Affairs
020 7397 0218
trudgillg@biba.org.uk

BIBA acknowledges with grateful thanks the advice and contribution of Flaxman Partners Ltd, professional Risk and Insurance Consultants and providers of BIBA Professional Indemnity Insurance Claims and Notification Advisory Service.
68 Lombard Street, London, EC3V 9JL.
www.flaxmanpartnersco.uk

British Insurance Brokers’ Association
8th Floor
John Stow House
18 Bevis Marks
London
EC3A 7JB

Find a Broker helpline: 0870 950 1790
Member helpline: 0844 77 00 266
Fax: 0207 626 9676
Email: enquiries@biba.org.uk
Website: www.biba.org.uk

Follow us

@BIBAbroker
‘BIBAbroker’
Group BIBA

Accredited broker