Errors and Omissions – What You Don't Know Could Cost You

By Jim and Nancy Fish

Agents under contract with Allstate are required to maintain Errors and Omissions (E&O) insurance with a minimum per claim and aggregate limit of $1 million.

According to the R3001 EA Manual, all R3001 agents – with the exception of those in New York State – must obtain E&O insurance through broker CalSurance, with coverage provided by Fireman's Fund Insurance Company.

The policy period for the Allstate agent group renews each year on October 1st. Agents are required to purchase the renewal policy online via the CalSurance website by a specified deadline, typically around September 21st. There are two payment options: agents can either pay in full, or pay in three installments via ACH, the last of which is due by November 1st.

If an agent fails to fulfill his obligation to renew the policy by the deadline, CalSurance will notify Allstate and they will pay the premium on the agent's behalf. The full premium, plus a 25% "processing fee" will then be deducted from the agent's commission until the premium and processing fee are paid in full.

New agents are required to purchase the coverage at least 15 days prior to their appointment date. The premium is prorated and must be paid in full.

Changes in company claims handling procedures are unconfirmed, but…

Agents have reported a large increase in the number and types of E&O claims that have been turned over to CalSurance in the past two years. Several agents who have been involved in recent E&O incidents have been told they are responsible for binding unacceptable risks, regardless of the fact that the company accepted the risk at the time of the transaction and upon subsequent renewals.

According to the agents, Allstate informed CalSurance that it incorporates underwriting guidelines into technology preventing agents from submitting unacceptable risks on new business applications, but that the same technology does not exist in the policy endorsement system. One example is the ineligible vehicle list, wherein the new business application risk assessment alerts the agent and rejects the application, but when an agent adds the same vehicle to an existing policy, it sails right through the system. An example of such a scenario was detailed in a letter that appeared in the last issue of Exclusive*focus*.

Another example involved a $20,000 SPP item on a renters insurance policy. The customer had covered the item on their homeowners policy for ten years and when they sold their home and moved to an apartment, the agent transferred the ring to their renters policy by endorsement.

The company then renewed the renters policy twice before the insured had a loss. It became an E&O claim because the amount of coverage on the ring was out of proportion to the amount of underlying personal property coverage on the base policy.

Once a claim is turned over to CalSurance, they pay the claim and submit a bill to the agent for the deductible. The consent clause in the policy leaves the agent with virtually no recourse.

In its explanation for the 17% rate increase in 2012, CalSurance stated there has been a significant increase in claims in recent years. They also cited the overall decrease in the size of the agency force as a factor contributing to the increased rate.

Some agents speculate the increased claim activity has not only boosted premiums, but may have also been the impetus for prompting Fireman's Fund to implement a sliding deductible schedule that became effective with the October, 2011 policy renewal – a change that could indicate the company's expectation that an increasing number of agents will suffer multiple losses going forward.

Prior to the October, 2011 policy renewal, the deductibles for E&O claims were $1,000 on Allstate policies and $5,000 on Expanded Markets policies. The new sliding deductible schedule states that the standard policy deductible will be increased if there are more than two paid claims reported during the prior three policy periods. Hence, Allstate agents who experience three, four or five E&O claims could see their deductibles rise to $2,000, $3,000 or $4,000 respectively. The Expanded Markets deductible is also increased for multiple claims.

Ignorance is no excuse anymore

In order to avoid potential E&O claims, it is essential that agents and their staff be fully familiar with applicable MMGs and binding authority. Review the MMGs frequently to stay abreast of changes, and be sure to seek underwriting approval prior to endorsing an ineligible risk; then do your best to document any details relating to the exception.

Agents must be knowledgeable about the products they are selling. This is especially true of new products, such as House & Home, which presents a multitude of potential E&O traps for unsuspecting agents. It is crucial that agents understand this product so they can fully explain the coverage limitations of the policy to the customer, especially when replacing an existing policy that has more comprehensive coverage. It will also be important to document those conversations with the customer. In our view, policies like House & Home present a greater potential for E&O claims than traditional homeowner policies. Don't let the customer scream, "But my agent told me I was covered." As always, make sure you cover the bases with the customer and document, document, document.

Equally as important is the obligation for agents and staff to submit complete and accurate applications, a task inherently more complex than ever before. The new House & Home policy application includes information about the customer's automobile ownership, auto insurance policies, driving record, roof geometry, construction materials, and more. Above all, agents and staff must be fully aware of the consequences resulting from intentional falsification of information in order to obtain a better rate or better coverage. If your staff is working on commission basis, there may be a temptation for them to "cheat" in order to make more money. At a minimum, agency owners should spot check staff applications and contact customers to verify information if something looks awry. With good oversight of your employees, you will have fewer E&O claims and you'll reduce or eliminate any unethical conduct by your employees.

CalSurance E&O Facts:

- Coverage is provided for any act, error or omission you become liable for in rendering or failing to render professional services in your profession as an insurance agent. The policy has exclusions, including dishonest, fraudulent, criminal or malicious acts.
- The policy covers the agent, and employees of the agent, including licensed and unlicensed staff.
- Coverage automatically ceases on the date the EA Agreement terminates. On that date, the automatic one-year extended reporting period begins.
- Agents may purchase an optional five-year or unlimited (lifetime) extended reporting period for 200% or 500% of the last annual premium. The extended coverage must be purchased within 60 days of contract termination date.
- If a terminated agent submits a written request for a mid-term cancellation and a short rate refund of premium, the one-year automatic extended reporting period is reduced to 90 days.

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Agents who have not been diligent in adhering to MMGs in the past also face another dilemma – how to mitigate exposures that still remain in their book of business from previous underwriting transgressions. As an example, the agent who wrote and told us about the ineligible vehicle that her staff added to a policy suddenly realized that there were probably many more "claims waiting to happen" within her book of business. When she tried to get a list of policies that had ineligible vehicles insured, Allstate was unable to provide her with an accurate accounting, making her efforts to fix the problems much more difficult.

Worse yet, errors made on policies outside your own book of business are virtually impossible to find. This is a big problem. And with the increased expectation for agents to provide service to orphaned policyholders, the agent's E&O exposure escalates significantly.

So Now What?

Once identified, how are past errors corrected? Obviously, Allstate has no incentive to "clean up" its book of business because they actually benefit from leaving things the way they are. First, turning over claims to CalSurance saves time and money. Once a claim is deemed to be an E&O, they have little more to do with it, saving additional claims handling. Then, by not identifying problems that need correcting, they can continue to renew the affected policies for years on end – collecting premiums on risks for which they will never pay a loss. It's like free money. Last, they save the time and expense it would take to identify the problem policies.

Fixing problem policies is not all that simple either. Many states have laws that prohibit insurers from canceling or non-renewing policies once they have insured a risk for a certain amount of time. This problem could be further compounded if state insurance commissioners uncover that Allstate is collecting premiums on risks with no intent to cover future losses. This leaves it up the agents to ferret out the tainted policies, and then what? Should they approach each customer and ask them to voluntarily drop their policies?

In our view, the company has some, if not most of the culpability here. Their primary emphasis has traditionally been on new business underwriting, as evidenced by the lack of technology for screening policy endorsements. Renewal underwriting has typically been confined to property reinspections, loss history, credit and MVR history and driver and use classification. Rarely have SPP items, add cars or replacement cars ever been questioned, which leads us to ask, "Where is the oversight?"

Indeed, it is unprecedented for a company the size of Allstate not to have a state-of-the-art system in place to identify problem renewal risks. And by simply turning a blind eye to this massive elephant in the room, Allstate could feign ignorance and continue to collect premiums on risks they really don't insure, thereby saddling the agency force with mounting E&O losses that can only lead to ever-higher E&O deductibles and premiums.

Certainly, the agents aren't without fault here. There are some who intentionally disregard the guidelines because the system allows them to do so. And there are repeat offenders who scam the system time and again. With a good oversight system in place, smart management could readily identify the offenders and take appropriate action. But, as we've seen in the past, regional and local leaders are often reluctant to take action, especially when the culprit is a top producer.

Going Forward

In our opinion, the company needs to take the high road here. First, they need to recognize that they bear some culpability for this E&O mess. Second, they should institute a claims amnesty program which pays for losses resulting from endorsement changes – occurring before 2013 – that they failed to underwrite. And finally, they should immediately incorporate policy endorsement technology that warns agents of MMG violations.

Responsible agency owners take great pride in app completion and adherence to company standards, but like anything else, nobody is perfect. That's why computers come with spell check and grammar correctors. Likewise, there needs to be need a system that alerts agents and staff of possible underwriting infractions before an endorsement is submitted to Allstate.

Only time will tell if Allstate will adopt these suggestions. In the meantime, all agency owners should take proactive steps to ensure that they and their employees fully understand the MMG guidelines and binding authority. Clearly, higher E&O rates are driven by those who are ill-prepared and uninformed.

We suggest agents establish an in-house system to monitor new business and endorsement activity, which is something they can either do themselves or assign to their most fastidious employee. Obviously, if yours is a busy agency, it may not be practical or possible to check every app and endorsement, but you should be sure to spot check as many as you can and let your staff know you're doing it. They will soon understand that you mean business and will pay more attention to detail. Stay on top of every process in your agency and expect perfection. Raising staff awareness is essential for reducing or eliminating needless errors in your agency.

Other Resources

CalSurance provides several loss prevention resources that can help prevent E&O claims; it would be wise for agents and staff to review them. Hopefully, heightened awareness by all agents of their responsibility to be knowledgeable about the products they offer, diligence in their disclosures to consumers, adherence to binding authority, and making sure that everyone in their agencies takes time to document conversations with customers will result in more stability of the E&O group insurance program. **For more information, please visit www.calsurance.com/allstateagent.** *Ef*

"Allstate will handle errors and omissions claims involving Allstate policies (including facility, flood, and Assigned Risk policies written by Allstate) where you are alleged to have made a mistake, but the risk is one that Allstate would have otherwise written. An example would be where you fail to add rental reimbursement coverage to an Allstate automobile policy as requested by the customer. In this type of claim situation, Allstate will pay the claim once it is determined that an error or omission occurred as long as you had authority to bind the risk. Claims in which it is alleged that you made a mistake resulting in no coverage because the policy type or coverage was not offered by Allstate or you exceeded your binding authority in binding a risk that did not meet Allstate's underwriting criteria or claims in which it is alleged you owed a duty to a customer which you breached (typically related to inadequate or lack of coverage), will be covered by your errors and omission policy through CalSurance. Claims alleging that you owed a duty to a customer that you breached can often be brought after the end of the agency relationship with Allstate and this is one of the reasons it is important that agents who are no longer active with Allstate purchase the five-year or Unlimited Extended Reporting Period coverage."

Source: R3001 Supplement