



Take a Close Look at Those Insurance Exclusions

By Brian S. Kern, Esq. (1/04)

The New Jersey professional liability insurance market for accountants has drastically changed in recent months. Insurers that entered the state in the midst of an inflated bond market to capitalize on illusory opportunities are now fleeing. These carriers learned that big profits aren't generated overnight, especially under New Jersey tort law. Unfortunately, the negative impact on the insurance market continues to linger.

The once-saturated insurance market drove all carriers to lower rates to remain competitive. Now that market availability has dwindled, rates have risen to more normal levels. Confronted with an aggressive plaintiffs' bar, insurance companies also have been looking to mitigate future losses. The traditional solution: offer less coverage.

Reducing coverage is achieved several ways. The most obvious course is to limit the liability a firm can purchase. Recently, this has been coupled with a subtler tactic: refusing to insure specific risks or building in exclusions.

The combination of sharp rate hikes and coverage reduction is forcing firms to consider bearing increased risk. Firms now seem willing to exchange heightened future risk for current dollars, and one significant risk lies in the nature of the policy itself.

Virtually all accountant malpractice insurance policies are written on a "claims-made" basis, meaning that the policy in place when a claim is made determines coverage, regardless of the incident date. The two exceptions are if the incident occurs prior to a retroactive date or if tail coverage is purchased. The claims-made policy, once touted for its flexibility, is now creating unexpected hardships. Many firms, such as those that have performed publicly traded company audits, may already have experienced problems.

Some carriers are avoiding insuring firms that conduct these audits; others charge high premiums and some exclude it entirely. Before firms waive coverage for any work, however, they should understand the implications. Assume, for example, that a firm conducted audits for SEC companies for several years and proper coverage was in place at the time. Recently, the firm stopped providing these services and excluded its SEC audit insurance coverage. As soon as the new policy takes effect, the coverage – including coverage for all past audits – is eliminated, leaving the firm uninsured for all those years of hard work.

Additional exclusions are also surfacing. The predominant origin of a lawsuit against an accounting firm is a “suit for fees.” When a suit to collect receivables is launched, a counter suit alleging malpractice is a common defense. Some insurers now exclude coverage on these counter suits for fees, while others offer discounts for voluntarily waiving the coverage. Other exclusions gaining prevalence include broker-dealer services, business and personal investment advice, even assistance with software purchase and installation.

Knowledge of policy exclusions is essential, as coverage for all past work disappears the day a new policy takes effect. Some firms may decide that the risks associated with excluding specific coverage are too great, but find they are unable to locate a reputable company to provide the coverage. In such cases, the best – and perhaps only – way to secure coverage for past acts is to purchase extending reporting coverage, or a “tail.”

A tail insures against future claims based on covered incidents that occur during the life of the original policy (i.e., before the policy cancels, but after the retroactive date). The cost of a tail should be readily available by contacting your broker. Compare that cost, plus the price of the first-year policy, with the cost of maintaining a more limited policy. The difference may be a nominal amount.

The reason is that tail coverage is priced at a percentage of the current premium, based on the number of years the tail will extend. For example, permanently extending coverage might cost 200 percent of an annual premium. In comparison, new policies are priced at significant discounts that decrease in percentage until reaching the mature rate – usually after five years. Hence, if the aggregate five-year discount resembles the price of the tail, the long-term benefits of purchasing the tail could prove considerable.

Tails are strongly recommended when a policy discontinues for any reason and when a firm merges or undergoes significant change. Tails also can serve as a useful tool to lock in current, more comprehensive coverage, while allowing firms to better prepare for a new, more limited policy.

It’s wise to discuss all these points with your broker each year, well before renewal. Due to current market conditions, broad coverage is going to be increasingly difficult to secure, so explore all possible options.