INDEPENDENT INSURANCE AGENTS & BROKERS OF LOUISIANA
9818 BLUEBONNET BOULEVARD
BATON ROUGE, LA 70810
TEL: 225/819-8007
FAX: 225/819-8027
www.iial.com

TA 219 **January 21, 2003**

SUBJECT: **Recent Agency Study Reveals E & O Concerns**

BACKGROUND: E&O concerns are never far from anyone's mind in the insurance business. But with the everyday demands on our attention and time, it's not always easy to have a clear vision of how one's agency is doing in following sound E&O procedures.

MAIN POINTS: A recent study which was done by Alpine Risk Management offers some extremely interesting and valuable insight into how agencies are doing managing their E&O exposures. It is the result of over 150 detailed, on-site E&O procedural audits done with agencies all across the United States.

Alpine Risk Management recently released the details of their study, and they have kindly given IIAL permission to reproduce the report.

In addition to conducting E&O procedure audits, Alpine also has one of the best E&O Risk Management Manuals in the country. For more information, contact Edgar H. Lion, BS, MS, JD, President and CEO of Alpine Risk Management Corporation, LLC. Phone 510-653-5117. Fax 510-653-6349. E-mail alpinerisk@earthlink.net.

NECESSARY ACTION: Circulate this report to all agency staff.

Special Report
E&O Procedural Audit Study
Copyrighted
Alpine Risk Management Corporation, LLC
(Reproduced with permission)

In our discussions with agents and brokers at seminars, office visits and conventions, our analysts have been told by the agency principals that the procedures in their agency are proper and they don't feel there are any procedural discrepancies in their operations. Unfortunately, this is not what our analysts have found when visiting agencies to conduct an internal analysis of office systems and procedures.

Our firm, Alpine Risk Management Corporation, conducts internal procedural analyses and reviews of agencies as one of five Alpine STAR* Risk Management and Loss Prevention programs that we offer. In the past five years our trained analysts have

conducted over 150 on-site procedural analysis reviews of agencies nationwide. While many agencies tell us they are different, a detailed review of our statistical data base tells us this isn't quite so. We would like to share with you some of the procedural deficiencies we have found in these agencies that we have reviewed:

1. Signed and Dated Applications. Over seventy percent of the agencies reviewed did not have the insured sign and date their application for commercial insurance. When asked why by our analysts they were told they couldn't go back to the insured and ask him/her to sign the application. Basically, what they were saying, "We sold the policy, now let's get policy issued and go on to the next one." From a defense point of view, it is extremely important to have the insured sign and date the application. If a claim arises regarding lack of a coverage that could have been included in the policy, you have a better defense if the insured has signed and dated the application. It indicates that he has read it. At the deposition or in direct questioning in court, the defense counsel can then inquire why the plaintiff didn't question the lack of inclusion of a coverage at that time.

2. Application Review. A majority of agencies did not have procedures for double checking an application for completeness by a second party after it had initially been completed by a producer or CSR. Our analysts found in many agencies the producer would complete the application and then send it directly to the company without having it processed by the CSR.

3. Rejection of Coverage. Again, in a majority of the agencies reviewed, there was no evidence in those files where higher limits or other coverages had been offered that the insured rejected the offerings by a signed and dated letter of rejection. It is extremely important when a coverage or higher limits or increased values are offered and the insured doesn't accept the offering that the named insureds sign and date a rejection of the offering. In the event of a loss, we have found they develop amnesia on the witness stand.

4. UM and UIM Coverage. In the files of a majority of agencies reviewed UM and UIM limits were lower than the Auto Liability. This was for both Personal and Commercial Auto liability. There was no evidence in the files that higher limits had been offered and the insured rejected them. Also, some companies would not write higher limits, but there was no documentation that the insured had been advised of this fact and had acknowledged his/her acceptance of the lower limits.

5. Property Values. On many occasions our analysts found the agencies had accepted the insured's figures for values on buildings or contents. In those instances where the insured had established the values to be insured, ninety-five percent of the agencies failed to record in the insured's file the fact that the insured had set the property values to be insured.

6. Property Inspections. Over seventy-five percent of the agencies reviewed had no established procedures for personally inspecting the property risks they had insured. In fact, they told our analysts they had never personally seen the property.

7. Umbrella Coverage. In many agencies reviewed, there were no established procedures for notifying the excess or umbrella carrier when a bodily injury claim was reported under the primary coverage. While the BI claim may be small, there have been many occasions where it has ballooned beyond policy limits and the umbrella or excess carrier had not been put on notice. One of our analysts was involved as an expert witness in a case where the excess carrier was not notified and the primary carrier refused an offer to settle within the primary policy limits. The case went to trial and the award was for $345,000 above the primary limits. The excess carrier sued the agent for breach of contract.

8. Defined Procedures for placing business through a Surplus Line Broker. Eighty percent of the agencies did not have any standardized written or automated procedures for qualifying or placing business through a surplus line broker. Also, the majority did not find out if the Surplus Line Broker carried E&O insurance in limits at least equal to their E&O limits. Furthermore, the overwhelming majority of the agencies had neither thoroughly examined nor analyzed the written contracts they had signed with the Surplus Line Broker. As a result they were totally unaware of the restrictive wording in the contract such as a unilateral "Hold Harmless" agreement.

9. Internal Quality Control. Eighty-five percent of the agencies reviewed did not have any type of a standardized internal quality control program. They had no internal audit procedures to make certain that all personnel were following established agency procedures. This is extremely important. Especially if the agency is hiring new personnel. Too often a new CSR will bring his or her own favorite way of doing something over from the former agency for whom they worked. Soon, everyone is doing his/her own thing. Standardization and procedural consistency goes out the window.

10. Change in Company Ratings. Eighty percent did not have any standard procedure for notifying their insured of a change in rating of the company with whom they were insured. Alpine strongly feels an agent has a fiduciary duty to their insureds to notify them if their insurance company has its rating lowered.

11. Independent Contractors. In many of the agencies reviewed, the producers were classified as "independent contractors" rather than employees. In the majority of these agencies, there was no written contract between the agency and the producer. In those agencies who had their producers under a written contract it was our analysts opinion the majority of them could be subject to question by the IRS as they did not clearly spell out the producer's duties. They did not comply with the generally accepted common law factors of independent contractors as confirmed by the United States Supreme Court in Nationwide Insurance v. Darden, nor the IRS rule of 20.

12. Procedural Observance. In addition to recommending that all producers the agency classified as "Independent Contractors" be placed under a written contract, we also recommended that all contracts contain a paragraph covering "Procedural Observance" by the Independent Contractors. Again, in our experience, in the majority of agencies many of the producers were doing their own thing in direct contrast to established agency procedures. We have referred to these individuals as "Loose Cannons".

13. Agency Automation. In ninety five percent of the agencies who were fully automated, none of them had written procedures complying with the Federal and State laws regarding the admissibility of their automated data. Another area of procedural deficiency found in the automated agencies was a lack of standard procedures to audit the accuracy of the data entered into the system.

14. Needless Duplication. In a several recent internal reviews of agencies that were on transactional filing, the analysts were told by the CSR's that several of the producers did not like nor accept the procedure of transactional filing and they wanted their own copy of all information for their insureds. They were having the CSR's make a photocopy of everything that went into the T-File so they could keep it in their own insured's file. In addition to the time wasted duplicating the information, what additional information did they maintain in their insured's file that was not in the T-File or automated file? In the event of an E & O claim, where all information concerning the insured is subpoenaed as evidence, what if there is a difference in the information in the two files? The plaintiff's case is immediately strengthened.

15. Brokering Business. Our analysts found that many of the agencies reviewed placed business for other agents. In almost every agency reviewed that engaged in this practice, there was no written contract between the two parties. The placing agent did not have evidence of the originating agent's errors and omissions policy, nor was there any Hold Harmless" agreement between them, protecting the placing agent against an error by the originating agent.

16. Cellular Phone Conversations. While most agencies had a procedure for recording phone messages in the office, over ninety percent had no procedures for recording cellular phone conversations.

17. Errors and Omissions Claims Reporting. The majority of agencies reviewed had no defined written or automated procedures for reporting an errors and omission claim to their E&O carrier. Or, if they reported an incidence, they did not have established procedures for follow up on the status of the incidence or claim.

18. Company Financial Ratings. Eighty-five percent of agencies reviewed had no established procedures for the regular monitoring of the financial ratings of the companies with whom they placed business, or notifying their insureds of a company's rating change.

19. Company Binding Authorities. In those agencies that had automated systems, over ninety percent of them did not have their companies' binding authorities entered into the system for all personnel to access prior to binding a risk.

20. FAX transmission verification. An overwhelming majority of the agencies did not attach the FAX transmission verification sheet to the original document FAX-ed, or maintained a record of FAX transmissions.

21. Claims Draft Storage. In the majority of agencies who had claims draft authority, the unused claims drafts were stored in unlocked desk drawers and easily accessible to anyone.

22. Intra-Office Communication. In many of the larger agencies, it was found there was a complete lack of communication among the various departments. In one particular agency reviewed our analyst found that producers in different units were actually competing against each other by using different insurers to try to sell the same account. A similar complaint was voiced to our analysts by the CSR's in many smaller agencies.

23. Agent/Broker of Record Letters. Many agencies did not have a standardized agent/broker of record letter. Each CSR made up their own letter. The majority of letters reviewed also did not contain a "hold harmless" clause where the insured held the new agent of record harmless for any errors or omissions on the part of the former agent/broker.

24. Confidentiality. Over ninety percent of the agencies reviewed had no established procedure or policy concerning the confidentiality of a customer's file. In the majority of the agencies if someone called to say they or their client had been involved in accident with the agent's insured, the agent taking the call would provide them with the insured's policy information. This is a violation of privileged information! Under no circumstances should any information be given to another party without the prior express written permission from the insured.

25. Failure to Sell due to Lack of Knowledge. With the exponential increase in Employment Practices claims against employers, agents should be aggressively marketing Employment Practices Liability Insurance to all commercial insureds. Our analysts found that over eighty five percent of the agents interviewed were not selling nor offering EPLI to their commercial insureds. When questioned why, our analysts were told by the producers: "We don't sell it because we don't know anything about the coverages."

26. "Baby Sitting." When an insured receives a notice of cancellation for non-payment of premium on a direct billed item, many agents will call their insureds to remind them to pay the premium before the cancellation takes effect. This practice is referred to as "Baby Sitting." This practice is acceptable providing all insureds are called whenever a notice is sent. However, should the agency miss calling an insured and there is an uninsured loss, they have exposed themselves to a potential errors and omissions claim.

By adopting this practice, the agency has developed a "Special Relationship with the insured and can be held to a higher standard of care by the courts.

An agent can cease this practice by notifying all insureds they are stopping this practice. We have designed a letter for agents to send to their insureds. We call it the "Babysitting Letter." Many of our subscribers have used it to cease this expensive and potentially dangerous practice.

27. Employee Handbook. Seventy percent of the agencies reviewed did not have an employee handbook outlining that agency's personnel practices. When asked why by the analysts, they were told that "We're a small agency and we work like a family. All our employees know what our rules are."

28. Written Job Descriptions. Over eighty percent of all agencies did not have written job descriptions outlining duties and responsibilities for each work station or job position.

We strongly urge our readers in the agency or brokerage business to review their procedures and check to see if they are remiss in any of the areas outlined above. It could save them from a potentially costly errors and omissions claim.