Mary LaPorte (left) conducts in-agency E&O audits.

IN THE KNOW ON E&O

How an agency audit can keep problems from turning into claims

By Elisabeth Boone, CPCU

If your agency has ever experienced an errors and omissions claim, you know only too well that sinking feeling in the pit of your stomach when you get the bad news. If you've thus far managed to dodge the bullet, you can be grateful—although definitely not complacent.

Statistics cited by underwriting manager Insurance Specialties Services, Inc. (ISSI), of Jamison, Pennsylvania, drive the point home. ISSI, which has more than 25 years' experience writing insurance agents' E&O, says it's likely that one out of seven insurance agents will report an errors and omissions claim this year.

According to Mary LaPorte, CPCU, CIC, an expert in conducting E&O loss control audits in independent agencies, there's plenty of reason to be concerned about the potential for a claim.

"Some carriers report that one in twelve agencies experience an E&O claim each year," she says.

For guidance in identifying and dealing with the myriad of procedural pitfalls that can trigger an E&O claim, many agencies turn to LaPorte, the owner of Insurance Training & Consulting in Martin, Michigan.

LaPorte established her consulting practice after more than 30 years' experience with an independent agency where, in the course of moving through the ranks, she became intimately familiar with every phase of agency operations.

LaPorte also serves on the national faculty for the CIC program of The National Alliance for Insurance Education and Research.

A significant part of LaPorte's consulting practice is devoted to visiting agencies around the country to conduct a comprehensive E&O audit.

The exponential increases in agent E&O claims frequency, severity, and cost, LaPorte observes, can be attributed in great part to the litigious nature of society and a "victim" mentality that leads people to believe that if something bad happens to them, it must be someone else's fault. Such individuals, LaPorte remarks, have no trouble finding legal representation thanks to the strong U.S. plaintiff's bar, and also because the insurance industry is widely viewed as having deep pockets.

Agencies are vulnerable to E&O claims from both insureds and insurers, LaPorte says. Insureds may allege that the agency failed to procure needed coverage for specific exposures. "Ask questions," LaPorte says emphatically. "It's your job to be nosy!"

Claims also arise from an agency's failure to maintain or renew coverage; failure to get the best terms, "especially in excess-surplus markets"; failure to provide requested service; misrep-resentations of coverage; and placing coverage with an insolvent insurer. "If you obtain coverage from an E&S carrier, be sure the insured knows he's with an E&S market," LaPorte cautions. "For policies subject to audit, each new policy and subsequent renewal should be accompanied by a statement that says 'This policy is subject to audit,' followed by an explanation of what an audit entails and how it could affect the insured."

To forestall coverage-related E&O claims from insureds, LaPorte recommends that producers be required to use an E&O checklist for every account. One agency, she says, has an ironclad rule: "We don't pay the producer unless the E&O checklist is in the file." If an E&O claim is found to be solely the producer's fault, LaPorte continues, some agencies require that he or she must pay all or part of the deductible. "According to one estimate, 75% of E&O claims against agencies could have been prevented if the agent had used a coverage checklist," she says.

It's not safe, LaPorte warns, to assume that insureds are familiar with insurance terms. She suggests a simple and effective loss prevention technique: "In your proposal, include a glossary of insurance terms—admitted, nonadmitted, deductible, coinsurance, and so on."

Less common but equally threatening are E&O claims filed against agencies by insurers, LaPorte says. Such claims can arise from failure to follow company instructions and failure to supply information. "Whether the insurer asks for it or not, you're under a contractual obligation to disclose all pertinent information," LaPorte says. Claims also can be triggered by misrepresenting a risk to a carrier or by interpreting policy terms to an insured. "Don't do it," she

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advises. "Let the insurer be the one to deny coverage."

Failure to process claims also can give rise to an E&O action from an insurer, LaPorte says, whether those claims are from insureds or third parties. "If an agency makes a commitment to be involved in the claims process, it needs to understand how its actions or delayed actions could affect the outcome of a claim," she says.

Keys to loss reduction

An effective E&O loss prevention program, LaPorte says, has three components: education, consistent procedures, and documentation.

Education. The agency should bear the cost of industry-related education for employees and should encourage the pursuit of professional designations, LaPorte asserts. "Don't leave it up to the employees," she says. "Employees should participate in ongoing, meaningful education that strengthens coverage knowledge and enhances the agency's in-house expertise." Last but by no means least, LaPorte says, "All employees should attend an E&O class at least once every three years."

Essential elements of every employee's education, she says, are coverage knowledge ("Know both your companies' and your competitors' products"); knowing how to treat exposures; and understanding both the agency management system and companies' proprietary systems.

Consistent procedures. Most agencies have procedures in place and make a sincere effort to follow them. Problems arise, LaPorte says, when procedures are not written down and when they are not followed consistently. Effective E&O prevention, she emphasizes, depends on having written standards and workflow procedures, as well as written minimum standards for writing and servicing business. Employees should know that compliance with procedures and standards will be the basis for performance evaluation.

"There should be written procedures for every workflow in the agency," LaPorte asserts. "This includes new business, renewals and rewrites, policy changes, claims handling, cancellations, and excess-surplus lines transactions. When we conduct an agency E&O audit, our report includes many suggestions that are helpful in the development of standards and procedures."

Documentation. "Good documentation can save an agency in an E&O situation," LaPorte declares. "Documentation is not optional." To be effective, documentation must be both timely and detailed. "Documentation should be done by the person closest to the event or conversation as soon as possible after it takes place," she says. "Documentation related to a particular customer should be in one location where it can be accessed and understood by others."

What should be documented? Just about everything, LaPorte responds: "Conversations with or regarding a customer; coverage recommendations or refusals of coverage, and instructions given to an insured." Not all agencies follow this rule, she observes. "Agents have told me, 'We only document conversations with the insured that are significant.' The fact is that you will never know which conversation is significant until an E&O loss occurs. By documenting every conversation, the agency establishes a clear history of contact with the insured, which positions the agency for a stronger E&O defense," she asserts.

Documentation, LaPorte points out, is only as good as the format in which it is saved. "Many agency employees, particularly producers, save client information and files in programs like Microsoft Outlook or Lotus Notes," she says. "This may be quick and easy, but it's a bad idea." Why? "Documentation in these programs is in a changeable format. A plaintiff's attorney could accuse the producer of intentionally changing information to sway the evidence in the agency's favor." For optimum E&O protection, LaPorte advises, "Move all client information from these programs into your agency management system to encrypt the information as soon as possible.

"Explain why the agency has decided to have an E&O review performed," LaPorte says. "Tell employees when the audit will take place. One week's notice is appropriate; don't notify employees too far in advance, or some will try to hide problems that the audit will uncover, like too many items in suspense."

Employees also should be told that the auditor will ask many questions, and that they may be selected to talk with the auditor, LaPorte says. "They should understand that their individual performance is not being audited and that they should feel comfortable sharing information."

An audit begins with an on-site visit to the agency, LaPorte explains, and the length of the visit depends on the agency's size. For an agency with one location and fewer than 40 employees, the initial visit will take two days. Three days on site are required for an agency that has more than 40 employees or two office locations within 50 miles.

"We review procedures, forms, and documents, and we conduct an overview of procedures with key managers and supervisors," LaPorte says. "We also interview representative staff members and review selected customer files."

On day one of the audit, LaPorte often meets with management as a group to gather information about the agency's E&O loss history. In meetings with individual managers and supervisors, she asks about their management practices and style.

For example: "Are you a hands-on manager, or are you hands off? If you're hands off, you need to designate someone to act on your behalf." LaPorte also asks the manager to talk about specific carrier or product concerns.

In discussing a particular department's workflow, she addresses the challenges of moving from a paper-based to a paperless system, where gaps can give rise to E&O claims. When used correctly, she says, "Technology helps greatly in E&O preparation."

Next, LaPorte conducts private interviews with CSRs, account managers, producers, and support staff. "I'll go to an employee's desk, pick up a piece of paper, and ask 'What's this?' she says. Even though the agency may have written procedures for a specific workflow, she finds that not everyone always follows them.

Once the on-site audit has been completed, LaPorte prepares a comprehensive report that presents E&O recommendations for every area of the agency. The report contains a checklist that indicates whether a particular practice is acceptable, and it also may include sample forms or procedures that the agency can customize for its own use.

Given the possibility of increased frequency, severity, and cost of errors and omissions claims against independent agencies, LaPorte says, it's clear that the best defense is a good offense. In considering whether to have an E&O audit, she suggests, "Look at the E&O claims statistics and ask yourself: 'Could I be next?'" ■

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