ALLEN & OVERY

What to look for in a professional indemnity insurance policy

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A checklist setting out the key terms that insureds should review when notifying a claim or negotiating the terms of a professional indemnity insurance policy.

About this checklist

This is a checklist of the key provisions to be considered when reviewing a professional indemnity (PI) insurance policy, whether in the context of negotiating the terms of a future policy or considering a potential notification or claim under an existing one. Professional indemnity policies may also be referred to as professional liability policies and include errors and omissions (E&O) policies.

For information on the key terms that insureds should review when notifying a claim or negotiating the terms of a directors' and officers' liability insurance policy, see Checklist, What to look out for in a directors' and officers' liability insurance policy.

Overview of PI coverage

PI insurance is intended to cover specified losses suffered by a business (or individual acting in their professional capacity) where it is alleged that the business has caused loss to its clients or other third parties in the provision of services as a result of defined wrongful acts, for example negligence. The insurance will generally cover the costs of defending a business against claims as well as damages or costs that the business is ordered to pay.

Most businesses that offer professional services will require PI insurance. Some professions are required to hold adequate PI insurance as part of their regulatory obligations.

As with many types of insurance, PI policies can offer one of two bases of cover:

- An 'any one claim' policy provides cover up to the full policy limit for each individual claim made in the period of insurance.
- An 'aggregate' policy provides cover up to the full policy limit for all claims made in the period of insurance.

Who is covered?

A PI policy typically provides cover for losses arising from claims both against the business and against individuals within a business.

Some key points to consider:

- The policy is likely to state that cover is provided for claims made against "the Insured". Check the definition of "Insured".
- If the definition of "Insured" includes entities, check which entities are covered. A typical PI policy will cover a named policyholder entity plus its subsidiaries. Alternatively, the policy may insure the "company", where "company" is defined as a number of specified entities within a corporate group. Check the situation regarding acquisitions and disposals of subsidiaries during the policy period. Also check whether any entities or jurisdictions are specifically excluded from cover. If they are, look to see if there are local policies for those entities, as there may be a local law requirement that PI insurance be issued by an insurer in the same jurisdiction as that entity.
- If the definition of "Insured" includes individuals, check which individuals are covered. This is likely to include current directors and employees, but consider whether it also includes former or future directors and employees.
- In addition, check under which circumstances these individuals will be covered. It will usually be when they are acting on behalf of the business. The policy may state that the individuals are only covered when providing professional services (or similar) on behalf of the business, with 'Professional Services' defined by reference to a list of specified activities.

What is covered?

An example insuring clause of a PI policy might read:

"This policy covers Claims first made during the policy period against the Insured by a third party, for loss arising due to legal liability, provided that the Claim arises out of an actual or alleged act error or omission in the provision of the Professional Services by the Insured, or any other person for whom the Insured is legally liable."

A key definition to review in interpreting a PI policy is, therefore, that of the word 'Claim'. A common definition of 'Claim' is *"a written demand for damages or compensation"*. The definition of 'Claim' may also include a list of examples of what would constitute a 'Claim', such as a letter before action (or other written demand for damages) or statements of case in civil proceedings, an official investigation commenced by a government body, or a criminal prosecution.

The policy will also generally require that the Claim arises out of an actual or alleged act, error or omission in the provision of professional services by the insured. As explained above (*Who is covered?*), 'Professional Services' may be defined by reference to a list of specified activities or to a description of the sort of work the insured carries out. Claims arising out of circumstances unrelated to the provision of professional services by the insured are unlikely to be covered.

If a business finds itself on the receiving end of a complaint from a client or third party, it is important to consider carefully whether that complaint would meet the definition of a 'Claim' for the purposes of PI insurance. Consider whether the client has demanded damages or referred to legal proceedings, and whether the complaint relates to professional services provided by the business or to something else.

What else is covered?

In addition to covering losses resulting from claims, most PI policies will also cover:

- 'Claim Expenses', which may include legal costs and expenses reasonably incurred in the investigation, defence and settlement of any Claim, but may not include internal or overhead expenses or costs.
- 'Investigation Costs', including costs of responding to or participating in regulatory or criminal investigations in relation to the provision of professional services by the insured.

The consent of insurers is often required before incurring these categories of loss. The policy may state that insurers' consent may not be unreasonably withheld.

Check whether these costs are covered in addition to the main limit of liability under the policy (see *How much cover is there?*) or whether they will erode the limit of liability available. There may be specified sub-limits that apply in respect of each category.

Policy extensions may also be purchased for certain categories of loss, such as:

- Loss of documents, that is claims arising from the loss or destruction of documents under the insured's care.
- Losses arising from intentional or dishonest acts (although the scope to insure such losses may be limited by public policy considerations).
- Losses relating to libel, slander or defamation.
- Losses arising from certain specified activities undertaken by directors or employees that would not otherwise be caught within the scope of professional services.

How much cover is there?

Check the limit of liability and whether it is per claim or aggregate. Also check whether there are any sub-limits.

If cover is provided on an aggregate basis, during the policy period, insurers will pay up to the limit of indemnity regardless of the number of claims. Finally, check what deductible(s) might apply. The deductible is the amount that the insured has to pay before insurers will step in to cover the balance of the loss.

What is the policy period?

The policy period refers to the duration of the policy. That is, the period between inception of the policy and its expiry or cancellation. The policy period of PI policies is typically one year, but multi-year policies exist, and multi-year discovery periods (where the insured has several years to report the claim but it must arise from events that happened in a single policy year) can be purchased. PI policies are generally issued on a claims-made basis, meaning that the critical question in terms of timing is when the insured became aware of a claim or potential claim, rather than when the alleged act to which that claim relates took place.

Claims will only be covered if the claim or the circumstances that gave rise to the claim are notified to insurers during the policy period or an agreed extended reporting period. If negotiating a policy, consider how long the policy period should be. If seeking to notify a claim, check that the policy period is still active (including whether it has been extended by any endorsements) and how much time remains before it expires. Remember that you may have to act quickly to notify a claim or circumstances that may give rise to a claim – late notification can be fatal to recovery if timely notification is a condition precedent to insurers' liability.

Businesses that are ceasing trading can also purchase 'run off' cover. This insures against professional negligence claims brought after the business has closed or been sold.

Are there any typical exclusions?

PI insurance may exclude losses resulting from some or all of the following:

- Fraudulent, dishonest or criminal acts.
- Personal injury or death.
- Property damage.
- Insolvency of the insured.
- Breach of contractual warranties.
- Delay in performance or non-performance of contractual obligations to third parties.
- Claims brought by directors, officers or employees.
- Computer viruses and cyber attacks.

However, whether any of these categories of loss is excluded will depend on the nature of the business being insured. It may be possible to bring certain types of loss back within the scope of cover by way of policy extensions.

PI insurance will also not respond to claims that commenced prior to the period of insurance or that could have been notified to previous PI policies.

Policies may exclude cover for losses arising from claims brought or maintained in particular jurisdictions. There may also be specific exclusions from cover that are included by way of endorsement to the policy.

What are the notification requirements?

Check the requirements for notification:

- It will generally have to be in writing.
- Notification by email may be expressly permitted; if it is not, it is advisable to notify by email and by post.
- A time limit for notification may be specified, for example, "*as soon as reasonably practicable after the Insured has become aware of the Claim*" or within 30 days of the policyholder – or a named person within that business – becoming aware of the claim or circumstances that would cause a reasonable person to believe that a claim was likely.
- Notification may also need to include certain details to be valid: for example, details of the claim and/or an estimate of potential loss.
- Requirements for notifying a claim may be different from the requirements for notifying a circumstance that could give rise to a claim.

Check whether an address is given for the notification of claims. If a broker is to make a notification on the insured's behalf, ask that the broker ensures notification is made to the correct address.

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