

UNDERSTANDING PROFESSIONAL INDEMNITY INSURANCE

CLAIMS GUIDANCE NOTE

Notification of Claims & Claim Circumstances

The aim of this Guidance Note is to help our clients understand:

- A) What constitutes a Claim or Claim Circumstance
- B) The importance of prompt notification of Claims and Claims Circumstances

What constitutes a Claim or a Claim Circumstance?

Claim

A “Claim” against a professional, from a Professional Indemnity point of view, is an assertion of rights against the professional communicated to him by a third party (normally - but not always - the client) arising out of the professional’s business activities, which usually involves a claim or threatened claim for financial compensation. The communication can be made by way of a formal claim in the form of legal proceedings, by letter, e-mail or even verbally. In practice, a lot of Claims take the form of a complaint, made either verbally or in writing, about the quality of the service / advice provided by the professional. Any Claim should be notified to the Professional Indemnity Insurers. Please take particular note that it does not matter whether or not the professional considers a Claim to be totally without merit and unjustified – the very fact that a Claim has been made triggers the notification conditions of the Professional Indemnity Insurance policy.

Claim Circumstance

Unlike a Claim, a Circumstance is not so easy for Insureds to recognise and is more difficult for them to assess in the course of their day to day business affairs.

A Professional Indemnity Insurance policy normally requires that any Claim Circumstance, i.e. a circumstance which ‘*may*’, ‘*might*’, ‘*could*’ or is ‘*likely to*’ give rise to a claim (“Circumstance”) is notified to Underwriters as soon as an Insured becomes aware of this occurrence.

The difficulty Insureds face is not helped by the fact that different Insurers have a slightly different definition of what a Circumstance is as can be seen from the preceding paragraph. ‘*May*’, ‘*might*’, ‘*could*’ and ‘*likely*’ [to give rise to a claim] are different words used by different Underwriters when referring to Circumstances, so Insureds will have to refer to their specific policy wording to confirm what the notification provisions specify.

However, as a general guide, a Circumstance can be one or more of the following scenarios:

- (1) An intimation of an intention or a threat to claim against an Insured
- (2) Any known direct or indirect criticism of an Insured's professional services, whether expressed or implied, which could give rise to a loss to a third party
- (3) Any known direct or indirect criticism of a party for whom and for which an Insured is responsible, whether expressed or implied, which could give rise to a third party loss
- (4) An awareness by an Insured of a failing or shortcoming in their work, or a real doubt about the efficacy of their own performance, or a party for whom an Insured is responsible, in the course of their professional business activities, which could give rise to a third party loss

It should be stressed that the fact that an Insured regards an intimation of claim or criticism as unjustified and without merit does not remove the obligation from it to notify Insurers. The fact that an Insured is aware of such an occurrence at all triggers the notification provisions of the typical Professional Indemnity Insurance policy.

An Insured's own losses (first party losses)

The scenarios referred to above refer to claims by a third party. However, in addition to providing an indemnity for third party claims, most Professional Indemnity Insurance policies also indemnify Insureds against certain losses that they themselves suffer, e.g. loss of documents, dishonesty or fraudulent acts and criminal prosecution defence costs.

Insureds should be aware of what first party losses are covered by their Professional Indemnity Insurance policy and they should notify their Insurers as soon as possible once they become aware that such a loss could arise.

The importance of prompt notification of Claims and Circumstances

For Insureds

Most Professional Indemnity Insurance policies state that it is a condition precedent to any indemnity that an Insured must promptly notify Insurers of Claims or Circumstances of which they first become aware of during the policy period. In effect, if this condition is not complied with, Insurers can repudiate the notification and thereby refuse an indemnity to an Insured. The financial consequences to an Insured for failure to promptly notify both Claims and Claim Circumstances could be very serious indeed.

If an Insured fails to notify Underwriters of a Claim or a Circumstance and their policy renews in the intervening period before notification is eventually made, then in addition to having the Claim or Circumstance repudiated (as referred to above), the Insured's Insurers could elect to treat the then current policy as being voided *ab initio* (from inception) for failure to disclose information material to the underwriting of the risk. Obviously, this would have extremely serious consequences for any Insured.

Whilst certain professions can have special conditions that give protection to Insureds against late notification and/or non-disclosure of a Claim or Circumstance, an Insured could still end up with having to bear a higher policy Excess than would have been the case if prompt notification had been made to an earlier policy. Furthermore, the indemnity provided by Insurers could be reduced to reflect the prejudice that has been caused to their position as a result of the late notification. In addition to the direct financial effect of the aforementioned two points, a lot of valuable working hours can be lost in dealing with a policy coverage dispute arising out of late notification and/or non-disclosure.

For Underwriters

Prompt notification of Claims and Circumstances is important to Underwriters because although an Insured normally carries a self insured Excess, they carry the main financial exposure and therefore they need as early notification as possible so that they can form some assessment of an Insured's potential legal liability; advise on how the Insured should best proceed and, if appropriate, take over the handling of the Claim or Circumstance and/or appoint a solicitor or loss adjuster to investigate the notification and assist the Insured.

Whilst most Insureds are good at 'fighting their corner', they are not best placed to form an objective assessment of the situation. Also, Professional Indemnity disputes can be quite complex and involve legal principles outside the knowledge of the average Insured.

Professional Indemnity Insurance policies operate on a 'Claims Made' basis, i.e. the policy responds to Claims or Circumstances which an Insured becomes aware of, and reports to Underwriters, during the policy period. In that respect, it is different to most other policies of insurance. A PI underwriter assesses a risk based on the information provided by an Insured with their proposal form and accompanying information. This information includes, amongst other things, details of all Claims and Circumstances of which the Insured is aware of that time, which are taken into account when considering whether to offer renewal terms for the risk and, if so, what premium to charge. However, Insureds should not withhold notification of Claims or Circumstances due to concerns about the adverse affect this would have on their premium.

Summary

Insureds should be aware of what constitutes a Claim or Circumstance. They should be fully aware of the notification provisions of their Professional Indemnity Insurance policy and understand the importance of prompt notification. Insureds should remember the Golden Rule, "*If in doubt, shout*", i.e. if they are at all unsure about what or when to notify they should discuss the matter with their insurance broker.

A proper understanding of what and when to notify and adherence to the notification provisions of their Professional Indemnity Insurance policy should form part of an Insured's overall risk management procedures in the course of their business activities.

Always ensure your clients have tailored policy coverage for their individual needs.