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Run Off insurance – a review

First we need to explain

1) what is **professional indemnity insurance (Pi)** and

2) what is **Claims Made.**

In brief **Pi** is the insurance which covers you for claims and costs arising out of any advice you give, written or verbal, done for a fee or not, which causes the recipient a financial loss, bodily injury or property damage – it does lots of other things but that is the gist of it.

All **Pi** policies are underwritten on a **claims made** basis.

A **claims made** policy covers you for when a claim is made against you and reported to the underwriters during a live policy period and after the **retroactive date** shown on the policy.

What is a **retroactive date**?

The **retroactive date** is 1) the date from which you first take out a professional indemnity insurance policy or 2) a specific date applied by underwriters from which claims can apply. The retroactive date says that only work done after that date or any ongoing works from and exiting job at that date is covered by the insurance policy.

So, if you did work last year but a claim is made and reported to underwriters this year then it is this years' policy which will respond. There must be a live policy in place to respond.

So, if for instance you stop your **Pi** at the end of a policy year say 01/01/2018 and a claim is made against you 03/01/2018 – you have no insurance 1*. Hence the need for **Run Off** cover.

What is Run Off Insurance – What does it do?

Run Off insurance is a special form of insurance which applies to insurance policies which are on a '**claims made basis**' and provides cover for any claim(s) which sneak out of the woodwork arising from any advice or work you may have done in the past once you have ceased your business or work and stopped trading. Claims are still a possibility after that date. Run off insurance will provide cover for legal costs and upheld claims relating to anyone protected under such a policy

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Why do I need Run Off ?

Just because you have stopped working does not mean that you are not liable for the work you have done in the past – you have an open period for claims to be made as set out under the statute of limitations. Generally 6 years past the last date at which advice was given but some situation can give an open period of much longer – 15 years plus

You may also have rules which are imposed upon you by your Institute or Association.

ICAEW stipulate that a member or practices holds at least 2 years and recommends 6 years run off.
ACCA stipulate a period of 6 years under their rules.

In the case of a partnership without a limited liability, it is especially important to purchase this type of insurance after a dissolution, as liability cannot be removed during the winding up process.

Even as a Limited Liability or LLP firm when closed or sold there is still residual exposure. Claims can still be made and will have to be defended. And odd ball ones like Merrett v Babb [2001] EWCA Civ 214 do happen. 2*

For sole traders and smaller firms, retirement is a common reason for purchasing run off insurance, whereas larger firms are often passed on to a new generation of owners who can continue the existing PI policies.

Sometimes contracts have been entered into with time and distance – ie your must have a certain type of insurance for 12 years is common in the current market and this period may run past your cessation date. For instance, contracts signed as deeds, such as Collateral Warranties and letters of appointment, can extend the length of time needed for a run off insurance policy. Details of the obligations a professional has concerning any work undertaken can be found in the contract.

Professional businesses close down for many reasons, including foreclosure, acquisition and retirement. In cases such as these, it may be necessary to extend an indemnity policy beyond the end of trading in order to comply with regulations, or simply to take the sensible option and protect against all eventualities.

These eventualities may include claims of negligence in one form or another. A business and it's partners or directors and officers does not simply remove itself from its client responsibilities once it ceases trading. Professionals have to prepare for the possibility of claims such as those mentioned years into the future. It is one of the few legal duties imposed on directors and officers (other instances are rules) to ensure that the firm has proper insurance.

The definition of a professional is nowadays broader than it once was. It used to be that when one thought of a professional, it was engineers, architects, accountants or surveyors that came to mind, but now people who provide a variety of services to their clients are also considered professionals. We also have the influence of Strict Liability.

If you provide a service to a client you are liable for it. A claim may not have any validity but you will still have to defend and the PI pays for the costs of defense and any award

Who can benefit from run off insurance?

Any professional firm or practice or individual that has ceased trading and is looking to extend their PI cover in order to protect themselves from historical claims will need this run off.

Purchasing a run off policy

Run off insurance is slightly different to standard **Pi**, in that it covers you for past claims and underwriters apply a special clause which says,

"It is hereby noted and agreed that this Policy will not indemnify the Insured in respect of any work undertaken on or after xx / xx/ xxxx" – that being the date that all work is ceased.

So, if you carry on any work at all do not purchase run off cover – it is only for when all work has stopped.

You can buy run off as an individual of as an entity.

Normally a person or firm knows when they or it are going to wind up. What should happen is that well in advance for that date you should discuss a run off provision with your **Pi** broker, who is preferably Legalrisks Professional Indemnity Ltd!

What happens then?

A run off insurance policy will often simply be carrying your previous **Pi** policy over into a run off status, with the addition of the run off endorsement detailing the start date of the run off.

If your current insurance provider does not give run off you will have to apply to one that does as though it is a totally new **Pi** policy.

How long for?

This is determined by either guidelines set out by the relevant professional bodies, what is a reasonable period after your last piece of work – if all of your work is on the basis of an annual review then one year after the very last piece of work should do as everything will have been reviewed by someone else! Or legislation – the statue of limitations.

As we said previously

ICAEW stipulate that a member or practices holds at least 2 years and recommends 6 years run off.

ACCA stipulate a period of 6 years under their rules.

Six years is standard for professional bodies, the period for claiming negligence in regard to a tort or breach of contract. In the case of a tort, a client can pursue damages up to six years after losing out as a result of the negligent actions on the part of a business. Likewise, breach of contract cases can be claimed against from the moment the work has finished. Don't forget that the courts can determine that the duty of care is broader than to just your direct client and tort can be longer than contract

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Do I do it year by year or as a one off?

You can do either – it comes in two forms.

Continuous year on year cover or multi year

The decision on what type of policy you should choose should be carefully, with the input of an insurance experts such as Sennet Professional Indemnity Ltd who can assess your obligations and liabilities before making a call on the length of cover to opt for.

Year on Year

This form of run off simply follows on from your last years cover for a further 12 months on the basis of an annual no claims declaration.

Advantages

- You can determine your own length of cover
- Premiums may go down
- There are more underwriters who provide this cover so far more choice

Dis-advantages

- You have to re-apply every 12 months
- Cover after the first period may not be obtainable form that underwriter
- Premiums may become unaffordable
- New restrictive underwriting terms can be applied

Multi-year

Some insurers for provide full term covers of 2, 3, 5 or 6 years at a fixed premium but not many and they are usually closely associated to Institutes or Association.

Advantages

- You benefit from a fixed price.
- There is no requirement to renew your policy every year.
- The long-term costs are usually cheaper than renewing annually.

Disadvantages of multi-year run off policy:

- The short-term costs are often greater than the annual renewal methods of payment.
- Insurers can sometimes close down, so there is an element of risk in committing to a long-term premium.
- If you start working again within multiyear period any work new work will have to be catered for separately under a new title and new policy so more costs.

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What does it cost?

Year by year

These premiums usually reflect the final trading years' premium and then decrease annually by as much as 25% after the first year, providing there are no claims coming in and the market rate doesn't increase. There are minimum premiums which vary between underwriters and that will always be the bottom – it won't decrease to zero!

Multi Year

These are usually worked out on a function of the last years premium and then adjusted so as to include a discount, depending on the work sector between 1.8 to 2.5 time the last trading years' premium

1*

Some **Pi** policy do have a limited form of extended reporting period for claims but these are very limited often to only 30 days

2*

In that case, an employed valuer personally signed a mortgage valuation. In 1994 his employer became bankrupt and later that year the practice's professional indemnity insurance (PII) was cancelled by the trustee in bankruptcy without run-off cover. In 1997 a claim was made against Mr Babb for negligence. He was found personally liable – and was uninsured.

Professional liability claims usually arise some time after the alleged act – typically three years or more. The judgment in *Merrett v Babb* does not say when the claim was made, but we do know that the valuation was undertaken in 1992 and the proceedings commenced in 1997. The Court of Appeal thought Mr Babb had been imprudent for failing to arrange his own insurance after his former employer's trustee in bankruptcy cancelled the practice's cover.

Disclaimer
Any views or opinions expressed in this briefing are for guidance only and are not intended as a substitute for appropriate professional guidance. We have taken all reasonable steps to ensure the information contained herein is accurate at the time of writing but it should not be regarded as a complete or authoritative statement of law.

This article was written by Paul James CEO of Sennet Professional Indemnity Limited.