Extended Reporting Periods: What Are They and Why Do You Need Them?

Whether your firm is closing its doors, acquiring or merging with another firm, or wondering what happens to your professional liability policy during these types of changes, you need to understand Extended Reporting Periods (ERPs) and how they work.

Professional liability insurance is written on a "claims-made and reported basis," which means that claims have to be made against the policyholder and reported to the insurance company during the policy year in which the claim is made. Once the policy has terminated or been cancelled and a claim is made against an insured and reported to the insurer, there is no coverage unless the policy contains an ERP. An ERP extends the time allowed to report claims that were made against the insured during the ERP *as long as they resulted from a wrongful act that occurred during the term of the policy*. An ERP is not a new policy, and any claim submitted during the ERP is governed by the terms and conditions of the terminated policy.

An ERP (also known as "tail coverage") is defined in the CNA professional liability policy as:

> the period of time after the end of the policy term for reporting claims to the Insurer that are made against the Insured during the applicable extended reporting period arising out of:
>
> 1. a wrongful act that took place prior to the end of the policy term that is otherwise covered by this Policy: or
>
> 2. activities that took place prior to the end of the policy term that result in a pollution incident that is otherwise covered by this Policy.

An ERP can come in several varieties and may be important to you depending on the specific circumstances affecting your firm. Let's take a look at the different ERP options and why you may need to consider each.

Automatic ERP

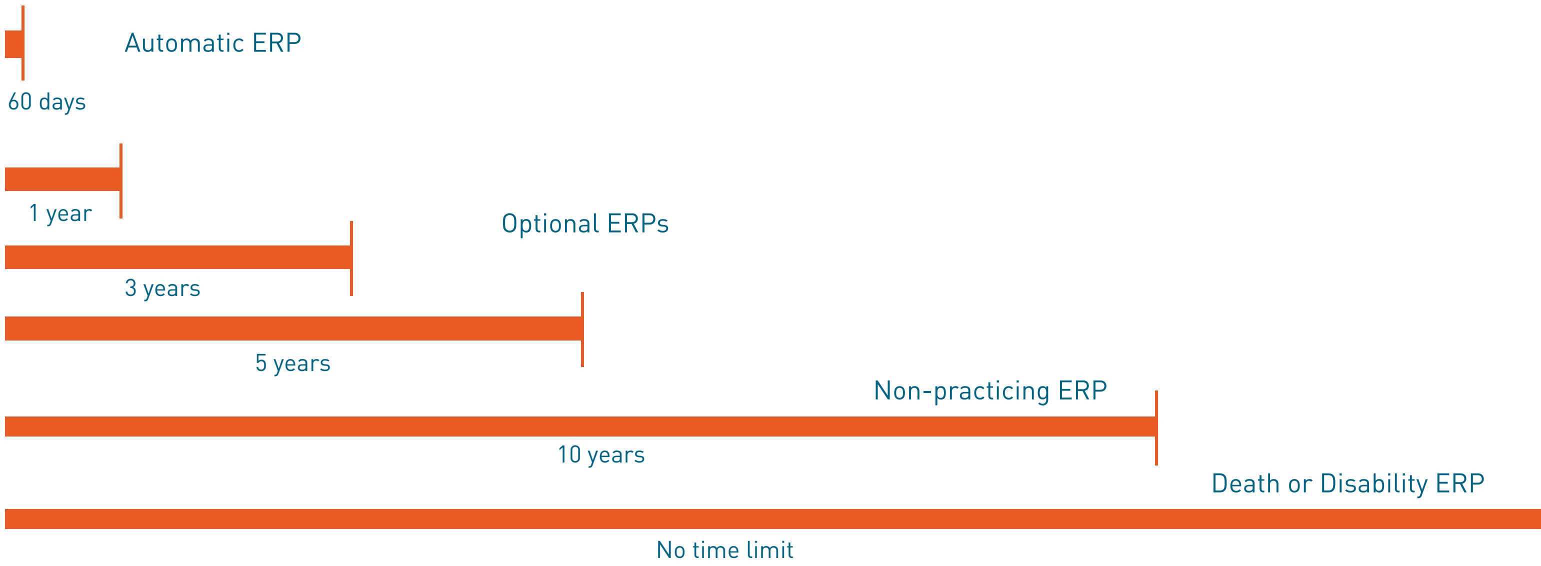
The Victor and CNA policy contains an **automatic extended reporting period**. The policy states:

> If this Policy is canceled or non-renewed either by the Insurer or by the first Named Insured and the first Named Insured has not obtained similar coverage, the Insurer will provide an automatic, non-cancelable extended reporting period starting at the termination of the policy term. This automatic extended reporting period will terminate after sixty (60) days.

WHY YOU MIGHT NEED THIS COVERAGE

If a design firm or individual is unable to secure a new professional liability insurance policy immediately after the

Timeline of Various ERP Options



termination of an existing policy, the automatic extended reporting period provides protection for claims that may be made during the gap between policies for wrongful acts that occur during the policy term.

Optional ERP

If a design firm or individual needs coverage for more than 60 days, they might consider purchasing an **optional extended reporting period**. The CNA policy states:

> If this Policy is canceled or non-renewed either by the Insurer or by the first Named Insured, then the first Named Insured shall have the right to purchase a non-cancelable optional extended reporting period.

The optional extended reporting period can be purchased for one, three, or five years. The cost is based upon a calculation that includes the cost of the current premium and the number of years purchased. If purchased, the first 60 days of the optional ERP run concurrently with the first 60 days of the automatic ERP. The first named insured must provide the insurer with written notice of its election to purchase the optional ERP and pay the full payment within 60 days after the end of the policy term.

WHY YOU MIGHT NEED THIS COVERAGE

When a design firm closes its practice, the firm and any professionals who sign and seal documents may continue to have liability for those projects, subject to applicable statutes of repose and limitations. This may be true even if the firm merges with another firm. In a merger, the acquiring firm's professional liability insurance would not automatically provide coverage for projects completed by the acquired firm. The acquiring firm's professional liability insurance may provide coverage for projects that were not completed by the acquired firm. If the acquiring firm is planning to complete the projects, this complicated topic must be discussed with attorneys and insurance brokers and addressed in the buy/sell agreement.

The firm that is closing its doors or is being acquired by another firm can protect itself and its professional staff from claims that may arise from completed projects by purchasing an optional ERP.

As noted above, the optional ERP is only available for up to five years. To determine if five years provides sufficient protection, a firm must determine when their projects were completed, what statutes apply to those projects, and the likelihood of future claims. While our statistics show that almost all claims against design professionals are made within the first three years after substantial completion of a project, some project types (such as condos) often don't result in claims until just prior to the running of the applicable statute of repose. In the majority of states, the statute of repose allows for claims against design professionals for a longer period than five years.

Non-Practicing ERP

If a firm is concerned about claims that may be presented after the five-year extended reporting period, and they have been insured through Victor for at least 10 consecutive years, they may want to consider purchasing a **non-practicing extended reporting period**. This special, long-term client benefit is only available if all of the owners intend to retire and cease practice.

> If, during the policy term, an Insured retires from, or otherwise voluntarily ceases, permanently and totally, such Insured's practice as an architect, engineer or any other profession specifically listed in the definition of professional services, and has been continuously insured by the Insurer for at least 10 consecutive years, then such Insured shall have the right to purchase a non-practicing extended reporting period commencing upon the latter of the expiration of: the policy term; any renewal or successive renewal of this Policy, or any automatic or optional extended reporting period.

WHY YOU MIGHT NEED THIS COVERAGE

Purchasing a non-practicing extended reporting period provides protection from past performance of professional services regardless of how the practice is organized: sole proprietorship, partnership, limited liability company, corporation, or some other entity. This protection is extended to both the retired owners and any employees for the covered acts committed in the performance of services on behalf of the dissolved firm. To be able to purchase this coverage, all projects must be completed through construction and any claims from past projects must be closed. However, coverage is not disturbed if the practitioner provides *pro bono* services after terminating the insured practice.

Death or Disability ERP

Lastly, the Victor and CNA policy provides one additional type of extended reporting period. The death or disability ERP is defined as:

> If an Insured dies or becomes totally and permanently disabled during the policy term, then, upon the latter of the expiration of: the policy term; any renewal or successive renewal of this Policy; or any automatic or optional extended reporting period, such Insured shall be provided with a death or disability extended reporting period.

WHY MIGHT YOU NEED THIS COVERAGE

If a firm can no longer provide services because the principal dies or becomes disabled during the policy term, this ERP offers no specific time limit and comes at no cost. If the policyholder's estate, heir, executor, or administrator provides notice of an insured's death within 60 days of the policy's expiration date, an ERP is provided so that the estate can be closed while coverage is provided for services performed prior to the insured's death. If the insured is unable to continue because of a medical disability, an open-ended ERP can be provided that ends when the insured resumes practice or dies.

Conclusion

Firms need to recognize the importance of extended reporting periods. Professional liability exposures may exist long after the expiration of a policy period since the claim may not be made for several years after services were performed. This exposure, often referred to as "tail exposure," requires coverage that provides protection during this extended period. "Tail coverage" is not commercially available as a stand-alone insurance product. As a rule, an ERP is only available following the coverage of a previously issued claims-made policy, and the decision to purchase the ERP must be made during the period allowed by the policy. An ERP cannot exist during the practice policy's period of coverage.

Note that there is no right to any ERP if the insurer cancels or refuses to renew the policy due to non-payment of amounts due, non-compliance with any terms of the policy, or any misrepresentation or omission in the application for insurance. The ERP also never covers any services performed after the termination of the policy term.

Ownership transition can be a difficult time with an unlimited list of issues to work through. Having a better understanding of your professional liability policy and how an ERP may work will only serve to simplify your needs and address your insurance solutions.

Visit us at victorinsuranceus.com/schoolofriskmanagement to learn more.