

What limits should I carry with My E&O

By Robert Burns - E&O Underwriting Manager

A very common question that we deal with is what limits should I buy? The old adage of buy until it hurts is perhaps too simple and not very helpful.

Perhaps some of the processes we see at work can be of use.

The first method is the "what's the worst thing that can happen?" Here it is important to know your book of business. Where your normal policy is a personal home and

auto the limits can be pretty predictable and you can probably gauge by a review of your agency management system for casualty and property limits. Some things to keep in mind are the potential for umbrella policies and other lines such as workers compensation and health insurance. The most common cause of action against agents is failure to procure coverage. What is the potential loss if you fail to place a health policy or enroll a member who protracts a serious illness or injury?

The point to remember here is not to focus on what you do write, but to look at what you may have failed to write or place. When you include umbrella policies this lead to very high limits for the policy that your office failed to place.

A commercial agency has more things to consider. Property schedules can be complex and a serious error in valuation (or difference of opinion) can reach into the millions of dollars. Also business income differences can be very costly. Also don't neglect to look at bond penalties. Any of these areas in addition to the normal items such as umbrellas can lead claims of up to tens of millions of dollars.

Another popular method is the 'what is it worth?' method. In this case the agency uses a limit that is in proportion to it's worth. Very often we see in this case an agency that felt its' worth at no more than a million dollar in the early years set their e&o limits and neglected to update it as the years went by. The pattern for renewing their e&o being established, the tendency is to look at price on apples to apples basis year after year. Often they can look up after several years of growth and acquisitions to find their value at several million dollars with limits of one million per claim and two million aggregate.

Most of our policies are issued with limits of one million dollars or higher. Most of our claims are settled for well under that amount. So why should you buy something that you will probably not use? Well for one thing there's always a first time, but it would not be; we have had five million dollar plus awards. The other thing to consider is that we don't generally get to the end settlement very quickly in large claim cases. Having a high dollar claim over your head for years can be unnerving without adequate limits.

Settlement of professional liability claims is a different process. First all of the underlying coverage issues have to be decided before the e&o damages can be properly assessed. Sometimes this process can take years. In most cases plaintiff's attorney has taken special pains to push up the damages as high as possible. You can be looking a multiple million dollar damage potential for years. While the defense can assure you that the final result will most assuredly be a fraction of that monstrous sum, you're the one that has to sleep nights.

Another consideration of the 'what's it worth?' method is the question; will you really be ready to cash in the agency chips just then? This is true particularly if the cost of some additional limits of e&o can be reasonably obtained.

Some agencies are guided solely by the contractual requirements of their agency agreements. This is certainly a basic step. Over the years we have seen agencies call in to increase limits because they are taking on a new carrier with substantially higher limits requirements. Generally this is a fairly simple and straight forward process but it is not an automatic. Consider if you have just had a claim, the carrier may not be in a position to increase the limits at least quickly.

Not only carriers require higher limits. There are times when a potential client, particularly a municipal entity, may require higher limits as standard practice.

Obtaining limit proposals can be a fairly simple process particularly at renewal anniversary. Most e&o carriers will happily provide an additional one or two million dollars of limit. The cost can be like lobster, according to market prices. Limits will likely be more easily obtained in the soft market and at a better price.

You should also discuss the availability of additional limits with your carrier to know what limits are available and what some of the considerations would be for your agency's particular situation. Mix of business, market specialties and agency claims history can all be factors in the decision.

An example of cost is shown here for an insured with 5 employees and \$4.5 million in premium all limits are with a deductible of \$1,000 on a loss only basis:

| Limit | 1m/1m | 1m/2m | 2m/2m | 2m/3m | 3m/3m | 3m/4m |
|------------|---------|---------|---------|---------|---------|---------|
| Premium* | \$2,867 | \$3,175 | \$3,717 | \$3,749 | \$4,036 | \$4,064 |
| Cost | na | \$308 | \$850 | \$882 | \$1,169 | \$1,197 |
| Variance % | na | 11% | 30% | 31% | 41% | 42% |

*Premiums will vary according to mix of business, location and other variables

Note that you can double your limit for a 30% increase in premium and triple it for only a 41% increase. In addition you can add depth to your coverage with another million dollars in aggregate limit for a nominal increase.

Certainly an agency with five to ten employees should be carrying limits higher than one million dollars. A simple inquiry at renewal can be very valuable.

In the final analysis the limit of liability for your e&o is your decision. It should be a limit that you are comfortable with. However it should be a decision visited annually and using a logic that fits your situation.