

INSURANCE AS STRATEGY FOR MANAGING PROFESSIONAL LIABILITY RISK

Vera Karadjova

University “St. Kliment Ohridski”, Bitola
Faculty of tourism and hospitality, Ohrid
verakaradzo@yahoo.com

Svetlana Razmoska

tsvetle@gmail.com

ABSTRACT

Professional liability insurance is designed for businesses that sell their expertise, such as accountants, financial consultants, lawyers, engineers, architects. This type of insurance protects businesses and individuals who provide professional services to clients from the legal costs or for the damages that may arise from an act, omission or breach of duty in course of their business. Professional liability insurance is safety net for business mistake such as failure to deliver work product the clients expect and for which they paid.

On the insurance market in Republic of Macedonia are offered almost all type of products related to professional liability offered in the neighboring countries and in EU. The participation of this type of insurance in Gross Written Premium is increasing as well as the number of sold policies. But is this increase due to awareness of the businesses for the advantages of having professional liability insurance or it is related to legal obligation for buying this insurance in order to comply with legal requirements or acquire license/permit for certain profession.

The purpose of this paper is to analyze whether and to which extent the professional liability insurance is used as efficient strategy for offsetting the consequences and losses arising from professional liability risk.

KEY WORDS: professional liability, risk management, professional liability insurance, PL insurance products

INTRODUCTION

No individual or business is perfect. All participants in the economy are at risk of being sued when a mistake occurs or when there is omission to execute something important. So professional liability risk arises from professional services to clients i.e. wrongfully provided expertise in the area of architecture services, engineers, lawyers, accountants, financial consultants, analysts and similar.

For this type risk the most common strategy to manage it is buying professional liability insurance which is also known under other names such as Professional Indemnity insurance, Errors and Omissions Insurance, Civil Liability Insurance. The different names are due to differences in the basis of coverage: some of the policies cover negligence only (Errors and omissions) whereas the full Civil Liability insurance provides cover for all claims which are not explicitly excluded, much wider cover against multitude of eventualities.

CHARACTERISTICS OF THE PROFESSIONAL LIABILITY INSURANCE

Subject of this insurance is legal liability for damages occurred from errors and omissions during executing of the professional activity which can have catastrophic (financial) consequences and leave serious negative mark on the reputation and career of an individual or legal entity especially if not covered with such insurance. Professional liability insurance is an absolute must for business owners that provide a professional service.

What is usually covered with PL policy typical cover?

Claims not covered by general liability insurance but that are covered by professional liability insurance include negligence, misrepresentation, violation of good faith and fair dealing, and inaccurate advice.

Depending on the policy PL covers:

- Damages and claimant costs
- Legal and court costs
- Claims investigation costs
- Court attendance costs
- Public relations costs

Following damages usually are not covered:

- Intentional damage
- Known claims and circumstances
- Fraud and dishonesty
- Bodily injury/property damage

There are two types of professional liability policies: claims-made and occurrence. Most professional liability insurance policies are “claims-made”, meaning that the policy must be in effect both when the event took place and when a lawsuit is filed for a claim to be paid.

Professional liability insurance will pay the cost of legal defense against claims and payment of judgments, up to the limit of the policy. In general, coverage does not extend to non-financial losses or losses caused by intentional or dishonest acts. Other fees, such as licensing board penalties, may also be included. Policies for PL generally have a deductible. The amount of professional liability insurance needed and how much it will cost depends upon the size of the business and the level of risk it poses.

Professional liability insurance policies are usually arranged on a claims-made basis, which means coverage is good only for claims made during the policy period. Typical professional liability policies will indemnify the insured against loss arising from any claim or claims made during the policy period by reason of any covered error, omission or negligent act committed in the conduct of the insured's professional business during the policy period. Incidents occurring before the coverage was activated may not be covered, although some policies may include a retroactive date.

Concerning the Professional Liability Policy wording, some professional liability policies are worded more tightly than others. While a number of policy wordings are designed to satisfy a stated minimum approved wording, which makes them easier to compare, others differ dramatically in the coverages they provide. For example, breach of duty may be included if the incident occurred and was reported by the policyholder to the insurer during the policy period.

Wordings with major legal differences can be confusingly similar to non-lawyers. For instance, coverage for "negligent act, error or omission" indemnifies the policyholder against loss/circumstances incurred only as a result of any professional error or omission, or negligent act (i.e., the modifier "negligent" does not apply to all three categories, though any non-

legal reader might assume that it did). Meanwhile, a "negligent act, negligent error or negligent omission" clause is a much more restrictive policy, which would deny coverage in a lawsuit alleging a non-negligent error or omission.

This insurance does not apply to: Any "claim", "suit" or "wrongful act" that might result in a "claim" or "suit", of which any insured had knowledge or could have reasonably foreseen at the signing date of the application.

Errors and omissions insurance (E&O) as a type of professional liability insurance protects companies, their workers, and other professionals against claims of inadequate work or negligent actions. Errors and omissions insurance often covers both court costs and any settlements up to the amount specified by the insurance contract. This kind of liability insurance is generally required for professional advice-giving or service-providing businesses. Errors and omissions insurance protects companies against the full costs of a claim made by a client against a professional who provides advice or a service such as a consultant, financial adviser, insurance agent, or a lawyer.

For example, a client may sue an adviser or broker after an investment goes sour, even if the risks were well-known and within the guidelines established by the client. Even if a court or arbitration panel finds in favor of a broker or investment adviser, the legal fees can be very high, which is why E&O insurance is important. The benefits E&O insurance gives companies or individuals vary greatly depending on the policy and issuing insurance company. E&O insurance may or may not cover temporary employees, claims stemming from work done before the policy was in force, or claims in various jurisdictions. These policies do not cover criminal prosecution and certain liabilities that may arise in civil court not listed in the policy.

Insurance brokers and dealers, registered investment advisers, financial planners, and other financial professionals can obtain E&O insurance. Regulatory bodies or company investors often require E&O insurance. E&O insurance is also applicable to businesses outside the financial industry including nonprofits, general maintenance companies and contractors, and engineering firms. Any other company or professional who provides a service such as wedding planners and printers also need E&O insurance. Doctors, dentists, and other medical professionals also take out E&O insurance called malpractice insurance.

A person or company with numerous litigation problems has a higher underwriting risk and is likely to find E&O insurance more expensive or less favorable in its terms as a result.

Premium amounts for PL policies are unique to each business type and depends on several factors including: length of time in business, industry, geographic location, claims history, annual revenue risk management policies, amount of coverage requested, height of selected deductible.

PROFESSIONAL LIABILITY INSURANCE IN REPUBLIC OF MACEDONIA

On Macedonian insurance market the professional liability insurance is classified in Class 13 – General Liability Insurance (General and Professional Liability). The participation of Liability Insurance in the Gross Written premium in the period 2013-2018 varies from 2,5% to 2,7% which leads to a conclusion that despite the growth of the GWP the Liability insurance participation in the total GWP is remaining the same.

Table 1. Comparison of Liability products vs. total insurance products

	2012	2013	2014	2015	2016	2017	2018
Number of policies / Liability	14.223	17.031	20.793	24.542	31.583	37.484	41.446
Number of policies / Total	1.017.012	1.058.075	1.126.338	1.191.177	1.279.016	1.368.493	1.454.110
GWP/Liability (in 000 MKD)	140.316,00	160.758,00	178.608,00	192.431,00	200.607,00	203.375,00	212.179,00
GWP/Total (in 000 MKD)	6.415.488,00	6.464.042,00	6.742.404,00	7.178.720,00	7.429.950,00	7.546.224,00	8.257.687,00

Source: Insurance Supervision Agency

From the analysis of the reports issued by Insurance Supervision Agency it could be noted that the insurances related to Liability products is increasing with steady rate if compared in number of concluded contracts - policies. The most significant increase is noted in 2013 which in comparison to 2012 is for 20% and the highest increase is noted in 2016 where the number of concluded contracts for liability insurance is for almost 30% higher vs. 2015.



Picture 1. Number of policies and GWP for Liability insurance

Source: Insurance Supervision Agency

Within Liability products the General Liability Insurance is still primary in relation to Professional Liability when compared as part of Gross Written Premium for the General liability products forms around 67% of the Liability insurance GWP in the period 2013-2018. The other 33% of the Liability GWP refers to the Professional Liability insurance products which are part of further analysis.

Table 2. Comparison of PL products vs. total Liability products

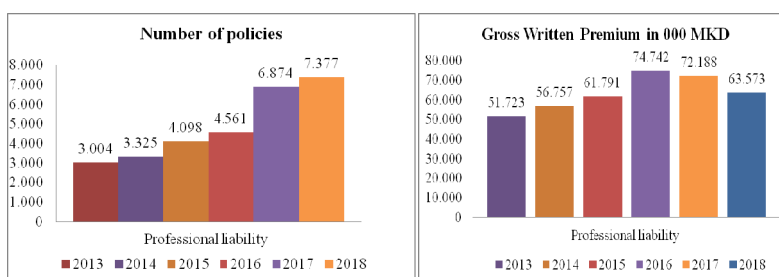
	2013		2014		2015		2016		2017		2018	
	No.of policies	GWP in 000 MKD	No.of policies	GWP in 000 MKD	No.of policies	GWP in 000 MKD	No.of policies	GWP in 000 MKD	No.of policies	GWP in 000 MKD	No.of policies	GWP in 000 MKD
Class 13 - Liability Insurance	17.031	160.758	20.793	178.608	24.542	192.431	31.538	200.607	37.484	203.375	41.446	212.179
Professional liability	3.004	51.723	3.325	56.757	4.098	61.791	4.561	74.742	6.874	72.188	7.377	63.573

Source: Insurance Supervision Agency

On the Macedonian insurance market it could be said that are present almost all insurance products related to professional liability offered in neighboring countries and in EU countries. For certain professions, buying professional liability insurance is a prerequisite for their execution. In line with that, the increasing of the specialization and professionalization of certain profession especially the intellectual ones set up new challenges for the legal theory – professional liability and the ability for its coverage. From there the most significant characteristic of professional liability insurance is the status as mandatory insurance. The other is that almost all PL products are related to the laws/regulations which regulate the corresponding area as: Law for valuers, Law for notary services, Law for audit, Laws in the area of medical services and similar. Namely without exclusions all insurance

conditions for the PL products as subject of insurance, limit of liability and especially in the part of the provisions that quote the exclusions from damage compensations are tightly connected to the law regulative i.e. what is out and not allowed in line with positive law, is excluded in the insurance coverage.

Despite its low participation in the GWP related to PL products, the professional liability insurance shows increasing trend if compared the number of policies issued.



Picture 2. Number of policies and GWP for Professional Liability insurance
 Source: Insurance Supervision Agency

The implementation and establishing of professional liability insurances on existing and on new professions besides from moral reasons (solidarity, third party protection), efficiency and in line with the examples from developed insurance countries show that with implementation of the mandatory status of the professional liability insurance leads to lower premiums if otherwise this insurance is left to be bought on voluntary basis. This conclusion can be seen from the graphs above if compared the years: 2016, 2017 and 2018. The number of policies is increasing while as the Gross Written Premium is decreasing.

Concerning the Professional Liability products the review of the offer presented by the insurance companies in Macedonia it could be stated that almost all insurance companies offer professional liability insurance for the following professions:

- Lawyers
- Notaries
- Bankruptcy trustee
- Mediators

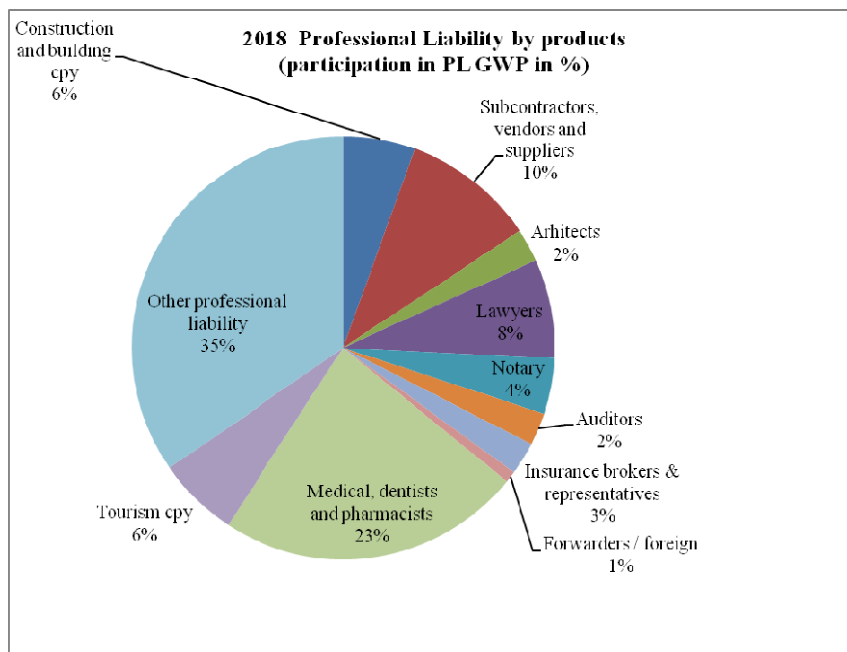
- Executors of court decisions
- Auditors
- Health workers
- Freight forwarders
- Tourist agencies
- Accountants
- Architects, surveyors, construction work contractors
- Forensic experts and appraisers
- Bodyguards, detectives, security agencies
- Usage of product
- Waste management and storage
- Waste transport
- Companies management
- Clinical examinations

All mentioned above professional liability products have numerous similarities but for every liability the insurance companies have created particular insurance contracts based on their experience and practice related to this type of insurance.

Although the PL insurance is increasing in numbers of concluded insurance contracts – policies (almost 41% from 2013 till 2018) this increase is mostly due to the law requirement in certain profession and connected to acquiring license for performing the activity or getting this type of insurance as requirement of a tender process.

Below is chart of with data of 2018 – participation of each PL product premium in the total.

In 2018 were concluded 7377 insurance contracts at GWP of 63.573.000,00 denars of which 3340 are for Health workers, dentists and pharmacist with GWP of 14.491.000,00 denars and 1968 are for other PL products with GWP of 21.580.000,00 denars which 56,73% of the total PL GWP for 2018 (Source: Insurance Supervision Agency data).



Picture 3. Participation of PL products in GWP for 2018
 Source: Insurance Supervision Agency

CONCLUSION

The demand for Professional Liability insurance is constantly increasing although not as predicted and desired by the insurance companies due to the increase in number of professionals in accounting, architecture, engineering, law, medicine, and other specialized fields. With so many business sectors experiencing growth in the current economy, the need for professional liability insurance should be incredibly high. At this period that is not the case. The professional liability insurance is bought only if required by law. Architects, IT consultants, engineers, and many other experts rely on Professional Liability coverage to protect them from claims of misrepresentation and negligence, regardless of fault.

To resume Professional Liability Insurance provides coverage and benefits for:

1. Expenses and costs related to a judgement
2. Expenses and costs related to a settlement
3. Attorney fees
4. Other expenses such as court fees and private investigators

Even if state laws or client contracts do not require purchasing Professional Liability Insurance, one should still secure a Liability policy to protect its business from any financial strain caused by a civil lawsuit. Purchasing Professional Liability temporarily so to have proof of coverage when bidding on work (then cancelling it) is not in best interest of the company or individual. What is best is to invest in a Professional Liability plan that will protect the business for years to come.

The offer of Professional Liability insurance products on Macedonian insurance market is diverse but as mentioned before the demand is still low and the sale concentrated mainly to the professions for which such insurance is mandatory i.e. depends on law requirements for some professions. For example as at 31.12.2018 in Macedonia were registered 7.474 authorized accountants, number which is beyond the number of total sold PL policies in 2018. If to this are added other professions as lawyers, notaries, auditors and professions for which there is no tailored PL insurance product we can reach to a much higher number than the number of total sold PL policies in 2018.

Also it is of importance to mention that the total number of active companies in Macedonia in 2019 is 75.914 among which 74.278 are SMEs. Professional Liability Insurance is not established just to cover the intellectual services by individual professionals but can be introduced in every company as part of the other insurance they buy – property and general liability. The SMEs should be taken as target market for offering PL insurance. Here the proactive approach of the insurance companies is needed i.e. of insurance professionals who can advise the clients appropriately of the advantages and protection offered with PL insurance. Even, when there is no mandatory requirement the professional liability insurance should be considered as normal and most acceptable protection from possible third party claim for damage compensation.

REFERENCE:

1. Marsh Limited, Understanding Professional Liability Insurance - A Friendly Guide for Advisers
2. William Douglas, ARM-P & Greg Kildare LA County Metro, Professional Liability Insurance White Paper
3. Michael McCoy, Partner Fowler Rodriguez, Professional Liability Claims And Coverage Issues
4. Zurich Professional Liability Insurance, Financial Institutions – Policy Wording
5. Scurria et al. BMC Research Notes 2011, 4:544 <http://www.biomedcentral.com/1756-0500/4/544>
6. Insurance Supervision Agency, Reports on the activities of insurance companies for 2013, 2014, 2015, 2016, 2017, 2019
7. State Statistical Office, T-01: Number of active business entities by sections of activity according to the National Classification of Activities NKD Rev. 2 and by number of persons employed, 2019
8. <https://www.mslawllp.com/faqs/professional-liability-faqs/> (assessed on 25.04.2020)
9. <https://www.lexology.com/library/detail.aspx?g=4697264e-d5e3-44ac-b3fa-ebf3b2a4a949> (assessed on 25.04.2020)