Real Estate E&O Insurance
Understanding the Basics
brought to you by NAR's Risk Management Committee

Risk management is both avoiding or mitigating inherently risk-potential situations in business and dealing effectively with problems when they inevitably do occur. One of the tools used by brokers to manage the risk exposure for their firms is insurance. The typical office will carry many different types of insurance ranging from fire insurance for the office and its contents to liability for vehicles to fidelity bonds for employees who handle the firm's money. One type of insurance that is unique to the real estate business is real estate agent errors and omissions insurance (Real Estate E&O insurance).

This guide is intended to help in two ways. First, it will assist brokers in making informed judgments regarding the purchase of E&O insurance products whether they are buying their first policy or renewing with an existing program. Second, the guide will also help sales agents in understanding real estate errors and omissions insurance and how it fits into their company's risk management program.

KNOW *YOUR* POLICY

- E&O insurance policies terms vary from insurance company to insurance company. Comparing policies and understanding your coverage requires you read the policy itself.

When buying E&O insurance the broker must realize that there is not a standard form policy. Each company will have written their own policy form with its own description of the coverage and the terms and conditions of that coverage. In general, E&O insurance provides coverage in instances where a real estate professional has failed to carry out his or her professional responsibilities or done so in a negligent manner. From that point the policies offered by different companies will begin to differ in their terms. To avoid comparing apples to oranges when shopping for E&O insurance, the careful broker will have to obtain the policy form and carefully read it. This brochure identifies seven issues you will want to understand when comparing different policies: who and what is covered; the conditions under which you are covered; the costs, limits and deductibles of coverage; and how your office policies can impact your insurance.

WHO IS COVERED BY THE POLICY?

- Will the policy cover the firm's employees and independent contractors?
- Are personal assistants covered if they are not employees of the firm?

Determining who will be covered under the policy is an important first step. There will be the named insured (the person or entity in whose name the policy is obtained) and whoever is included in the definition of that term. Knowing how the policy defines the "named insured" will answer questions such as: Are the firm's employees and independent contractors included in coverage? Are personal assistants (licensed and unlicensed) included, even if they are compensated by the salesperson rather than the broker? Are related companies also covered under the policy? This will also be particularly important to brokers who have formed multiple business structures to manage their affairs. Related firms, even those with common ownership, may not be included under the coverage provided by a real estate brokerage E&O insurance policy.

WHAT IS COVERED BY THE POLICY?

- Policy generally covers delivery of professional services by those insured
- There will be exceptions to the coverage that are listed in the policy and these must be read and understood
- Make sure the policy covers the aspects of the real estate business delivered by your firm
- Don't just accept exclusions that are important to your specialties, ask for coverage

Although the insurance covers liability for professional services you must review the exclusions from coverage. Each policy will identify circumstances under which it will not provide insurance coverage. The list of exclusions can be quite lengthy and it is important that each be considered in evaluating a particular policy. Some common exclusions include claims arising from: bodily injury; fraudulent or criminal acts by the insured; bankruptcy; discharge of or failure to identify pollution; mold; other environmental issues; employment related issues for the brokerage staff; misappropriation or commingling of funds; discrimination; related business activities such as property management, title insurance, property/casualty insurance or mortgage brokerage; violation of securities laws; and dealing in properties owned by the insured. While not a comprehensive list, the foregoing demonstrates that the coverage can be diminished by exceptions if the buyer is not careful in reviewing the scope of coverage the policy actually provides.

In states with mandated E&O insurance requirements, the scope of the policy's coverage may be a part of the statutory or regulatory requirements. Before selecting any carrier's policy it will be necessary to compare the policy's coverage with that of the state's requirements.

The policy review should also determine if the coverage fits the business of your brokerage. If you do not use lock boxes, a policy that excludes claims arising from their use will not be a factor in your decision, but if you use a lock box on all your properties it will be very important. Similarly, you will want to fit the policy to the types of transactions in which your brokerage specializes. A broker that does all commercial work is not going to want a policy that limits coverage to residential real estate.

Understanding the exclusions will also enable the broker to identify areas where critical gaps in coverage exist. It is possible to negotiate with the insurance provider and many, although not all, of the exclusions listed in the policy can be reinserted into the policy for an additional premium. It is not uncommon for insurance companies to have standard endorsements and fees for adding back coverage for exclusions that are listed in the policy. In reviewing the coverage exclusions in the policy, whether or not coverage is available for an additional fee should be reviewed with the insurance broker.

WHEN DOES COVERAGE BEGIN AND END?

- Understand the difference between claims-made and occurrence insurance policies and which would apply to your policy
- Make sure that there are not gaps in time when your coverage does not apply either before or after a new policy

Most E&O insurance will be sold as a "claims-made" policy. This is in contrast to most other insurance policies with which brokers are familiar that are sold on an "occurrence" basis. A claims-made policy only covers claims that are filed during the term of the policy and for a relatively short period of time following the policies expiration. Often there is a special provision dealing with coverage for claims which arise from events that occurred prior to the effective date of the policy. The event must have occurred during a specified period of time prior to the initial effective date of the policy and the insured must not know of the potential claim at the time the policy is issued. The policy may then provide coverage if a claim does arise from such an event during the specified time period prior to the effective date and the claim is filed during the term of the policy. Similarly, at the end of the policy there is usually a period of time during which claims can be filed if the event giving rise to the claim occurred during the policy period. However, if an event occurs during the term of the policy, but the claim is not made until after the expiration of the policy and the post expiration window for filing claims, then there is no coverage under a claims-made policy.

Understanding these time frames is vital, particularly for a brokerage changing insurance providers, if gaps in coverage are to be avoided. When changing to a new company the time frame for filing claims after the expiration of the policy can often be extended. Again, the length of extension that is desirable will be affected by the statute of limitations for bringing lawsuits against real estate agents. You should consult with your attorney to determine the appropriate amount of time for an extension.

HOW MUCH COVERAGE IS AVAILABLE?

- The dollar limits of your policy should be appropriate to your business risk
- What limits apply to the amount of coverage available for an individual claim
- Is indemnity for any liability included or only defense cost
- How will frivolous complaints be handled and can insured exercise any control over their settlement

Understanding the amount of coverage is also important to understanding what is being purchased. While the face amount of the policy may be obvious, the insurance buyer should ascertain whether the policy includes a "per claim" limit and/or an "aggregate" limit for all claims during the policy term. Many policies contain both limits.

It is also important to understand the difference between coverage for defense costs and indemnity. Indemnity coverage is for the amount of damages that the insured may be liable for as a result of the claim. The maximum limit the insurance company may be liable for in connection with indemnification is the amount of the policy limit. Defense costs are the cost of defending a claim and are generally not subject to the policy limits expressed in the policy. There are, however, some types of claims for which the insurance only provides defense cost and not indemnification. In those instances there are likely limits on the amount of defense costs that the policy will provide.

Control over the coverage is another important aspect of the insurance policy. Many brokers believe that although settling “frivolous” complaints for their nuisance value may make economic sense in the short run for the insurance company, in the long run it may encourage more lawsuits to be filed against the brokerage. That would cost the brokerage more money in deductibles and could even end up making the brokerage look like a bad risk for the insurance company resulting in either higher premiums or even cancellation of the insurance. For brokerages where this is an issue, brokers are going to want to investigate a special endorsement to the policy which requires that the broker consent to any settlement proposed by the insurance company.

This “consent” endorsement gives the broker a degree of control over the coverage that does not exist if the provision is not included. However, the broker must fully understand the consequences as they relate to the coverage if a proposed settlement suggested by the insurer is rejected by the broker. These may include caps on subsequent amounts the insurance carrier will pay for settlement or defense costs.

DEDUCTIBLE EXPENSE

- The size of the deductible will impact the cost and availability of the insurance
- Deductible may be applied to an entire claim or just any indemnity that has to be paid

One of the principal means the insured has of effecting the cost of the insurance is the deductible. In some markets brokers may find it necessary to accept substantial deductibles, essentially self-insure the amount of the deductible, in order to obtain affordable insurance against the possibility of a very large claim.

How and when that deductible applies differs in different policies and understanding how it applies in connection with a policy affects the value of that policy to a broker. There are two principal ways in which deductibles are applied in the event of a claim. In some policies the deductible applies only to indemnity payments and all defense costs are paid by the insurer. In most policies however, the deductible must be paid by the insured before the insurance company will pay anything towards the defense of the claim.

OFFICE POLICIES OF THE BROKER

- Strong risk management policies can help control the cost of insurance and may assist in broadening the areas the policy will cover
- The portion of the premium paid by licensees and how it is paid should be explained in the office policies
- Responsibility for paying the deductible should be a part of the office policy
- Integrate your office policies with the insurance policies to assure they do not conflict

Before beginning the process of shopping for E&O insurance the broker should prepare a summary of the office policies that have been established to eliminate or minimize situations in which the brokerage may be sued by clients or customers. The summary should include not only the processes used in the office (e.g., standardized forms, property condition disclosure requirements, broker supervision of sales people, use of state mandated forms, etc.), but also the client or customer relation steps taken to address potential problems before they lead to lawsuits or claims. What has the company done and what is it doing to minimize the risk exposure and how successful have these efforts been for your company.

Using this summary of your company's policies and their effectiveness to demonstrate why an insurance company would want your company as a customer can influence the availability of insurance for your company in at least three ways. First, your summary will demonstrate the importance of risk management in your office and if these policies have resulted in no or very few claims against the company, more insurers may be interested and will to insure your company and compete for its business. Second, insurers sometimes have different rates at which they will offer policies based upon a company's loss experience or other factors. Showing your company is a "good risk" may get you the best available rate from that insurer. Finally, some policies precondition certain types of claims on the insured having taken specific steps, for example using a property condition disclosure form. If your summary of office policies demonstrates that you meet the condition, then you are maximizing the scope of the coverage under the policy.

It is common for licensees in the office to participate in the payment of the premium and the deductible for any claim arising out of the actions of the licensee. The expectations should be carefully spelled out in the office's policies and in the agreement maintained with the independent contractor agents in the office. Each agent should have indicated that they have read and understand this provision along with the balance of the office policies.

Understand any obligations you may have to assure that a claim will be honored. In particular you will want to be sure you know where and when claims must be reported and what information must be included. As importantly, you should also know what may and may not be done by you in attempting to resolve the claim as the policy may penalize you if you have compromised any defenses you may have had to the claim.

COST OF THE INSURANCE

- Start early so you can comparison shop whenever possible for insurance
- Take control of the process by knowing who is reviewing your insurance needs
- Use your office procedures to make you look like a better risk to insurance companies

To get the best price it is sometimes necessary to shop with different companies. In preparing to do so the broker should identify all the companies offering E&O insurance in your marketplace and whether these companies are themselves good insurance risks as providers. If you are a good risk you want all of these companies competing to get your business. If you use multiple insurance brokers, make sure to know who (which insurance companies) the insurance broker is planning on working with to place the insurance. This will enable you to avoid making your company look desperate by having your information sent multiple times to the same insurer.

When discussing the cost of the policy brokers should use their office risk management plan have a plan which includes all of the reasons why the broker and his or her firm are good risks for the insurance company and should receive the best premium quote. The broker should also determine what services or benefits (in addition to the insurance itself), that the insurer may provide to assist or even supplement the broker's existing risk management program. You may be able to replace elements of your risk management program with something provided at no additional cost by the insurer.

The cost of the insurance is far from the last consideration in selecting a policy, but it is only after comparing these other factors that anyone can truly compare the value of different policies. The purpose of this brochure is to provide brokers with a quick reference they can use to help in determining the value of a policy. This brochure is not intended to be a substitute for the assistance of a qualified insurance specialist in accessing your insurance needs, but it does raise the important issues you should consider when buying E&O insurance for your firm.