MANAGEMENT & PROFESSIONAL RISKS

LANGUAGE MATTERS

The Significance of Extended Reporting Periods

It is abundantly clear that not all Management Liability ("ML") policy wordings are of the same quality. The difference is perhaps more acutely observed when comparing off line language with e-traded/statement of fact based policies, an environment where contracts are engineered around the absence of underwriter intervention. This is understandable, given that operational framework, but a lack of finesse might not always be obvious on a straightforward reading of a policy wording. And in some vital areas, such as reporting periods, this can present some challenging situations.

'Extended Reporting Periods' ('ERP's') or 'Discovery Periods' are often conflated with 'run off', essentially because they are the same thing i.e. a period of time after a trigger event during which a claim can be reported which relates a wrongful act committed or allegedly committed prior to the date of such trigger event. The difference between the two is what pulls these triggers, and also one of timing. A policy should provide two options on an ERP:

1. In the event of acquisition or change in control of the policyholder, a range of pre-quoted options up to six years should be available; and
2. In the event of a 'refusal to renew' the policy at what would have been the renewal date, options should also be available up to the most commonly advised period of six years.

These options will specify limits on the time available to activate them and pay the premium (typically 60 days), and this is understandable because policyholders will have greater control of the premium availability and payment closer to the trigger event date. Moreover, the insurer cannot give an open ended option without creating the possibility that the policyholder could wait to see how their risk landscape develops before they pay, particularly as there is not normally a requirement to complete any forms (a fresh warranty in situations 1) or 2) above would be somewhat counter intuitive). If this 60 day window is missed for whatever reason, underwriters may engage in a discussion about 'run off'. As we have said, this is the same as the invocation of the ERP in point 1 above, simply done at a later date. The difference here might be that, at this stage, it is likely to involve fresh disclosures and any "run-off" terms provided may well be on a more restrictive basis of cover.

It is also important to distinguish between 'bilateral' ERPs and 'unilateral' ERPs. The preference should always be to have a bilateral position, which means that the ERP can be invoked in consequence of the policyholder or the insurer refusing to renew the policy (refusing is not usually a defined term so takes an everyday meaning). This is much more policyholder friendly than the unilateral version, which only allows the ERP to be invoked if the insurer refuses to renew. This is a crucial difference because, no matter how unpalatable the terms on offer might be, this will not constitute a refusal to renewal.

A well-constructed policy should embed both options in the standard language. However, a review of most of the low-touch products clearly shows a lack of availability of ERPs of any kind. At this point it is next to impossible to obtain the cover the client may seek unless, and this seems to be uncommon, the incumbent underwriter consents to the availability of options outside of the policy framework. It is most frequently here that the realisation that there is a dead end is reached. One other quirk of recent years is for go-forward cover to stop on a sale of the majority of assets (both on and off line wordings). This can also lead to some rather awkward scenarios which are equally difficult to navigate.

So whilst there may some advantages to online trading, language sophistication does not appear to be one of them and such trade-offs should at least be considered before the point in time is reached where room for manoeuvre no longer exists.

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