



I Still Owe How Much? Dealing with Auditable Policies

Even in today's "buy now/pay later" society, no one is overjoyed when they receive a bill some time after the sale, especially if the bill is a surprise or for more than anticipated. This is true in the insurance business as well. While premium audits may be a routine necessity for many types of insurance (i.e. workers compensation or business interruption), customers still seem surprised when the audit indicates they owe an additional premium.

This is an area where agents often face errors and omissions claims. A typical claim looks something like the following: A new customer comes into the agency needing to replace his workers compensation policy—often right as his previous policy is expiring. While completing the application, he does not have the information with him to give you the number of employees, work classifications or payroll amounts. In order to get the application completed and submitted, he gives an estimate. A quote is received based on the estimate and the customer accepts and submits the premium down payment. At that point, payments are set up and everything appears fine. No revisions or updates are made on the estimates and the customer continues to make the premium payments.

Fast forward to two years later when the carrier decides it is time to do a premium audit on the policy. Suddenly, the customer finds himself receiving an "unexpected" premium invoice for the back amounts owed. Faced with paying what can sometimes be a hefty amount, the customer is now looking for someone to share the burden. Often, that someone is their insurance agent. It is not unusual for the customer to start pointing fingers at the agent claiming that the agent should bear these costs since premium audits were not explained to him, or even claiming that the agent told him to underreport the payroll to save on premiums.

Another variation on this claim is when the customer undergoes rapid growth and takes on new employees without notifying the carrier or updating the policy. Sometimes, the claim relates to a misclassification of the type of employee (i.e. office clerical instead of laborer). This can result in a reclassification of the employee on the audit and an increased premium based on a riskier class.

This type of claim is not limited to workers compensation; it can occur on any policy that has a premium audit provision (i.e. business interruption). Furthermore, it is important to note that many of these policies allow for audits to occur up to three years later. As you might imagine, a three-year audit could generate a significant premium deficit and create a cash flow issue for the customer.

While nothing you do can guarantee that a claim won't be made against you, there are some things you can do to help prevent claims and make them more defensible.


Know your products. You should definitely know which of the policies you sell have premium audit provisions.

Know your customer. You should know something about your customer. Is he new to commercial insurance? Is this her first policy with an audit provision?

Make your client aware of the audit provision. While it might not be your legal duty, it does not hurt to advise your client of the audit provision. This will allow him to make better estimates in order to avoid later premiums, or at least, minimize them. He will also be able to update the carrier during the policy.

Is their estimate correct? While you may not be responsible for making an estimate (on payroll for employees), you might want to make sure that your customer is aware of the impact underreporting might have on the ultimate premium she will pay. At any rate, it might not be a good idea to tell her that she should underreport.

Document! As with all errors and omissions defenses, documentation helps you defend the claim. Document that you explained the premium audit provisions. A note in the file is helpful. A letter confirming is even better.

Helping your customer plan his premium payments and avoid surprises will go a long way towards avoiding errors and omissions claims. 

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Keeping Track of Documents

Workers compensation policies are among the most common types of auditable policies. In addition to explaining how such a provision works, a value added service you could provide for your customer would be to remind him to keep good records so that a premium audit will go smoothly. Some of the documents he might want to keep track of and be prepared to produce for the carrier or its auditor would include the following:

- Payroll register
- Financial statements
- 1099, W2 and W3
- Unemployment tax reports
- Tax returns
- Overtime wage records
- Benefit plans and records
- Bank statements and checks
- Subcontractor records of same

In addition, you might want to suggest that your customers keep track of the actual duties of employees, which is especially useful if they need to prove the work classification of an employee.

—C.P.