Coverage Crossroads

Distinguish between occurrence and claims-made policies

By Matthew Davis

How do you decide between occurrence (coverage for loss events that occur during the policy year) and claims-made (coverage for claims made during the policy year) insurance policies?

Though the vast majority of the language contained in these two policies may be identical, a subtle shift in the DNA of one versus the other can lead to very different outcomes. And take it from an E&O professional: they're not all good.

Most coverages tend to be written on one form or the other, but a few can be written on either. Assume, for example, that a claims-made policy provides "full prior acts" coverage: In the event of a claim on an undiscovered error that happened years ago, it will be covered even though the policy in place at the time of the mistake has long since lapsed. That's the beauty of claims-made coverage.

Now the peril: If an unsuspecting broker receives a quote on replacement coverage, they may well find a surprisingly competitive price. Either the broker is great at their job, or they failed to note that the replacement policy will switch the insured's coverage from claims-made to occurrence—creating a coverage gap.

Where the renewal policy would have continued to provide "full prior acts" coverage for past years of mistakes, the occurrence policy provides coverage for loss events in the current year, but not for prior years. As a result, the customer now lacks coverage for past events that could still remain within the statute of limitations for filing civil lawsuits.

Changing from one claims-made policy to a competitor's? Some policies include a "retro date" at inception of the first policy that denies coverage for any negligent acts or losses in prior years even though no claim has been made. Of course the replacement policy is priced lower: It cuts off years of potential liability, which the renewal policy would continue to cover—an apples-to-lemons comparison if ever there was one. Tail coverage is likely available from the current carrier, but add that cost to the would-be replacement policy for a more accurate side-by-side comparison.

Switching from occurrence to claims-made can also cause problems. In theory, a series of occurrence policies would provide protection for those prior policy years, with a new claims-made replacement policy simply adding to the coverage. But the agent may find their customer's final occurrence policy imposed a time limit on reporting new claims that would not have been an issue had that policy renewed. Couple that with a claims-made policy that sets a retro date at policy inception, and we're back to a serious coverage gap—despite the fact the policy periods fit edge to edge with no daylight between.

Study your options carefully before making a decision for your clients—and choose wisely.

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