Professional Indemnity.co.uk

What you need to know about...

...run off

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0345 251 4000

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Run off cover is a professional indemnity insurance policy which comes into effect when a business stops trading and any claims made under it will relate to work carried out before trading stopped.

The key to understanding run-off cover is in understanding the "claims made" nature of the protection. Given that you have probably already been purchasing professional indemnity (PI) insurance for some years you will appreciate that PI policies are all underwritten on what is referred to as a "claims made" basis as opposed to "claims occurring".

The claims made basis of professional indemnity insurance means that a policy always needs to be in force to ensure that you have cover should a claim be made now for work undertaken in the past. Run off cover is a professional indemnity insurance policy which comes into effect when a business stops trading and any claims made under it will relate to work carried out before trading stopped. This is particularly important to partnerships where liability isn't limited and can't simply be wound up.

How does run off work?

PI provides cover to firms, whether they are limited companies or partnerships, including LLPs or sole traders. It covers the businesses principal or partners the directors and the staff both past and present. A run off PI policy will provide ongoing protection to cover the cost of defending any claim made against those insured under the policy and will reimburse the losses occurring should the claim be upheld against the insured parties.

Retirement is a typical reason for run off insurance which is required by smaller firms or sole traders. For larger firms the business is often sold or taken on by a younger principal who maintains the PI Insurance and continues the PI policy. This is not always the case, as the new owner may not be prepared to take the businesses legacy liabilities.

The consequence of this is that it may be necessary to keep a run-off policy in force after closure to cover any claims that may arise in the future.

Who needs it?

When any professional practice comes to an end, it can be essential that it continues to maintain PI cover for claims which may be made after the practice has ceased to trade.

There are many reasons why a professional practice may come to an end, foreclosure, sale, merger, acquisition, or it may be the owner has just reached a point where they want to cease to trade and either retire or do something else instead. In all these cases run off insurance is either desirable, sensible or a regulatory requirement.

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Claims for losses caused by a negligent act can be brought under contact law or tort and a professional's duty to their client does not necessarily end just because the business entity ceases to exist. A client can claim against the professional long after the business has gone.

Once clearly defined and distinct, the responsibilities of the professional have changed over time. Traditionally, people like accountants, surveyors, engineers, solicitors and architects, were seen as 'professionals', but these days those who offer a wider range of services are seen as professional.

Anyone holding themselves out as a specialist, expert or consultant could be held responsible for negligent acts, errors and/or omissions by clients who claim reliance on the services or advice provided.

Going into run off

Once you have decided you need to provide run off insurance for your business you need to advise your current insurer.

If your policy has a while to run before its renewal date, you will need to inform your insurer that you have ceased trading. They will attach an endorsement to your policy stating that cover will not be provided for any service or work provided after that date. At the next renewal the insurer will offer run off renewal terms and may ask you to complete a proposal form as in the past, so as to establish what work you undertook from the last renewal to the date your company closed.

You will have the option to then either take up the run off policy for another twelve months or not. If you renew the policy it should carry the same terms and conditions as the previous policy but it will also now include the new endorsement noting the run off date. Insurers will respond to any claims notified or made against you during this new policy year so long as the work was undertaken prior to the run off date.

If you do not take up a new policy and or make any alternative arrangements your professional indemnity cover will cease and any claims brought against you for work undertaken in the past will be uninsured. You should remember, even spurious or speculative claims require a defence and without Professional Indemnity Insurance cover these can be damaging.

Traditionally, run off insurance would be maintained in this way every year for up to six years. Six years is the period many professional bodies require their members to carry run off PI for, this is therefore a good benchmark to use for all professions. That said there are other factors that should be taken into account when considering the period that run off needs to be maintained for and which may result in a shorter or equally longer period of cover being more relevant.

How long should run off insurance be maintained?

There is no set answer to this question, and will vary between individuals. Other than the guidance provided by the various professional bodies, a significant factor in determining the length of cover is the relevant limitation period fixed by law - the time limit within which any claimant must commence proceedings against a professional.

A professional indemnity policy will potentially cover liability in both contract and tort. Clients can sue for negligent acts within six years of the work being finished - the time limit for a claim under breach of contract. Clients can also sue within six years of suffering damage or loss caused by negligent advice or other work - the time limit for a claim under tort law. Non-clients can also claim in tort if the professional in question is found to owe them a duty of care.

The delay between a negligent act taking place and the loss or damage suffered means that a claim in tort can be made several years after the deadline for contract-based claims. If the agreement between the parties is drafted as a deed, the deadline for making a claim in contract can be extended to 12 years after it is completed, while the time limit for making a claim in tort can be extended by up to 15 years where claimants can prove there was hidden damage which was unknown to them and which they could not reasonably be expected to have discovered at the time.

Appointment and Collateral Warranty contacts, if signed as deeds can extend the time that Run off insurance needs to be held after the closure of the practice, many of these contract stipulate in contract what the professional's obligations with regard to coverage and periods. Careful consideration of such contacts should be given and legal advice is always recommended.

A single premium multiple year run off policy

Although run-off is generally purchased each year as a 12 month policy, it is also possible to purchase a longer period policy, paid for with a single up front premium. There are only a limited number of insurers who provide run off cover on this basis where cover can be purchased for up to six years cover. We always suggest that businesses and their principals seek legal advice on the liabilities and obligations they have with regard to their business including any ongoing contractual obligations they may have. They can then decide what period of cover to purchase.

Advantages

- Cover is boxed off, no need to go through the renewal process every year
- Premiums paid up front from the closing business, which has also on occasions been more efficient

- If there are any changes in market rates you will be unaffected as your premium has been paid for already

- More often this method is cheaper and more cost effective (long-term) than purchasing annually

Disadvantages

Biggest risk is that there is no guarantee that the insurer will be around for six years. However before any proposition is put forward we carry out checks on the Financial Strength and Stability of the insurer that is put forward.

- The method will obviously cost more in the short-term than purchasing run off for just 12 months

- If the principal returns to work the option of covering the previous work on a new PI policy is lost and this may have been a more cost efficient proposition.

What is the cost of run off?

The problem with run off insurance is the problem of the premium still needing to be paid each year, particularly when there is no further income coming into the practice to pay it.

Generally the premium in the first year after closure is the same as the proceeding last year of trading. The tail of the potential liability takes a number of years to show any significant decrease so from an insurers perspective there is as much chance of a claim in the first few years of run off as before.

After the first full year of run-off, premiums should start to show signs of reducing and we would normally expect them to fall by between 20% and 25% per annum subject to claims and the market rates not increasing.

At Professional Indemnity Insurance Brokers we regularly advise clients on run off. To talk to an adviser please call us on 0345 251 4000.