Claims-made vs. occurrence trigger

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This resource kit will outline the differences between an occurrence and claims-made policy.

The tail policy
The policy with a long tail is the one we generally know as an occurrence liability policy. With this policy, the covered event, an occurrence, must take place during the policy term. Once that condition is met, a claim arising out of that occurrence will be covered regardless of when it is actually presented. The insured could be sued during the policy period or five years later (the tail). In either case, coverage for the suit under that policy would apply just the same. An occurrence policy requires us to keep track of one (occurrence) date in relation to the policy term in order to determine whether coverage has been activated.

While this policy has a long tail, it nevertheless has the misfortune of having no nose. The nose is coverage for occurrences which take place prior to the effective date of the policy. (The nose also is referred to as "prior acts" coverage.) With an occurrence policy, the insured will need a policy for every occurrence in the past that leads to a claim. A business that has been operating for 20 years will need 20 continuous policies to obtain full protection for all claims which proceed from all past occurrences.

The trigger
For many types of injuries there is no difficulty in identifying the precise trigger for insurance coverage, because the injury and the event causing the injury appear simultaneously. For example, an auto accident or a slip or fall will normally cause immediate injuries that can be traced to one moment in time when the event occurred.

However, the kinds of latent injuries that typify long-tail claims are not so easy to pinpoint within a specific policy term. Latent injuries caused by asbestos, silica, beryllium, formaldehyde, toxic wastes, pharmaceuticals, and medical procedures can lead to trigger confusion. Is the trigger the moment the first contact (or mistake) was made, when the cumulative damage was done, when the diagnosis was made or when the suffering begins? I don't think you will be surprised to discover that the courts have come up with more than one theory on this trigger question.

Exposure theory. Coverage under this theory is triggered by the entire period of time that a claimant is exposed to harmful conditions. If exposure occurs over many years, then every policy in force over those years could be triggered.
Manifestation theory. Coverage under this theory is triggered by the time that the injury manifests itself, when the claimant knew or should have known of the illness or injury. Presumably, this would limit the trigger to one policy period.

Injury-in-fact theory. Coverage under this theory is triggered by the time injury actually occurs, which may be some period of time other than the exposure to harmful conditions or the manifestation of injury. When this theory is applied, multiple policies may be required to respond to a claim.

Continuous theory. Coverage under this theory is triggered continuously from the first exposure to harmful conditions through to the manifestation of the illness or injury. All policies in force during the exposure and manifestation would be triggered, as well as all policies in between when the illness or injury was developing.

While the stacking of multiple policies triggered by the exposure theory, the injury-in-fact theory and the continuous theory produces desirable results for the claimant, the insurance industry does not find this outcome manageable from an actuarial point of view. In addition, insureds who do not maintain complete records of past policies are left without the ability to enforce the coverage they had. Even if a 20-year-old policy can be found, a lot can happen to an insurer in that period of time. Also, the limits may be inadequate by present standards. The insured could end up liable to the claimant without sufficient insurance protection.

The nose policy
As an alternative, the insurance industry conceived a way to make a single policy respond with contemporary limits to a claim presented during the current policy term. For exposures having long tails, insurers now offer a claims-made policy instead of an occurrence policy. This policy bundles past occurrences (the nose) into present coverage. It responds to a claim first made (look for clarification in the policy on what is meant by "first made") during the policy period, or any extended reporting period, for an occurrence which falls after the retroactive date but before the expiration date of the policy.

Professional liability insurers used this concept years before general liability insurers took an interest in it. Insurance producers need to be familiar with claims-made policies, if for no other reason than to understand their own insurance agent/broker errors and omissions policy.

You might find it curious that a policy designed for long-tail claims does not even feature tail coverage (coverage beyond the policy period). This is because it is looking backward to prior occurrences, where such occurrences produce injuries having long tails, to provide coverage for a claim presented today.

Most state laws have limited the types of risks than can be insured on a claims-made policy. Consequently, the Insurance Services Office Inc. claims-made commercial general liability policy (CG 00 02), which was introduced in 1986, stays on most insurers' shelves. The types of risks that do get written on a claims-made basis are environmental liability, professional liability, medical malpractice liability, directors and officers liability, employment practices liability, fiduciary liability, excess liability, products liability, completed operations liability, employee benefits liability, and large risks qualified by some threshold for size. Some of the covered events in the insuring agreements of these policies are expressed as occurrences, errors or omissions, accidents, wrongful acts, negligent acts, or incidents.
In referring to the claims-made policy as a nose policy, one might assume that unlimited prior occurrence coverage is available to the insured. In contrast to the Pinocchio character, the nose on a claims-made policy theoretically starts out long, but can get shortened. Full nose coverage is achieved by specifying in the policy that no retroactive date (retro) will limit coverage for past occurrences. To shorten the nose, a retroactive date may be entered on the declarations page indicating that no occurrences prior to that date will be covered for claims presented during the policy period. The nose can be 20 years, five years or one year. In fact, the nose can be cut off entirely by stating the policy's effective date as the retroactive date, leaving the policy both noseless and tailless.

Ideally for the insured, the nose should cover the entire period that the insured has an exposure to loss that is not covered by other insurance. Generally, this will be the entire time that the insured has been in business or the time the insured was functioning in a capacity subject to liability. If the insured was covered by occurrence policies for a portion of this time, the nose should be long enough to span the gap between the expiration date of the last occurrence policy and the inception date of the claims-made policy. The nose must fill the gap because the occurrence policy will not respond to an occurrence that falls after its expiration date. (For that matter, neither the claims-made nor occurrence policy covers occurrences that fall after the expiration date of the policy.)

### The implanted tail

There is one thing in particular about claims-made policies that will keep you and your clients on your toes at policy inception and renewal time—the retroactive date is a negotiable item. As a result, an opportunity exists for the insurer to cut off part or all of the nose. Anytime the nose is insufficient to cover the entire period at risk, there is cause for alarm.

At policy inception time, the applicant is at the mercy of the marketplace; one insurer may offer adequate nose coverage (if, in fact, any do) and another may not. If the last policy was an occurrence policy, then there is no gap to cover with the nose coverage so the retroactive date will likely be the effective date.

Since the premium on a claims-made policy increases each year as another year of nose coverage is added to each successive renewal (usually, these premium increases are phased out after several years; five years with the ISO CGL policy), it is possible that the insured might request an advanced retroactive date to keep the premium lower at policy renewal time. More likely, though, the insurer will be the one to initiate moving the retroactive date forward to preclude nose coverage for the prior policy period(s).

This is where extended tail coverage comes into play. Most claims-made policies offer (state law often compels them to offer) some type of basic extended reporting period (BERP) and supplemental extended reporting period (SERP). The BERP (short tail) comes automatically without charge, and the SERP (long tail) may be purchased as an option. The length and terms of these tail coverages can vary by state, by line of insurance and by the insurer, so careful analysis will be required. Thus, when the retroactive date is advanced, a SERP may be purchased to cover the gap with tail coverage; ideally, with one covering an unlimited time period. Should the SERP provide unlimited tail coverage, the claims-made coverage for the risk embraced by the SERP then becomes the equivalent of occurrence coverage.

There are other underwriting actions besides moving the retroactive date which could leave an insured vulnerable. An insurer might terminate the policy, substitute an occurrence policy or carve out of coverage a specific accident, product, work, location or operation with some type of laser beam
endorsement. Each of these will put an end to some or all of the tail coverage. In order to provide seamless coverage, an occurrence policyholder requires continuous coverage in the past and a claims-made policyholder requires continuous coverage into the future (assuming there is full nose coverage). When an insurer chops off the nose or eliminates coverage with an underwriting action, the need to purchase a SERP is certain to follow.

Minimum standards
Many states promulgate minimum standards for claims-made policies. Often, the time period offered in the BERP and SERP found in the ISO claims-made commercial general liability policy (the form frequently used for teaching purposes) is more generous than required by state law. Unfortunately for policyholders, unlimited extended tail coverage is more difficult to obtain in most markets than may be suggested by the terms of the ISO policy.

If you sell claims-made policies, it is important for you to know the minimum policy standards applicable in your state.

PIA—your best source of information