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Ensuring Continuity of Coverage on Claims Made Policies: Directors and Officers Liability and Employment Practices Liability Coverage

The term "continuity" is frequently used when discussing directors' and officers' liability insurance; employment practices liability insurance and other claims-made policies. The objective is to see that the original coverage is maintained, without gaps, as insurance is renewed from year to year.

The "chain of continuity" begins when coverage is first written for an insured. If coverage renews with the incumbent insurer, continuity is maintained at the anniversary and thereafter, as long as coverage is maintained with the same insurer. However, if the insured opts to renew with another insurer, continuity may or may not be maintained.

Ideally, to maintain "full" continuity the insurer issuing the renewal policy should allow for the backdating of the pending and prior litigation date to the initial date coverage was written. The insurer should also provide full prior-acts coverage. Any departure from this process could adversely affect the insured's coverage.

Continuity of coverage in the context of a D&O/EPLI policy means "reporting" continuity, not actual policy coverage continuity. In other words, from one policy term to the next, an insured may experience a change in policies. When considering whether or not to grant continuity, the new insurer would review the detailed underwriting application to examine the risk. This means that insurers do not automatically grant continuity simply because there is an existing policy. A decision is made based upon the specifics of each risk.

When a D&O or EPLI policy is initially written the insured completes a long form application which includes warranty questions. For example: "Is any person or entity proposed for this insurance aware of any fact, circumstance or situation which may result in a claim against the organization or any of its directors, officers or employees?" Once the corporation's chairman, CEO or president signs the completed application it becomes part of the policy.

The insurer materially relies on the warranties in the application to issue coverage. Breach of the warranties can affect the outcome of a claim settlement.

Ideally, to maintain coverage continuity, a new insurer should agree to use the inception date of the insured's initial D&O/EPLI policy as the new pending and prior litigation exclusion date. A new insurer may agree to keep the expiring policy's pending and prior litigation exclusion date if the insured provides copies of all notices or claims given to previous insurers.

The reality is that the insured most likely will not be able to maintain full continuity of coverage when moving from one insurer to another. Most often a new long form application will be completed or a previous policy's pending and prior litigation date will not be honored.

The pending and prior litigation exclusion bars coverage for any prior or pending litigation that is known, including any facts or circumstances the insured had knowledge of prior to the time the policy was written and/or of which any notices were given to any prior insurer. The reason for pending and prior litigation exclusion is to ensure that a new insurer does not have to pay a claim arising from active or pending litigation that an insured knew about before the effective date of the new coverage. After all, the insured should have notified the previous insurer of all such litigation or incidents that could lead to claims.

Because of threats to coverage continuity it is usually desirable for the insured to maintain coverage with the incumbent insurance company. Unfortunately, the insured often gives a lot of weight to price and may not attach much importance to continuity. A good insurance broker however will make sure that client fully understands the importance of a loss of continuity and will do everything possible to have the new insurance company offer this important protection without a gap.