Why E&O Audits for Small Agencies (or any agency) Should Not Be Feared

by Chris Burand

I've heard quite a few owners of small agencies avoid E&O audits because they feared the results would cause more damage than the benefits generated. In fact, beyond possibly minimizing future E&O claims, and I emphasize "possibly," these owners did not see **any** benefit to an E&O audit. Thoughts like those trouble me because these owners are foregoing considerable benefits including, in some cases, significant discounts on their E&O premiums, helping their agencies run more easily, and definitely making their agencies safer from suits because their fears are so great. Fears often have the consequence of causing people to forego considerable benefit. Fears can be rational or irrational, it does not really matter and in agency owners' situations, some of their fears are indeed irrational relative to E&O audits.

Here are some of the fears I have heard and my response. I can only speak to how I do E&O audits and not others, so please do not read into this any universal promises.

- Concern: When the E&O carrier sees the audit results they will nonrenew my policy or at least jack up the rate.

  Reality: This is a possibility. I have only seen this happen once in 25 years but it was combined with a large E&O claim. Maybe without that large claim, the agency's rate would not have increased or maybe without the audit but with the claim it would not have increased. The underwriter would not tell my client.

  With that one exception, rates usually decrease especially if the carrier offers a discount for completing the audit. They are pleased the agency is taking steps to minimize the odds of incurring a claim which means the agency is taking steps to increase the carrier's profitability. The carrier understands that without an audit, the agency may be following potentially injurious processes (or lack thereof). The audit simply specifies which of those processes exist but they know a plan has been developed to fix them. This fear is somewhat akin to not going to the doctor. If I don't go to the doctor, I won't get a serious disease. Obviously that is wrong. If you don't go to the doctor, you just won't know you're dying of a serious disease until it is too late to fix. E&O audits are quite similar.

- Concern: The procedures the auditor recommends only fit large agencies.

  Reality: If this is the result, get a different auditor. With a few exceptions that are almost always tied to group benefits and surety, the recommendations specific to a certain exposure are the same regardless of agency size, all else being equal. In other words, an exposure relative to proposals has the same solution regardless of agency size.

  Can large agencies institute the solution more easily? Sometimes they can because they have more resources but quite often in my experience, their size is more of an impediment than a benefit. Large agencies have to get so many layers of management to approve changes that improvements take forever. Then, almost inevitably, someone has a personal stake in leaving things the way they are even if that way is wrong.

The reality is that what makes a difference is the level of leadership and commitment to becoming a better agency without regard to agency size.

- Concern: I will not have enough time to implement the auditor's solutions which will cause a problem with the underwriter.

  Reality: I have never seen this happen if the agency works diligently. Even when the agency did not get everything done but could show the underwriter they were working hard, the underwriter has given them more time. I cannot speak for all underwriters everywhere, but they generally seem pleased to see significant improvement even if it takes longer than expected.

  The exception is the agency that does not do anything until the deadline approaches.

- Concern: I will have to institute the auditor's recommendations.

  Reality: This is generally true unless the agency can make the point the auditor misunderstood the situation. In other words, if the auditor has correctly identified a material exposure, why would an agency owner refuse to implement a reasonable solution?

  I have met several agency owners who have advised that if they personally have to abide by rules that reduces their E&O exposure but takes away their freedom to operate however they want, it is not worth it to them. That is a personal choice and generally a bad business decision, but it is yours to make.

- Concern: Procedures will reduce profitability/efficiency.

  Reality: This is not true unless an agency is cheating, unethical or so sloppy they are lucky to not have already been sued out of business. Good procedures reduce E&O exposures and increase efficiency, at least the way I recommend procedures be instituted. During the transition, productivity is affected but a few months, sometimes only weeks, of extra work is worth a decade of extra efficiency.

  The reason good procedures benefit E&O and efficiency is because CSRs can operate more quickly since they do not have to look as hard to find data, they get the data they need the first time and because they see the agency being run fairly because everyone has to follow the same rules. It is not unusual for my clients to increase productivity at least 10%.

- Concern: The auditor will identify an exposure but not a practical solution.

  Reality: I ALWAYS provide a workable solution. Sometimes an agency owner may not like the solution but that is different from providing a workable, reasonable solution. A few exposures exist where an agency principal may not understand how to implement a solution which is different from the auditor not providing a solution. A good and simple example is a coverage rather than a procedure. Business income is a coverage that I find many agencies avoid discussing with clients in detail because they simply do not know how to discuss it. If an auditor makes a recommendation and you simply do not know how to deal with it, ask. I can only speak for myself but I am happy when agents ask for more help because it means they want to improve.

Another example involves factors like creating proper contracts and following certain rules where owners and producers regularly argue they should not be required to follow the auditor's recommendation because it will cost too much money. I cannot judge what "too much money" means to any given person. However, a claim is likely to cost far more and these steps almost always bring additional benefits. One of the best benefits of a good E&O audit that is followed, is the agency becomes more professional in a completely positive sense. The result is an agency that is easier, not harder, to manage.

- Concern: An E&O audit, if followed, will reduce sales.

  Reality: Agencies that actually follow the recommendations, at least the way I do audits, almost always increase sales. A common reaction a year or two later is, "I didn't believe you and I didn't want to believe you when you said your recommendations would increase sales, but they did."

  Does the sale take more time? Yes, but the agency makes more money, builds a better client relationship and reduces E&O exposures.

  Does the sale potentially require more knowledge? Yes, but that is why clients and carriers need agencies. If they do not need on-the-ground knowledge, they can sell just as effectively, for less money, through the internet and 800 numbers.

An E&O audit results in entirely positive results if an agency embraces the opportunity to improve its services to clients, decrease its E&O exposures, increase sales, and often improve the workplace environment for its staff.

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