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Insurance Tips and Traps for Consultants

By Scott Simmonds

Let's try to simplify some of the insurance issues consultants have to deal with in running their practices.

Errors & Omissions

Also called professional liability insurance, E&O coverage protects consultants from suits alleging poor decisions or bad advice.

Policy Language - There is no standard professional liability policy for consultants. Each insurer will offer its own coverage. A detailed analysis of the insurance contract is required to judge the coverage offered. The exact definition of "wrongful act" can affect coverage. What is specifically excluded from coverage? Does the insured have the right to refuse a settlement offer in a claim? Does the policy pay on behalf of the insured or indemnify the policyholder?

Wrongful Act - Professional liability insurance protects consultants from allegations of a "wrongful act" defined by most policies as "An act, error, omission, misstatement, misleading statement or neglect or breach of duty". Policies specifically don't cover bodily injury, property damage, and claims arising out of the use of a car, boat or plane. Also excluded are claims resulting from an employment injury or employment practice. All such events are covered by other policies—general liability, auto liability and workers' compensation insurance, for example. Professional liability insurance protects a consultant from allegations that the job was not done right or that the job was not done well enough.

Defense Costs - In addition to any award that is made against a consultant in a lawsuit, professional liability insurance pays for the cost to defend a suit. Many errors and omissions policies pay defense costs from within the policy limits. If you have a \$1,000,000 policy, the cost of your attorney is part of the maximum payment of \$1,000,000.

Claims Made Coverage - Most liability insurance policies (general liability, automobile, workers' compensation) pay for events that occur during the policy period. For example, an auto insurance policy will pay for an accident that occurs while the policy is in force. Professional liability insurance is usually on a "Claims Made Basis"—the policy pays for lawsuits brought during the policy. Many legal actions are brought years after the actual event occurs. Allowing coverage to expire can jeopardize protection.

Deductibles - Sometimes called retentions, deductibles are the part of the claim you pay before the insurance company steps forward. High deductibles (\$5,000 or \$10,000) are a great way to control premiums.

Disability Insurance

Insuring your earning capacity is vital. Even the young and strong become disabled. Actuarially, a 35 year-old is seven times more likely to be unable to work due to accident or illness than he or she is of dying.

Limited Selection - Many insurance companies will shy away from freelancers and consultants. The concern is with the volatility of income and the lack of workplace supervision/outside judgment on work output. Those new to consulting may have a tougher time qualifying for coverage without an earnings history. Workers compensation may be a valid alternative in many states where business owners can buy coverage on themselves. Obviously protection is limited to work-related accidents. We work all the time, though, don't we?

Coverage Amount - Most insurers will tell you the amount of coverage they will offer based on your income history. It will usually be about 60% of your net income. Some insurers will reduce the coverage based on fluctuating income or for working out of the home.

Waiting Period - Think of this as a deductible. It's the time you must be disabled before the insurance will start paying—30, 60, 90, 120 and 365 days are normally offered. The longer the waiting period, the lower the premium is.

Own Occupation - Different insurers use different definitions of disability. The best use something like, "the inability to perform the major activities and duties of your own occupation." Looser definitions can be as broad as, "The inability to perform any occupation." Such are less desirable. However, they are less expensive. Have your agent explain the policies being presented to you.

Length of Coverage Period - Once you become disabled how long will the policy pay? Common terms are 1, 2, and 5 years. The best policies cover you until you become 65 years old. The longer the term, the more expensive the policy is.

Premiums - Some policies cannot be cancelled unless you stop paying premiums. Some premiums stay the same throughout your life. Work with your agent. Insurers will charge you more if you are sick, on medications, or overweight.

Payout Increase With Cost Of Living - Many policies contain a rider that increases the benefit based on a cost-of-living index. Some allow you to increase the coverage while you are healthy, without evidence of insurability.

Life Insurance

If others are dependant on your income or you have large debts, then you need life insurance. I like term insurance from a strong company. The only people I hear from that recommend universal life or whole life (also known as "permanent insurance") are selling the stuff. Term coverage lets you buy a lot of death benefit for a relatively low premium.

Consider multiples of your income as a method for deciding how much insurance to buy. Review your family's needs with you out of the picture. Then determine the principle needed to generate that amount over a number of years. Think of life insurance as a way to fund a savings account on which your family can draw if you die.

If you make \$75,000 your family may need 70% of that to live on. Using a financial calculator you can determine how big a pot of money you need at a certain interest rate for \$52,500 to be paid in interest. Some people want the income stream to last forever—some want the money to last for five or ten years. My website has a free calculator that will do the math for you—www.insurancewiz.biz. Go to the section on free stuff.

Once you know how much money your family needs you can determine the amount of life insurance. Some people just buy seven times their salary. Some buy seven times their income plus \$50,000 for immediate expenses.

The key is planning and follow-through. Oh, make sure you have a will too.

Home Office Coverage

Many consultants operate out of a home office. Don't rely on your homeowner's insurance to protect your business property. Also, the homeowner's policy will not provide you with business liability coverage. Talk to your agent about a "Business Owners" policy.

Auto Insurance

Most consultants are adequately covered by a personal auto policy. Make sure your agent knows that you use the car in business, though. You should have at least \$300,000 of liability coverage. Consider a \$1,000,000 umbrella policy for extra liability protection. Buy the offered coverage when renting a car from Hertz, Avis or another short-term rental company. Their contracts make claims a nightmare. Your credit card company may provide collision damage waiver coverage as a cardholder benefit. Call the toll-free number on the back of your card.

Workers' Compensation

Workers' compensation pays for injuries to employees. Most states require coverage if you're an employer. The premium should be about \$300 for an office assistant. You may be able to buy workers' comp on yourself as a way to buy some protection if you can't find health or disability insurance. Talk with your agent.

Pick Your Agent

Your agent should have a working knowledge of professional liability insurance and the marketplace for consultant's errors & omissions. Talk with your peers and friends. Not every insurance agent has the expertise to find you the right coverage. Find one agent for all your insurance needs—business and personal. Sit down with your agent at least once a year to discuss your business and insurance needs.

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Scott Simmonds, CPCU, is an insurance consultant. He and his firm, Insurance Consultants of Maine, never accept fees or commissions from insurance companies or agencies. His work for insurance buyers is unbiased. Scott can be reached at www.icofmaine.com or 207.284.0085.