The Insolvency Exclusion

Christopher J. Boggs, CPCU, ARM, ALCM, LPCS, AAI, APA, CWCA, CRIS, AINS
Executive Director Risk Management and Education

In the most basic terms, the insolvency exclusion is designed to dissuade an agent from placing business with a carrier that is known to be financially unstable, is not financially backed by a third-party fund or governmental body, or is not the "market of last resort."

Policy exclusions exist for one of six reasons. One is that the loss is not unexpected. When coverage is placed with a financially questionable insurance carrier, it is no surprise when it fails. This lack of fortuity (unexpectedness) is the reason the insolvency exclusion exists within the E&O policy.

When coverage is placed with a carrier that becomes insolvent during the policy, there is no E&O coverage when/if the insured sues the agent because of the insolvency. But there is a "however" that gives coverage back when specific qualifications are met.

The E&O policy still responds to suits if the agent placed coverage with:

- a carrier rated B+ or better by AM Best at the time of placement;
- a carrier rated A or better by Demotech at the time of placement;
- a carrier protected by the state Guaranty Fund or that has similar governmental protection; or
- a "market of last resort" such as a FAIR plan or other residual market.

Notice the "or;" this means that if any of these conditions is met, the E&O policy defends and pays the loss. One other note, the "time of placement" is the beginning of the current policy period, not the time of the initial placement.

Perhaps a few examples:

- Assume the agent places coverage with a risk retention group that has **no** AM Best or Demotech rating or a rating lower than B+ for AM Best or A with Demotech at the time coverage is placed. During the policy term, the insurance provider becomes insolvent and cannot pay claims to or on behalf of the insured. If the insured sues the agent because of the carrier's inability to pay due to insolvency, there is no E&O protection.

- However, if the carrier in the first example **is** protected by the state's Guaranty Fund, then coverage does exist.

- Assume the agent placed coverage with an insurance carrier that was rated A- by AM Best when the coverage was placed. For various reasons the carrier becomes insolvent during the policy term. Because the carrier's AM Best rating was better than B+ at the time the coverage was place, the claim would be covered.

Knowing the insurance carrier's financial condition is important. Failure to place coverage with a financially sound or financially protected insurance carrier is detrimental to the insured and the agent. The agent must undertake to know the financial condition of the carrier (using AM Best and Demotech ratings) and make sure the carrier is backed by the Guaranty Fund or other such mechanism.

Insurance is intended to provide a source of financing when something bad happens. If the insurance carrier can't provide this source of funds because it is insolvent and has no protection, and if the agent did not fulfil his/her duty to place the insured with a financially sound or protected carrier, there is no E&O protection.

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