Avoid Insurer Insolvency Claims

Monitor carrier ratings to mitigate risk.

By David Hulcher

The number of insurer downgrades in 2003 continued to outpace those upgraded, according to a report by A.M. Best Co. One of the primary reasons for this continuing trend is the adverse loss development from prior accident years and a volatile investment environment that weakened insurer balance sheets. For agents, insurer downgrades can present an E&O exposure to insurer insolvency if not properly managed.

Stay Vigilant

An agent can't be held responsible for the ongoing solvency of an insurer, but by doing some due diligence you can avoid potential E&O claims from the inability of an insurer to pay your clients' claims. Continually monitoring the financial stability ratings of insurers that you represent should be a consistent agency procedure. A key element is monitoring insurer ratings throughout the client's life cycle. This includes not only monitoring the insurer rating at proposal time, but periodically checking it throughout the year—especially at renewal time. The financial stability of carriers can quickly deteriorate, and staying abreast of these changes is important. There a number of companies that provide insurer ratings based both on quantitative and qualitative factors, including A.M. Best, Moody's, Standard and Poor's, and Weiss.

Establish a Baseline

As a first step, establish a standard agency baseline for insurers' financial strength. To determine this baseline, examine the protection offered under your agency E&O policy. When the market began to harden several years ago, many agents E&O carriers were influenced by reinsurers to start placing insolvency exclusions on policies. Coverage afforded by insolvency endorsements varies from carrier to carrier, so you should review your E&O policy.

Most E&O carriers structure insolvency endorsements to exclude coverage if agents place business with an insurer rated below a certain level, such as "B+." Some also may not provide coverage for specific insurers. Look closely at any insolvency endorsement to determine at what point a rating downgrade affects coverage. For example, is the insurer rating at the time of placement used to evaluate if coverage exists? Or, is the rating during the actual policy period used? If it is the rating at the time of placement, insolvency coverage could exist if the insurer rating changes during the policy period. However, at renewal, the policyholder would need to move to a market with an acceptable rating, according to the insolvency endorsement.

Other than what is outlined in E&O insolvency endorsements, what baseline rating should an agency use as minimum criteria? It is recommended to place business with carriers that have ratings from A++ ("Superior") to B+ ("Very Good"). Insurers in this range have strong balance sheets and operating performance with the ability to meet their claims obligations. Insurers with ratings below this level may be vulnerable to adverse underwriting performance and economic conditions.

Get It in Writing

Your agency sometimes might be required to offer coverage through an insurer below the B+ level or use one that is not rated. In this case, make the policyholder aware (through a signed disclaimer) that the insurer is rated below those generally used by the agency. Policyholders always should make the decision to place their coverage—not the agent. Here is some sample disclaimer language your agency can use in this situation:

"A rating is an indication of the insurance company's financial strength and operating performance, with the top rating being A++ (Superior). Our agency, generally, does not place coverage through any insurer that has a rating of less than B+ (Very Good). However, based on our search of the insurance marketplace and with your authorization, we will place your coverage at the premium amount outlined in our proposal. While A.M. Best Company's rating reported it was financially stable at the time it was reviewed, this is no guarantee of future performance. We are not experts in the financial analysis of insurance companies. Should this company become unable to satisfy its obligation to pay claims; our agency will not be held responsible for the insolvency of the carrier."

Keep Clients in the Loop

If an insurer is downgraded during a client's policy term, the agency should have a procedure in place for notifying insureds in writing. The notification can outline that the agency can transfer coverage to another carrier at the insureds' request. If the insurer rating drops outside of the agency's baseline, then the insured should be notified of the intent to move coverage to another insurer (with the permission of the insured) upon expiration.

Continually monitoring insurer ratings and only using those insurers that meet or exceed the standard baseline can minimize exposure to E&O claims. This will make the agency more attractive to E&O carriers, help to avoid E&O claims and help maintain more stable E&O premiums. **IA**

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