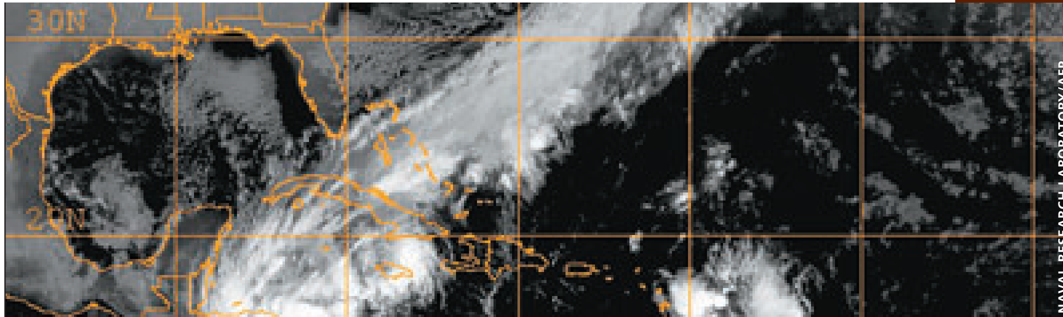
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Hurricane Season Raises Solvency Concerns

The 2005 hurricane season inflicted unprecedented damage and raised concern about how these losses will affect insurance carriers' financial strength ratings. Independent agents may recall the insolvency of Legion Indemnity Company in 2002. Once a pillar of the insurance world with A.M. Best ratings in the A– range, Legion's rating went from an A– (excellent) with a steady outlook to being declared insolvent and placed into liquidation within a two-month period. Millions of dollars in unpaid property and liability claims, many of which became errors & omissions claims against insurance agents across the country, soon followed. So it's understandable if your agency is apprehensive about what will happen with carriers' ratings in the not-so-distant future.

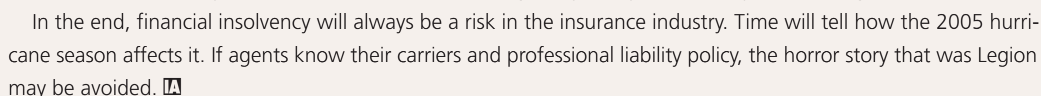
When it comes to insolvency claims, regardless of how the claims are couched in law, the allegations generally are that agents had a duty to properly investigate the carrier's financial solvency and ability to pay claims timely and in full. If agents are able to establish that duty, claimants merely point to insolvency and failure to pay claims as evidence of the agent's negligence and breach of that duty. If you haven't looked at your agency's E&O policy to see how it addresses insurer insolvency, do so today. You don't want to learn that the E&O policy contains an insolvency exclusion that, in many cases, excludes professional liability coverage for these claims. If you don't have coverage, your agency could spend hundreds of thousands of dollars of its money to defend and settle lawsuits, which can mean great personal loss—and even bankruptcy—for the agency's principles.

While there is no foolproof method for agents to completely avoid the risk of carrier insolvency, several steps can minimize it. First, know the carrier. Following rating agencies' embarrassment at Legion's surprising and quick demise, they made investigation techniques and rating standards more stringent. Thus, the industry rating agencies are the best place to look to determine if a particular carrier is an appropriate risk for the client. Agents can utilize more than one rating agency to investigate the carrier and can monitor those ratings throughout the year and during renewals. Even with the more stringent rating criteria, changes in a carrier's fortunes may happen quickly, as well as the subsequent rating downgrade.

Unfortunately, many carriers and programs are not rated by the industry rating agencies. While not inherently bad, vigilantly investigate these carriers' financial well being. How long has the carrier and program been in existence? Who or what is behind the program? How is it reinsured? What is their reputation for paying claims? Use the state insurance department as a resource and talk to agents who write business with the carrier.

Finally, in regard to E&O coverage, read over your professional liability policy, particularly the insolvency exclusion. Many exclusions have conditions that, if met by the carrier, will avoid the preclusion of coverage in the event of an insolvency. Each exclusion is different. Some exclusions are not triggered if the carrier is rated above a certain level by a particular rating agency or the carrier is admitted and subject to the state's guarantee fund. If the carrier does not meet the insolvency exclusion's conditions for coverage, any policy written may be at the agent's risk.

In the end, financial insolvency will always be a risk in the insurance industry. Time will tell how the 2005 hurricane season affects it. If agents know their carriers and professional liability policy, the horror story that was Legion may be avoided. IA


Nate Bunck (**nate.bunck@ge.com**) is a GE Insurance Solution claims specialist.

Take these steps to avoid E&O claims relating to the insolvency of carriers:

1. Review your E&O policy to see the financial strength rating of carriers required to be in place for coverage to respond.
2. Establish a minimum baseline for the carriers that your agency is willing to use. An example may be only using carriers with ratings from A++ (superior) to B+ (very good).
3. Continually and consistently monitor the financial stability ratings of the carriers you represent on a periodic basis.
4. If you have to place coverage with a carrier rating below your agency's balance, let the policyholder ultimately make that decision. If they decide to go with a carrier below your baseline, get it in writing that this is not your agency's normal practice and the agency will not be held responsible.
5. Keep the policyholder in the loop if the carrier is downgraded. Let the policyholder know that if the carrier drops below your baseline that you will move them at renewal.

—N.B.

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