

How Insurance Warranties Affect Your Clients

After loading the car with ski equipment and plenty of DVDs to entertain the kids, we set out for the 10-hour drive from Kansas City to Denver. Thirty minutes into the trip, the DVD player stopped working. We called the car dealership from the cell phone and found out the DVD player was still under warranty. Halleluiah! The warranty would pay for everything. This did not matter to our 8 year old; all she knew was that she had to endure 9.5 hours across the “scenic plains” of Kansas with no TV. Are we there yet?

Although warranties in insurance policies are similar to product warranties in the sense that they are based on representations, insurance warranties operate much differently. E&O claims arise when policyholders are left without coverage because of warranties made on applications or because of a failure to follow a warranty condition in the policy.

All insurance applications require the applicant to tell the truth. An applicant who misrepresents information on his insurance application (e.g., poor driving history, previous losses) risks the carrier denying or rescinding coverage. In some jurisdictions, carriers can deny or rescind coverage if there is any material misrepresentation on the application. Representations are material when the misrepresentation affects the carrier’s underwriting decision—whether or not to write the risk and the premium to charge. In other jurisdictions, the material misrepresentation must be germane to the loss. In other words, if the applicant states that his vehicle has an alarm system, the carrier would not be able to disclaim on a collision claim. On life insurance applications, there is typically a contestability period, usually two years, which means that after the contestability period ends, the carrier must prove fraud (a much higher standard than material misrepresentation) in order to deny or rescind coverage.

However, when an insurance application requires the applicant to “warrant” that all or some of the information on the application is true, the carrier can deny or rescind coverage simply by establishing that the information warranted to be true is not true. There is no requirement to demonstrate materiality to the underwriting decision or any nexus to the cause of loss. Obviously, agents should always counsel clients on the importance of giving a complete and truthful disclosure. However, it’s important for agents to understand the difference between mere representations and warranties so they can counsel their clients to take extra care in responding to such application questions. Courts typically disfavor application warranties; however, carriers can create them with clear and conspicuous language. The penalty for untruths on warranted responses are severe—and difficult for the applicant to avoid after the fact. The applicant is then left to blame his agent for telling him to complete the response as he did. When an application calls for warranties, it’s especially important to document that the applicant’s answers were his own and, as always, it’s critical that the client sign the application in his own hand.

E&O situations also arise when the policyholder claims that the agent did not explain the warranties and that he was therefore unaware of them, or when the policyholder asserts that the agent knew that the warranties were being breached but continued to provide coverage knowing that the warranties were being violated. Agents should write clients to remind them that their policies contain warranties and that failure to follow the letter of the warranties could jeopardize coverage. Agents with knowledge that warranties are being violated should write to the client advising that he should cure the warranty breach as soon as possible and alert the agent when accomplished. Send a copy to the carrier. That way, there is no question that the insured knew what he had to do in order to keep coverage in place and that the carrier had the choice to cancel the policy. [LA](#)

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Policies & Warranties

Insurance policies themselves also can contain warranties, which fall into two general categories: “affirmative warranties” and “promissory warranties.” Affirmative warranties promise that the state of the risk reflects particular specific conditions (e.g., a monitored alarm system, or that no flammable materials are stored). Promissory warranties promise that the insured will do or not do specific things (e.g., lock all doors before moving jewelry from the showcases to the safe or maintain all required licenses in good standing).

Many jurisdictions require that policy warranties be delivered to and separately signed by the insured in order to be effective. Agents should deliver policies containing warranties as promptly as possible and return the signed warranties to the carrier as quickly as possible, retaining a copy in the agency file. A carrier that cannot disclaim coverage because of an undelivered or unsigned warranty delivery will look to the agent’s E&O carrier if the agent negligently failed to do what was required to make the warranty operative.

—T.R.