

Too Good To Be True?


Nobody purchases insurance hoping to have a claim, but when a claim does arise, customers want the carrier to be in a financial position to pay it. Consequently, when placing business, agents should verify the financial stability of the insurance carrier. Not only does it benefit the customer who may face the potential for non-payment of claims if the insurance company becomes insolvent, but it also helps protect the agency due to the “insolvency exclusion” that is found in most insurance agents’ errors and omission (E&O) policies. In addition, most E&O policies now contain a “fraudulent entity exclusion” that will limit or exclude coverage if the underlying policy is placed with a fraudulent entity instead of a reputable insurance company.

In these difficult economic times, even the biggest insurers are not immune to financial problems. So what can an agency do to protect its customers and ultimately itself? Before placing business with any carrier or other entity, do a little bit of due diligence—review AM Best, for instance. If a carrier is not rated, look at its financial history and stability. Is the carrier covered by a state guarantee fund and, if so, does the guarantee fund place a limit on recovery (which may be much lower than the policy limit)? Even highly-rated carriers sometimes deteriorate quickly. If they do and you have done some due diligence, you will at least know that you have done your best for the customer and you may prevent a claim against you. Even if you are unable to prevent a claim, you might make the claim more defensible.

In addition to protecting your customer, taking some extra time to make sure you place your customers with an appropriately-rated carrier may also preserve some of your coverage under your E&O policy. Some E&O policies will not apply the exclusion if you meet certain criteria. Review your policy to know the criteria. An example of an exception would be placing the business with a company that had a certain minimal rating by AM Best, such as B+. You may also be protected if there is a state guarantee fund in place that applies to the carriers that you are working with.

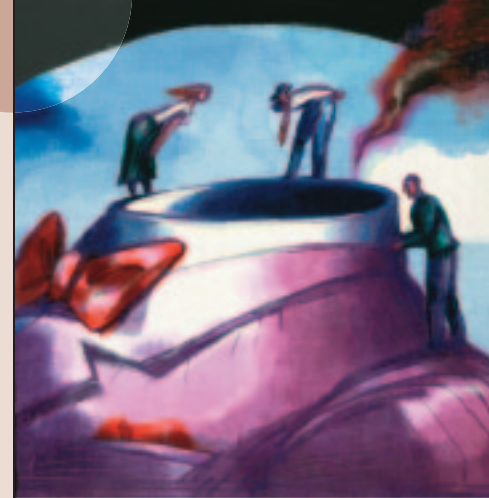
Problems can arise when the customer doesn’t qualify for placement with the B+ or higher rated carriers or the customer chooses not to pay the premium. This may be a good opportunity to walk away from some business that in the end might be more costly for you. If, however, you plan to write the coverage anyway, make it clear to the customer that the quote is from a lower or non-rated company and that there are potential risks. Have the customer sign off on the decision. While this procedure may still not bring you into coverage with your E&O carrier, it may make a claim against you more defensible. Swiss Re policyholders can find sample client letters to use in these scenarios at www.independentagent.com/EOhappens under the “Getting Started (Prevention)” tab.

Many customers, and eventually agents, have been burned by placing business with some new “program” that is marketed to be much cheaper than traditional insurance only to find out when a claim is made that the entity did not exist or the money collected has already disappeared to an off-shore account. If the insolvency exclusion was not enough to take you out of coverage for this type of activity, a “fraudulent entity” exclusion found in most E&O policies would clearly take away your coverage. Avoiding these situations is generally your best bet to prevent claims.

Whether dealing with lower or non-rated carriers or entities, remember that if it appears to be too good to be true, it probably is. 

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Fraudulent Can Mean No Coverage

A recent insolvency claim involved an agent’s placement of a bond. The agent advised the customer that the surety was not domiciled in the United States, was not Best-rated and even had the approval of the customer’s bank before obtaining the bonds. This still did not prevent the agent from being sued when the underlying bond claim was not honored because the surety and surety underwriter were fraudulent. Although the insolvency exclusion in the agent’s E&O policy did not apply because the surety was not a legitimate company formed for the purpose of providing insurance, the “fraudulent entity” exclusion did apply, since the surety was deemed to be a fraudulent entity (an organization that does not have a legal identity or legal existence, but which is represented to legally exist; or a legally formed entity that is used as a device to commit fraud or other unlawful acts). Consequently, not only was the agency facing a potentially large E&O claim, it was doing so without any E&O coverage.

—C.M.