E&O Risk Management: Meeting The Challenge Of Change

Compliance with State and Federal Laws

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Compliance with State and Federal Laws

Objectives:

- ***Understand the need to comply with both state and federal laws and regulations.***
- ***Discuss potential laws that may apply to agents.***

WHAT'S COVERED:

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INTRODUCTION

An agent's most basic obligation is to comply with state and federal laws, including statutes and regulations. It is important to understand what laws apply to agents and what they must do to comply with them. Not following the law opens agencies up to the risk of the following:

- Fines,
- Loss of license,
- Potential crime penalties,
- Damage to reputation,
- And loss of customers.

Below is a sample list of some state and federal laws with which an agent may need to comply. This list, however, is not intended to be exhaustive. We suggest that you consult with your attorney or your Big "I" state association to discuss the laws that affect you.

Section 1: State Laws

Unfair Trade Practices

These laws address acts an agent should not engage in. Since insurance law guides these practices, it would be unnecessary for an agency agreement to outline illegal or tortious practices. Although each state's laws are unique, virtually every state's laws are based on the NAIC model act and prohibit:

- Defamation - The act of making untrue statements about carriers, customers, or other agents which damages a reputation.
- Misrepresentation - Misstating facts about coverage or services offered by the agency to obtain money, goods or benefits of another to which the accused is not entitled. This can include misleading the carrier as to material facts affecting a policy or settlement of loss, either by directly or indirectly lying. This can void policies.
- False Advertising - The use of false or misleading statements in advertising the agency's services.
- Unlawful Rebating - An inducement to purchase an insurance policy that is not in the insurance contract.

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Unfair Claims Practices

Agency staff should be aware of their state's claims practice laws which protect insureds and claimants during the claims process. Although these laws directly apply to insurance carriers, agencies may also have claims handling authority and, therefore, may also be required to comply. Each state's laws are unique, but most address various issues of unfair handling of the claim including:

- Timeframes for communications with claimants and insureds
- Timeframes to deny or affirm coverage
- Timeframes for making claim payments
- Coverage and policy provision misrepresentation

Section 2: Federal Laws

Although the McCarran-Ferguson Act (Public Law 15) establishes that insurance regulation rests with the states, there are some federal laws that also affect the operations of an insurance agency.

Fair Credit Reporting Act (FCRA)

This act is not specific to the insurance industry. Rather it applies to any industry that accesses personal financial information or "consumer reports" which is very broadly defined. The most common issues for agencies relating to FCRA are the furnishing of Motor Vehicle Records ("MVRs") on drivers to their employers who are the agency's insured. The act protects consumers against improper handling of this information and establishes procedures for protecting the information. Your state may also have its own laws which may be even more stringent than their federal counterpart. It is important that agents be familiar with the requirements and restrictions of the FCRA and to be informed on the distinction between using MVRs for insurance underwriting versus employment.

Gramm-Leach- Bliley Act (Financial Services Modernization Act of 1999) or "GLBA"

GLBA puts great restrictions on "non-public, personal financial information" (NPFI). The agency must therefore be very careful how and to whom it shares NPFI of its insureds. The law also imposes strict but vague requirements regarding security and integrity of data. Lastly, GLBA requires that each "financial institution" – which includes insurance agencies – to send an annual privacy notice to personal lines customers, just like banks and credit card companies do.

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Sarbanes-Oxley Act (SOX)

Following a number of high profile corporate accounting scandals, SOX was enacted and contains specific mandates and requirements for the financial reporting of public companies.

Electronic Signature in Global and National Commerce Act (ESIGN)

Most states have their own law relating to electronic signatures. This, however, is a federal act that outlines guidelines for intrastate commerce. ESIGN has the general intent of assuring that a contract or signature may not be denied legal effect solely because it is in electronic form.

Telephone Consumer Protection Act (TCPA)

The FCC and the FTC have established a national "Do-Not-Call" list which prohibits telemarketers from calling parties unless they have an established business relationship. It also generally prohibits most unsolicited facsimile (fax) advertisements.

CAN-SPAM

The FCC has enacted rules that prohibit sending unwanted commercial email messages to wireless devices and computers without prior permission. Commercial messages are those that primarily advertise or promote products or services.

HIPPA

The Health Insurance Portability and Accountability Act (HIPAA) requires the security of health data and non-public information.

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Risk Management Tip:

This list is not exhaustive and there are numerous other laws and regulations that bear on the operations of an insurance agency. It is important that agency management keep up to date by regularly reviewing insurance related publications and taking advantage of insurance-related education opportunities offered by the national and state IIABA associations. The Legal Advocacy section of www.iiaba.net maintained by IIABA's Office of the General Counsel provides an excellent resource for learning more about federal laws and regulations affecting the insurance industry.

Discussion Topics

- ***What are some state laws that most prominently affect agencies duties to customers and their operations and procedures?***
- ***What are some recent laws for which agents may not be fully aware?***
- ***Protection of personal information is a major issue, what are your states requirements? What types of private information does your agency collect?***

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E&O Risk Management: Meeting The Challenge Of Change

Understanding Agent Duties

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Understanding Agent Duties

Objectives:

- ***Understand duties owed to clients.***
- ***Explore what determines an agent's standard of care.***
- ***Considerations in managing legal duties and a running an agency.***

WHAT'S COVERED:

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INTRODUCTION

Do you know the legal duties that you may owe to customers? Do you have an obligation to advise customers of the need for coverage, to determine values, or to offer increased limits? Understanding the duties you owe to customers is critically important as the minimum duties can lay the foundation for how your agency operates. It allows the agency to consciously decide on the level of service it provides to customers and put procedures in place to minimize E&O exposures for going beyond the legal duty.

This section will explore how an agent's standard of care is determined along with key components for determining negligence on the part of the agent. Legal standards vary by state in establishing an agent's duties. The concept of balancing your legal duties to the customer while running the agency in a way that creates more customer value and increased agency revenue is also explored in this section. It is important to remember that just because an E&O claim is made against the agency, it does not mean that the agency's duties to the customer were breached or that negligence exists.

DUTIES TO CUSTOMERS

In all states, agents/brokers can be held liable for their negligence in providing services to their customers. Each state's laws differ regarding the duties an agency owes to its customers. Similarly, different states have varying requirements of establishing standards of care with respect to the relationship between an agent and its customer. Awareness of the standard of care is a baseline for establishing how an agency operates including whether the agency simply takes customer orders, specializes in certain coverages, or performs more thorough risk analyses in an effort to advise customers of available coverage.

Section 1: Negligence – Prove it!

Negligence is created when the actions of agents fall below the standards of care established by law that would be expected of a reasonably prudent agent acting under similar circumstances. There are four (4) requirements that must be met for a customer to prove that the agency was negligent. Agents are, at a minimum, held to this standard of care.

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Negligence requires that all four of the following are met:

1. *A duty existed.*

> ***Duty Example:*** *The owner of an apartment building goes to an agency and asks for help obtaining coverage for his property, including coverage for loss of rent. The agent agrees to do so. At this point a duty is created either to procure the coverage requested or explain to the customer why coverage cannot be obtained. Some states require that an agent recommend specific coverages like "loss of rent" by virtue of his professional training and knowledge. Others require a 'special relationship,' e.g., one based on prior course of dealing, in order to impose a duty beyond simply procuring the coverage requested. All jurisdictions will find a duty where, as here, the broker agrees to an explicit request.*

2. *The duty was breached.*

> ***Breach Example:*** *The agent submits the application to the carrier on a timely basis, but forgets to request coverage for loss of rent, which is not ordinarily covered but could easily be endorsed onto the policy. The agent having failed to procure the coverage he agreed to obtain, his duty to his customer has been breached.*

3. *Proximate cause - A connection between the breach and duty showing that the particular error or omission was a cause of the loss.*

> ***Causation Example:*** *During the policy period a fire occurs in the fully occupied apartment building and, as a result, the building's tenants, who are forced to move elsewhere until substantial repairs are completed, stop paying rent. When the owner submits a claim for that 'lost rent' the carrier properly denies the claim, so the agent's error has caused an uncovered loss. If, on the other hand, the carrier offers several reasons for the denial, e.g., misrepresentation on the application, or if coverage could not have been obtained for some reason, the agent may argue that his error was not the legal cause of the owner's loss.*

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4. *Actual damages occurred as a result of the breach.*

> ***Damages Example:*** *Because the agent's failure to fulfill his task resulted in a denial of coverage, the owner sustained damage: the lost rent he should have received from his carrier for the 90 days it took to complete repairs and get the tenants back into his apartment building.*

To Whom Is A Duty Owed?

An insurance agent or broker may be found liable for negligence regardless of whether the duty owed is to the insurance carrier or to the customer. In addition, while some states require that the person or entity bringing a lawsuit must have a relationship with the insurance agent, other states allow an action to be maintained by anyone affected by the agent's negligence, such as an underlying tort claimant or party of interest, such as a Loss Payee or Additional Insured.

Section 2: What is standard of care and why is it important?

The standard of care is the degree of prudence and caution required when rendering services to customers. The level of standard of care is closely dependent on the circumstances and is based on how a reasonable agent would react under similar circumstances. Failure to meet one's standard of care can result in a claim of negligence being made resulting in the potential for damages owed to the injured party.

The determination of the legal standard of care varies in each state. Knowing your state's standard of care is important because your agency maybe operating in a way that creates an increased duty or a "special relationship" that could increase the chances of negligence claims being made against the agency in the event of an error or omission. How you run your agency to best meet the needs of customers while maximizing the profitability of the agency could be increasing your legal exposure because you are going above minimum legal standards owed. Agency best practices and legal duties are two separate issues; however, agencies need to be aware of their exposures and implement procedures to minimize risk.

Section 3: Differing Levels of Standard of Care

In general, agents across the country have a duty to use the care and skill of a reasonable agent in similar circumstances to procure the coverage requested by the customer. If coverage requested cannot be procured then the agent must notify the customer. More specifically, the standard of care for agents in each state is determined by state courts and can be divided into two categories: 1) Non-professional or order-taker status; and 2) Professional standard of care. To further determine the care status, the court will assess whether a "special relationship"

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exists which can potentially increase the standard. Everyone in the agency needs to be aware of the circumstances in determining how a special relationship is created.

Non-professional Standard of Care

In many states, insurance agents are not subjected to a professional standard of care. This means that in these states the agent's only obligation is to procure the coverage requested by the customer and to let customer know if that cannot be done. In these states, insurance agents typically only owe a duty to their customers to procure requested coverage or advise the insured of their inability to do so. The question of what constitutes a sufficient request to trigger a duty to procure a particular type or amount of coverage has been a source of continued litigation. Clear lines of communication with an insured are important in minimizing risk of loss. Where possible, it is preferable to obtain written confirmation from insureds regarding any specific coverage requests, and to document all steps, including the final outcome of any such requests.

Professional Standard of Care

In other states, insurance agents are considered professionals. This means an insurance agent's basic standard of care recognizes the insurance professional's skills and knowledge required to perform his/her duties. As professionals, agents have more of an advisory role meaning they may be expected to uncover and then inform customers of the possible loss exposures they face and offer insurance solutions. Therefore, the prudent agent's acts or failure to act will be based on this expected minimum level of professional service. States often require a "special relationship" to exist for the professional standard of care to apply. There are varying degrees of how easily the special relationship can be established.

Section 4: Determining Standard of Care and the "Special Relationship"

As indicated above, courts will often look to the nature of the relationship the agent maintains in order to determine the standard of care to be applied, particularly in states which do not treat insurance agents and brokers as professionals. Where the courts consider the nature of the relationship in order to define the duty owed, there are different factors that may be considered. Below are some factors the court might consider that could increase the standard of care or create a "special relationship" in the eyes of the courts.

Factors in Determining Higher Standards or Existence of Special Relationship:

- **Claims of Expertise**: Holding yourself out as a highly skilled insurance expert and the customer relies on this representation:
    - Advertising that the agency/agent is a skilled practitioner, specializing in a particular line (i.e. manufacturers, trucking concerns, homeowners, auto, etc.)

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- Various forms of advertisement using words or phrases such as “full service agency”, “counselor”, “advisor”, “extensive knowledge”, “expert”, “highly qualified”, etc.
- Indications or promises of the possession of special skills beyond the usual skills of other agents with a similar background.

- **Agreement or Additional Compensation**: Having a service contract or accepting additional compensation, such as fees, beyond commission compensation for specific services
- **Length of Customer Relationships**: Long-term relationships with the customer would be viewed differently than the relationship with a new customer. This is important when the agent knows from past experience that the customer specifically asks for and relies on the advice of the agent.
- **Rendering of Advice**: The agent is asked by the customer and agrees to provide advice. Or the agent assumes the duty to provide guidance or advice without the explicit request of the customer.

Discussion Topics

- ***Does simply having additional designations or a higher level of education with a deeper knowledge of insurance products in itself create a greater standard of care?***
- ***In the state where my agency operates do the following meet an agent’s standard of care or increase it? In the absence of a special relationship would be they considered the meeting the minimum standards or best practices for running they agency?***
  - ***Offering increased limit options***
  - ***Offering additional coverages not requested by the customer.***
  - ***Highlighting exclusions in the policy.***
- ***All of the following “promises” appear on current agency websites. Discuss whether you believe that there may be a higher degree of expectation and what the agency can or should do to assure that they can meet these promises:***
  - ***"To provide our Policyholders with as near perfect protection, as near perfect service, as is humanly possible, and to do so at the lowest possible cost."***

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- ***"Our agents take pride in providing outstanding service. Unlike most agencies, we continually check on your policies to make sure you are receiving the best rates possible"***
- ***"Our years of experience and education allow us to guide our clients in making well-informed decisions regarding their insurance needs."***
- ***"At (name withheld), our approach to claims management goes beyond the standard process, to true claim advocacy."***

Risk Management Tip:

Agents should be cautious when undertaking more responsibility than is required under the law of their state. If you undertake that duty, you may be responsible for fulfilling all of the obligations associated with that duty for every customer.

AGENCY PRACTICES VS. LEGAL DUTY

It is important to be knowledgeable about the prescribed legal requirements in your state, however, meeting the minimum requirements is not necessarily the way you may choose to run your agency. Generally, it takes an uncovered customer loss to create an E&O claim so ensuring that customers have adequate coverage and limits can reduce an agency's exposure to loss. Uncovering customer exposures and offering coverages and increased limits that may be appropriate may better serve your customer and provide the agency with more opportunity to increase revenue. The bottom line is that whatever the agency's operational practices are for working with customers they should consistently strive to fully communicate and follow-up to meet these standard practices - "say what you do, and do what you say."

Section 1: Creating a Duty Where None Previously Existed

Agents should always be mindful of creating additional duties when creating office procedures. Certain duties, while they may seem to be of value to the customer, can have a drag of agency performance and substantially increase E&O exposure. Here a couple of examples:

1. AVOID THE PRACTICE OF CONTACTING CRONICALLY LATE-PAYERS: As a "value-added service" the agent would call an insured about late payments as a "reminder." The insured came to rely

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on the agent's phone calls, and generally disregarded notices from the insurer or premium finance company. A loss occurred and there was no coverage in place because of a policy cancellation for non-pay. The insured blamed the agent saying they didn't call in the prior month to remind them of that payment was due which they generally relied on.

2. SAYING IT'S TAKEN CARE OF BEFORE IT REALLY IS: An agent who specializes in equine insurance takes a phone call from the insured late on a Friday afternoon indicating he just purchased a $3M race horse. Agent says he'll take care of it, but was able to secure only the first $1M coverage before the markets closed. On Sunday, the horse was standing under a tree in a thunderstorm, and was struck by lightning and killed. Agent lost $2M E&O claim. Only confirm that coverage is in place after it is truly bound and remind customers of this.

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E&O Risk Management: Meeting The Challenge Of Change

The Role of Agency Procedures

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The Role of Agency Procedures

Objectives:

- ***Understand invariable practices and procedures and their role***
- ***Learn how invariable practices serve as a valuable defensive strategy***
- ***Realize the benefits of a procedures manual that is consistently followed***

WHAT'S COVERED:

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INTRODUCTION

Does your agency have the proper policies and procedures in place to insure that your E&O carrier could mount a compelling defense in the event of an E&O claim? Having good procedures in place is not only critical from an E&O protection standpoint, but can also improve customer service and increase the efficiency of the agency operation. For true consistency procedures that are implemented must be continually audited for compliance. While documentation plays the largest role in defending an E&O claims, it must be tied to invariable internal procedures and practices to bolster your claims defense.

The reason is that documentation can only verify what actually took place. How do you defend against allegations of failing to follow through on a request when you have no record of any contact between the agency and the other party? There would be no documentation because the agency's position is that the request never took place. Therefore, the agency's most effective defense is its internal procedures manual and the consistency of its business practices. Invariable internal procedural practices require "everyone doing it the same way, all the time, for everyone". When the agency needs to prove that it didn't do something or the request was never received, that is when consistent business procedures provide a defense.

INVARIABLE PRACTICES ROLES IN AN AGENCY'S DEFENSE

Section 1: What are invariable practices/procedures?

Have you ever watched a precision military drill team? It is a beautiful thing to see when a group of military personnel move in perfect unison. If one member of the team misses a beat, or moves out of sequence, it becomes instantly recognizable and the majesty of synchronized movement loses its luster. Invariable practice can be compared with a military drill team. It has been described as "everyone doing the same thing, in the same way, for every customer, every time." When procedures are in place that require certain steps for each customer/carrier touch point, and all agency personnel execute the steps as prescribed, the agency operations are in unison. If one member of the agency fails to properly follow a procedure the defense advantage, gained by invariable practice, is diminished. Just like a drill team, agency personnel must complete procedures in exactly the same manner in order to achieve harmony of operations.

Section 2: Why are invariable practices/procedures important?

From strictly a management prospective, invariable practice is a practical way of training personnel, monitoring workloads, cross training employees and auditing operations. Aside from the operations advantages, as important as documentation is to an agency, invariable practice holds an equally important place in an agency's defense against E&O claims. Invariable

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practice provides the agency with a defense in times where follow-through on procedures comes into question. Review the claims scenario below to better understand this point.

Claims Scenario of Invariable Practices Inaction

Your insured has just suffered a loss that is excluded under their policy. The insured was surprised that there was no coverage since they distinctly recall discussing the exposure and the need for coverage with agency staff. They cannot recall who they spoke to, but the insured is insistent that they made the request for coverage to be added to their policy.

This potential claim will be difficult to defend if the agency is only relying upon their file documentation. If, in fact, the insured's recollection is flawed, this will become a "he said, she said". The agency would not have any documentation of a conversation that never took place.

Having standardized documentation procedures in place which everyone, agency-wide, consistently follows is crucial to mounting a defense of such a claim. If during the investigation of a possible E&O claim the E&O carrier can determine that whenever a call is received by the agency, an invariable process is followed, that could go a long way toward disputing that such a conversation took place. In this instance the agency would benefit from the lack of documentation combined with invariable practice – one way, all the time, by everyone. Equally important to having standardized procedures is that the adherence to them is audited and continued non-compliance with the agency's procedures is not tolerated. Periodic, preventative customer file reviews is important for compliance purposes.

PROCEDURES MANUAL

The Titanic had a Safety at Sea manual and Enron actually won an award for their Code of Conduct manual. What do these two manuals have in common? Apparently what was written did not reflect the actual day-to-day operations of either entity. If agency staff are not all going to follow the procedures manual, what's the use of having one?

Procedures manuals are an invaluable employee training tool, assist in reducing operating costs, can be used by management to evaluate employee performance, provide guidance for agency operations audits, and support an agency's invariable practices. The key is they must reflect the actual operations of the agency.

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Section 1: Training Tool

Procedure manuals provide guidance to new employees on the operations of the agency. Even without the E&O defense advantage, agencies should have a written record outlining all agency functions to assure quality control and customer service performance.

Section 2: Reduction of Operating Costs

When you awoke this morning, you most likely followed a usual morning routine before heading out for the day. Daily routines – or procedures – help you to navigate the day and accomplish all of the tasks you need to complete. The agency environment is no different. Rather than placing the burden on individuals to determine what steps to take to complete a task, procedures provide step by step instructions. Written procedures should represent the best and most efficient way for the task to be competed. Over time, these steps become second nature. Without a procedure, staff members are burdened with finding their own way of doing a task. This is both time consuming, costly to an agency, and has a negative effect on employee morale. Consistent procedures eliminate guess work.

Section 3: Employee Evaluation

Compliance with current procedures should be part of any employee evaluation. Inclusion sends the message that the procedures manual is not just for show but an active and integral part of the current operations. Of course this requires constant monitoring and periodic customer file reviews.

Section 4: Agency Operation Audits

An agency which conducts periodic audits to assure compliance with procedures presents a stronger defense in regards to invariable practice. Audits accomplish two goals of E&O loss control:

1. It reinforces the commitment to agency-wide compliance with operating procedures and allows individual adjustments to be made as needed
2. At the time of an E&O claim, audits clearly indicate that the organization has taken proactive steps to assure that procedures are continually followed

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EVOLUTION OF INVARIABLE PRACTICES

In order for an agency to provide a strong defense using invariable practice, the agency must be able to demonstrate that a procedure is not just expected to be followed but is followed by all staff members - without exception. Like the Titanic or Enron manuals, the existence of written procedures does not assure that the actual operations are in compliance. Periodic auditing of the operations with a comparison to the procedures manual, and corrections made for any variances, supports an agency's assurance of invariable practice. Auditing is important as a means of improving procedures, to reflect workflow changes. Auditing allows employees responsible to carry-out the procedures to provide input on amendments and updating necessary to reflect changes in business operations.

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E&O Risk Management: Meeting The Challenge Of Change

An E&O Claim - 360˚ View

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An E&O Claim - 360° View

Objectives:

- ***Understand what an E&O claims is***
- ***Use claims statistics to identify areas to focus risk management efforts***
- ***Review the specific types of errors made***

WHAT'S COVERED:

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INTRODUCTION

Often it takes an uncovered loss to create an E&O claim. Generally speaking, an uncovered loss would be caused by:

1. A lack of appropriate type of coverage, or
2. Inadequate values or limits to cover the full loss.

E&O claims don't discriminate by the size or location of agencies. All agencies, regardless of staff size, must proactively address E&O risk management!
Statistics show that annually one (1) in seven (7) insurance agencies and brokerages will report a potential E&O claim. Statistics also indicate that approximately 50% of those reported claims are closed with no defense reserves or indemnity payment made.

E&O claims statistics have fluctuated over the years and are often influenced by market cycles which drive changing behavior of insurance buyers, carriers, and agents. Catastrophic events such as tornados, hurricanes, flooding, earthquakes, and wildfires can be the catalyst for the discovery of uncovered losses that lead to E&O claims against agents.

In those cases where the claim goes forward, the agency may or may not have actually made a mistake. Just because an E&O claim was made against you doesn't mean that the agency staff did anything wrong or breached your legal duty. It may simply be that the agency finds itself in the uncomfortable situation of an allegation being made against them because of their inability to prove that they are not responsible. Unfortunately, many E&O claims allegations are "he said, she said" and **this is where documentation, combined with good E&O risk management procedures that are invariably followed, is a key defense mechanism**.

ERRORS AND OMISSIONS DEFINED

Errors and omissions can simplistically be described as "I made a mistake" (error) or "gosh I missed that" (omissions). When we look at E&O in this way, the mystique of "wrongful acts" can be described as human failings. An agency that has good E&O risk management procedures in place, that are enforced and monitored, can reduce their E&O exposure. This is especially true for those claims that could result from an omission.

Section 1: Procedural vs. Knowledge Based Errors

E&O claims can generally be broken down into two categories: procedural errors and knowledge-based errors. The spread of claims between these two categories is about 50/50 and in some cases there is overlap between the two. So, to truly reduce E&O exposure both error types need to be addressed. It is worth noting that knowledge-based types of errors

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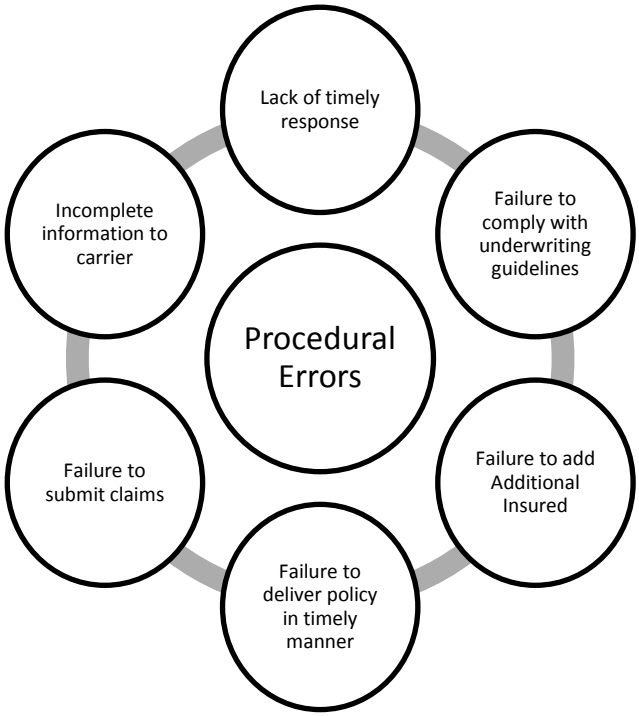
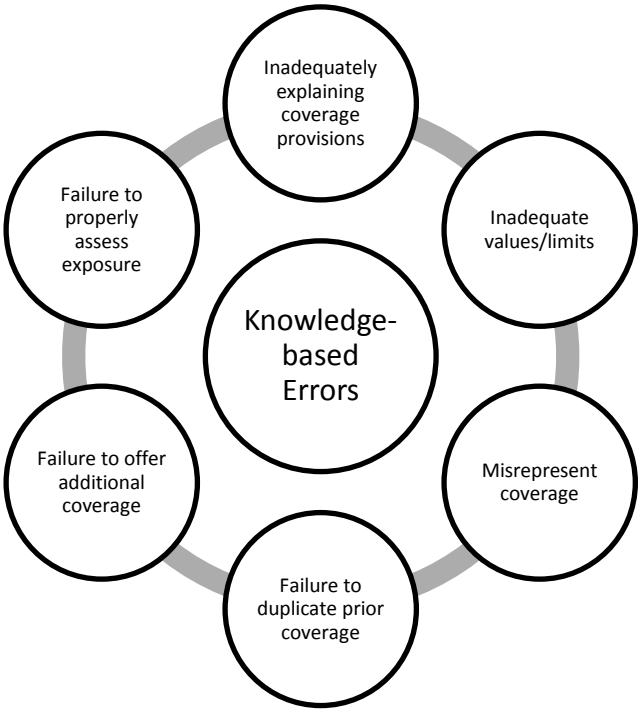
could include a lack of product understanding or technical coverage knowledge as well as giving bad advice to customers.

What are examples of procedural and knowledge-based claims?





Section 2: Agency E&O Culture - Staff Awareness

Making sure the agency staff follows agency procedures is one thing, but making sure they understand the concept of how errors and omissions may occur in the agency is also important, especially how it applies to them. The actions or lack of action of agency staff (including: owners, producers, CSRs, account managers, accounting staff, clerical personnel) ultimately affects the agency's E&O exposure. Employees may lose sight of this. A culture of E&O awareness can keep it top of mind and is the first step in successfully avoiding claims. Open discussions will create an environment where agency staff is more comfortable making managers aware of potential E&O claims. This will facilitate better claims reporting and meeting your E&O policy's reporting requirements to ensure coverage. If employees fear discipline or reprisal they may delay bringing a situation to management's attention until it is too late for either the agency or its E&O insurer to resolve the problem.

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FACT CHECK:

Swiss Re Corporate Solutions data reveals that agencies that attend an E&O risk management seminar have fewer claims. The more agency employees that attend a seminar, the better. Consider having an in-house seminar for all employees.

Class Discussion
• ***What are some of the reasons why a customer might have an uncovered claim from a lack of coverage?*** • ***What are some things agency staff can do to avoid claims from inadequate limits?*** • ***What factors may cause an increase in E&O claims when the insurance marketplace experiences a hardening?***

E&O CLAIMS STATISTICS

The E&O claims frequency statistics provided by Swiss Re Corporate Solutions provide guidance for an agency to determine their E&O exposures. They not only give you an understanding of the types of errors being made, they provide your agency with direction on where to focus your risk management efforts including:

- On whom to focus in reinforcing the importance of risk management,
- Areas of potential weakness in agency operations creating exposures and,
- Product education and training needs.

Section 1: Who is suing agents?

It is not only insureds that can and do bring claims against insurance agencies. Past claims experience shows that claims come from the following sources:

1. **Customers** – The vast majority of the time it is the customer bringing claims against the agent for failing to procure or recommend the coverage to protect them.

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2. **Carriers** – In the past decade there has been a visible trend in the number of E&O claims involving the carrier against the agent. These types of claims can be a result of agents:

   - Exceeding their binding authority

   > ***Example:*** *An agency may be granted binding authority by the carrier to bind policies up to specified limits, e.g., $250,000, without first submitting the application to the carrier for approval. When the agent binds a policy containing limits in excess of $250,000 and a large loss occurs, the carrier is likely to deny on the basis that the agent exceeded his authority -- or will cross-claim against the agent, seeking indemnity.*[*]

   - Not adequately explaining policy provisions

   > ***Example:*** *The agent obtains a policy for her customer's newly acquired property that contains a '60 day vacancy' clause. When the new owner fails to occupy the new property for over 60 days a water leak occurs and substantial damage occurs to the building while it is unoccupied. Both the customer and the carrier that denies coverage based on the vacancy clause will argue that the agency failed to properly explain the policy provisions.*[*]

   - Failing to comply with underwriting guidelines

   > ***Example:*** *An agent has binding authority with a carrier that insures boats, subject to the carrier's underwriting guidelines, which restrict coverage to pleasure crafts under a specified horsepower and length. After a serious loss occurs, the carrier investigates and determines that the boat in question slightly exceeds both limitations -- and denies coverage. If forced to pay the loss, the carrier will file suit against the agency for failing to comply with its guidelines.*

   - Providing inaccurate or incomplete information to carrier

   > ***Example:*** *An agent remarkets an account to a new carrier, but fails to include information regarding prior losses. When a new loss occurs the carrier takes the position that a material misrepresentation occurred and, had the information about the prior losses been known, then it would not have insured the customer. The carrier pays the loss and files suit against the agency to recoup its claim payment.*

   - Failing to provide timely notice of a claim to the carrier

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Example: *If an agent fails to provide the carrier with notice of a claim, timely notice to the agent could be deemed timely notice to the carrier. In that case, the carrier could pay the claim and then file suit against the agency, arguing its investigation of the loss was prejudiced by the delay in receiving notice of the loss. One such example would be an auto loss wherein the car was repaired before the carrier had a chance to inspect it.*

3. **Third parties** – Sometimes agents can be sued by third parties. These claims often involve:

    - Failure to add an Additional Insured or Loss Payee

    Example: *Agency customers frequently are obliged to add a party with whom they contract to the policy as an 'additional insured,' or in the case of a lender, to be named as an 'additional loss payee.' If the broker fails to make that change to the policy, the uninsured third party or lender will attempt to hold the agency responsible.*

    - Misrepresentation or inaccurate information on Certificates of Insurance

    Example: *Many COI claims occur when an overworked (or undertrained) staff member issues a COI, as requested by the customer, without first checking to confirm that the coverage being certified actually does exist as represented. In some cases, the customer was not even obliged to provide the coverage in question -- that is, until it represented to a third-party via COI that the coverage was in place.*

    - Failing to procure coverage that was relied on by a third party

    Example: *Landlords often require tenants to obtain insurance for the leased premises to cover damage caused by the tenant or others. If the agent is aware of that requirement but neglects to obtain the required coverage, the landlord may pursue a claim against the agent.*

4. **Regulatory/governmental entity** – In responding to complaints, regulatory bodies can investigate the insurance operations of agencies. Some E&O policies offer some amount of coverage for expenses in defending these investigations. These allegations may include:

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- Fraud or intentional misconduct

> ***Example:*** *In the event it is discovered that an employee has been embezzling premium monies, the state Department of Insurance may initiate a regulatory proceeding against the agency for failing to supervise an employee.*

- Failure to return premiums

> ***Example:*** *If an agency agrees to handle a customer's account on an agency bill basis and holds premium monies in a trust account, but fails to return any premium refunds, the Department of Insurance could initiate a proceeding against the agency. This could be the case even if the agency applied the return premiums to the customer's other policies.*

- Unfair claims practices

> ***Example:*** *If an agency has claim-handling authority, acts that violate state law might include: failure to respond to the claim promptly; misrepresenting significant facts or insurance policy provisions; or denying claims without a reasonable investigation.*

Section 2: Who in an agency is most likely to be involved in an E&O claim?

9 out of 10 claims involve the following categories of staff. They are listed below in descending order of frequency:

1. Producers – The types of errors where producers are most frequently involved include: coverage type and limit recommendations, policy interpretation, application and policy issuance errors. They are also involved in a surprisingly high number of claims involving failure to provide timely notice of a claim to the carrier.

   Here are more specific errors involving producers:

   - Not explaining policy provisions

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Example: *A broker's failure to explain the definition of "vacant" in a homeowner's policy may lead to uncovered losses, most notably for vandalism or water damage. Vacancy is defined by courts and in individual policies based on the amount of furniture/personal property that is left in the home, or the length of time it is left unoccupied, e.g., when a home that is for sale remains unsold for an extended period of time.*

- Recommending inadequate value/limit

Example: *This often occurs when an agent relies on documents that are provided by the customer, but were prepared by a third party. Relying on inaccurate square footage or age of a structure can lead to inadequate coverage. In addition, claims can occur when the customer requests only minimum required limits and the agent does not have process for always offering higher limit options.*

- Failure to recommend coverage type

Example: *Excess flood and wind coverages in coastal areas are examples of coverages that a broker should recommend to a customer based on his knowledge of the customer's location and the nature of the property.*

- Inaccurate information to the carrier

Example: *This can occur when an agent fills out an application without asking the customer each question individually, e.g., whether he has been charged with a DUI, or if the premises has a monitored alarm. Although the agent may ask the customer to review the application before signing it, errors often are not noticed because "I just signed where my agent told me to sign..." If the question is answered incorrectly, the carrier may declare its policy void.*

- Inadequate identification of exposures

Example: *Home businesses and non-owned auto usage for business purposes can cause coverage gaps when agents fail to familiarize themselves with the customer's business.*

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- Failing to duplicate prior coverage

> ***Example:*** *Failure to obtain a copy of the prior policy or dec sheet when replacing coverage which leads to gaps in coverage such as a hurricane deductible or a sublimit on the new policy.*

2. Licensed customer service representatives – CSRs are most frequently involved in errors involving the claims process, handling applications, certificates of insurance, and policy cancellation.

   Here are some specific errors involving CSRs:

   - Failing to provide timely notice of a claim

   > ***Example:*** *A commercial customer reported an auto claim to the agency to report to the carrier. The CSR reported to the primary carrier but not the excess carrier. The agency faces exposure if the claim exceeds the primary limits because the claim was not sent to the excess carrier is a timely fashion.*

   - Mishandling application resulting in failing to procure coverage

   > ***Example:*** *A customer sent in several renewal applications for multiple properties, along with the renewal premiums. The CSR failed to submit one of the applications and the error was not discovered until months later when a fire loss at the missed location was reported.*

   - Not notifying the customer of policy cancellation

   > ***Example:*** *A customer's fire policy cancelled six times due to non-payment of premium, and each time the CSR would contact the customer to advise that the premium needed to be paid. A year later the customer suffered a fire loss and the carrier denied coverage because the policy cancelled for unpaid premium. The customer alleged the agency failed to contact him as they had in the past regarding the payment of the premium.*

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- Failing to add Additional Insured or Loss Payee

> ***Example:*** *A customer asked the agency to add the auto lender as a loss payee to his auto policy. The vehicle was totaled in an accident and the carrier paid the proceeds to the named insured only. The lender is looking to the agency for payment of the loan balance.*

3. Account Managers – The error profile for account managers is very similar to that of producers. They are most frequently involved in errors relating to the recommendation of coverage and limits and assessing customer risks. The data also shows that account managers do a little better when it comes to explaining coverage to customers than producers.

4. Owner/Partner/Sole Proprietor/Principal – Looking at the claims data it seems that owner/principals are "jacks of all trades". Claims involving them are spread pretty evenly across the different processes. This is likely because they are involved in so many facets of the agency, especially when it comes to important accounts. In smaller agencies the term "cook, bottle-washer, and waiter" may apply. Interestingly, owners have the highest percentage of recommendation errors such as failing to recommend coverage or adequate limits.

Class Discussion
• ***Why are producers and CSRs most frequent involved in E&O claims?*** • ***Does your agency have staff meetings that specifically address the importance of agency E&O risk management?*** • ***Of the types of errors described above which do you think are the easiest to avoid? The most difficult?***

Section 3: What transactions are driving claims frequency?

The two transaction areas that make up agency's largest profit margins also drive claims frequency. Not surprisingly, 40% of all claims frequency arises from new business followed by renewals at approximately 25%. When it comes to new and renewal transactions the following process steps drive frequency:

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- Risk assessment and recommendation errors

> ***Example:*** *An agent's failure to ask probing questions of his customer and, where possible, visit the property insured, can lead to errors regarding such matters as: geographic location, activities undertaken, hazardous chemicals/processes utilized, supply chain disrupts, and jurisdictions where employees live/work.*

- Policy issuance errors

> ***Example:*** *The failure to accurately identify the persons and property insured. Also, failing to forward policy in a timely basis so the customer can review it for accuracy.*

- Application errors

> ***Example:*** *Common application errors include missing medical history on life & health policies, and errors regarding the value and/or square footage of the property insured. If there are misstatements in the application, both the customer and the carrier are likely to blame the agent who prepared and submitted the application -- particularly if it was filled out by the agent -- when the carrier denies coverage, or pays less than the entire loss.*

- Failure to duplicate prior coverage

> ***Example:*** *Both with renewals and new or remarketed coverages, agents often fail to compare the policy issued to the quote to ensure that the coverages requested are in place. Carriers often add sub-limits or remove small coverages. Certain perils are frequently excluded, such as pollution and snowplowing coverages. Oftentimes, these are changes that the carrier was willing to reverse by endorsement for a nominal fee which the customer readily confirms he would have paid.*

Section 4: What types of policies are driving claims frequency?

Any policy not properly written could generate a claim. It is no surprise to any agency to find that commercial lines forms make up about 60% of the claims frequency by type of coverage. Commercial lines frequency of E&O claims is double that of personal lines. Below are the underlying coverages most frequently involved in E&O claims:

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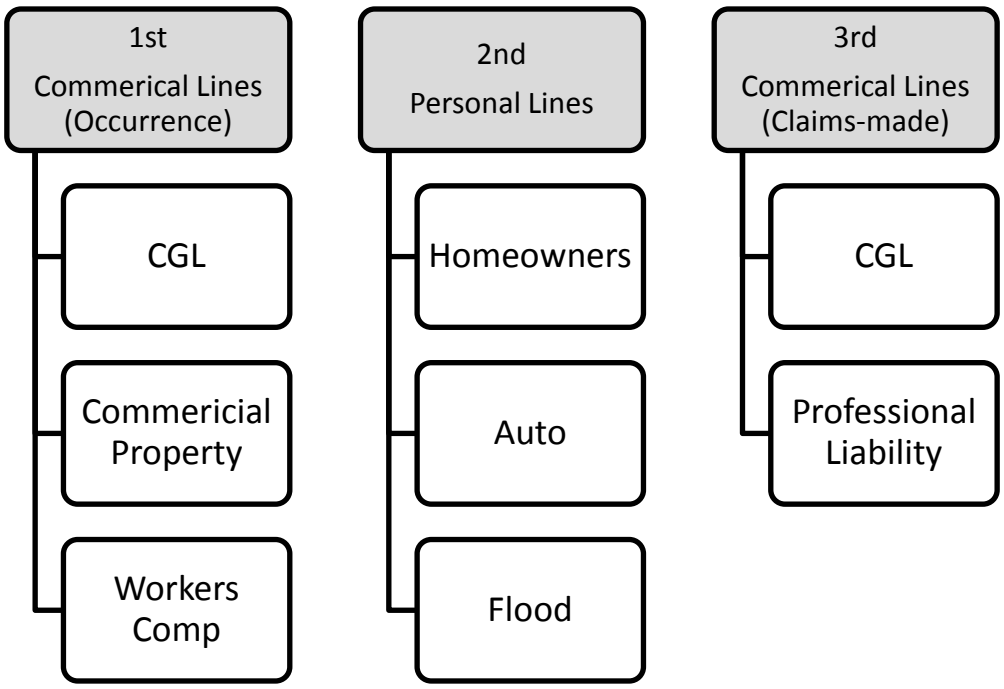

Class Discussion
• ***Why do you think twice the amount of claims come from commercial lines versus personal lines?*** • ***At what point in their process of working with customers are a producer and CSR most vulnerable or likely to make an error?*** • ***Why do 1 in 5 errors involve the CGL policy? What makes it so prone to be involved in E&O claims?***

Section 5: What type of error/omission are others alleging an agency has made?

An agency can be accused of making any type of error or omission. Just because a claim is made doesn't mean you did anything wrong. However, below are the errors/omissions that have been alleged by customers, carriers and others in descending order of frequency:

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- Failure to procure coverage

> ***Example:*** *A customer tells his agent that he plans to make an acquisition of new property, but the broker never follows up to determine whether the purchase was completed. Meanwhile, the newly acquired property sustains a loss and the customer expresses surprise that coverage was not obtained.*

- Failure to adequately explain policy provisions

> ***Example:*** *A common complaint in the wake of commercial property losses is that the agent failed to explain the policy's 'coinsurance' provision, as a result of which the insured is underinsured.*

- Failure to adequately identify exposures

> ***Example:*** *Because the agent is not entirely familiar with the customer's business and property and isn't using risk assessment questionnaires, a new provision on a policy that excludes coverage for a particular peril -- one for which the customer requires coverage -- is overlooked by the agency at renewal.*

- Failure to recommend coverage type

> ***Example:*** *The agent, through lack of familiarity with his customer's operations, never learns that the customer's officers and employees routinely use their own automobiles on the job. As a result, when one of the employees is involved in a serious at-fault auto accident on the job, coverage is denied by the customer's business auto carrier because the agent failed to recommend and procure 'non-owned auto' coverage.*

- Inaccurate/incomplete information provided to the carrier

> ***Example:*** *Agents placing coverage on commercial property routinely rely upon the customer to provide information regarding the building's square footage and present value. The carrier relies on that information and common estimates of construction costs to conclude that the limits requested offer adequate 'replacement cost' coverage. When the building burns to the ground, and it is discovered that the actual square footage was substantially more than represented, the customer likely is substantially underinsured -- especially if a coinsurance penalty is assessed.*

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- Failure to provide timely notice of a claim to the carrier

> ***Example:*** *The agent reports a workplace injury for his customer, and tenders it to his customer's workers compensation carrier. He neglects to consider that the general contractor has 'additional insured' status on the customer's GL and excess policies. As a result, when the employee sues the general contractor months later and the claim is turned in to those carriers, they deny for late notice.*

- Negligent misrepresentation

> ***Example:*** *An agency issues a COI showing 'additional insured' status for a third party, e.g., a contractor, where none exists. This can occur in situations where there was no obligation on the part of customer to provide such coverage, but the COI recipient claims to have relied on the COI to its detriment.*

- Failure to add an Additional Insured/Loss Payee

> ***Example:*** *The customer provides its agent with a copy of its contract with a general contractor, which contains a provision requiring that the other party to the contract be named as an 'additional insured' on the customer's policy. The agent does not carefully review the contract and does not ask the carrier for an 'additional insured' endorsement.*

- Failure to duplicate prior coverage

> ***Example:*** *The agency fails to note that particular activities, e.g., snowplowing, which were covered on an expiring policy, are now excluded on the replacement policy. Policies placed with a new carrier upon expiration of an old policy often have new exclusions or other limitations on coverage that avoid notice -- until a claim occurs.*

- Alleged failure to pay claim

> ***Examples:*** *Decisions regarding the payment of claims typically are within the discretion of the carrier, but some E&O claims occur because the claim report is made late, or is not made to all carriers with possible coverage, e.g., workers compensation, CGL and excess/umbrella.*

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- Failure to recommend adequate value/limit

> ***Example:*** *Agents open themselves up to claims when they (1) fail to verify the exposure characteristics of the property to be insured, e.g., square footage, (2) fail to recommend an appraisal to an unsophisticated customer, and/or (3) fail to recommend periodic increases in limits to keep pace with inflation in replacement costs. Even if the property is not a complete loss, inadequate limits may lead to the carrier's imposition of a coinsurance penalty, for which the broker will be blamed.*

- Failure to notify customer (re: policy cancellation)

> *Example: Customers who suffer an uncovered loss following the untimely cancellation of their policy routinely insist that they received no notice of the cancellation (while the broker usually has a copy in its file) and counted on their broker to provide notice and procure replacement coverage.*

** Note: Claims examples were provided courtesy of Swiss Re Corporate Solutions.

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E&O Risk Management: Meeting The Challenge Of Change

Reporting an E&O Claim

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Reporting An E&O Claim

Objectives:

- ***Realize the importance of E&O reporting claims sooner rather than later***
- ***Address agency concerns about reporting E&O claims***
- ***Provide things to consider if an E&O claim happens***
- ***Learn how deductible options can save the agency money***

WHAT'S COVERED:

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INTRODUCTION

The likelihood of an agency having an E&O claim over the course of its existence is high, whether the agency did anything wrong. However, the earlier a claim is reported and your E&O carrier involved, the more likely it will be resolved quickly. This section reviews some of the key considerations should the agency be faced with a potential E&O claims.

REPORTING AN E&O CLAIM - MYTHS VS. REALITY

The Swiss Re Corporate Solutions insurance agent's E&O policy requires that insureds report "claims" and/or "potential claims". Often professionals, including insurance professionals, do not believe that they have done anything wrong when confronted with a claim or potential claim. Their reaction may be to provide their own "proof" or "defend" their actions to those making allegations. **STOP before you proceed to defend your actions or provide any documentation and contact your carrier for assistance!**

> **Fact Check:**
>
> **Claims-Made Policies vs. Occurrence forms: Your Swiss Re policy is a claims-made form that includes a known loss provision. Both actual claims and potential claims (incidents) that could result in a claim must be reported ASAP! Failure to report a potential claim constitutes a "known loss" and will void coverage for any actual claims presented during future policy periods.**

Section 1: The Cost of Reporting

The reporting of a claim or a potential claim to Swiss Re does not automatically result in any underwriting action by the Swiss Re underwriters. Underwriters individually review each claim/incident to determine the facts and circumstances surrounding the alleged wrongful act. If no reserves or payments are applied, generally no underwriting action will be taken. The cost of not promptly reporting a claim to the carrier far outweighs reporting it. E&O carriers are there to help you and some carriers will even step in on your behalf with the primary carrier in an attempt to get the underlying claim covered.

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Section 2: Concerns of Loss of Policy Premium Credits

E&O carriers often offer premium credits to reward proactive risk management in the agency. These often include loss control credits for attending seminars as well as some sort of claims-free credit. In the case of Swiss Re Corporate Solutions you will not lose these policy credits simply for filing a claim because of how a claim is defined for premium determination (See Below).

Fact Check:

Definition of a claim: An Errors and Omissions incident or situation for which any expense payment, any loss payment, or any loss reserve is made or established by or on behalf of the insured in excess of certain values (plus any applicable deductible) that are based on agency Gross Annual Premium ("GAP") size.

Minimum Agency GAP	Minimum Loss to Lose Credits
$1	$10,000
$5M	$15,000
$10M	$20,000
$25M	$25,000
$50M	$30,000
$75M	$35,000
$100M	$40,000

Reporting of an incident where no payment is made will not be considered as a claim. In addition, any time or expenses for the Westport Insurance Corporation staff does not constitute a payment for loss or expense.

Section 3: When it happens to you

If you are presented with a potential E&O situation, it is good to have staff prepared as to what to do and what NOT to do. Below are some things to consider:

- **Do not admit liability**—to the insured or the insured's insurance company
- **Be empathetic**, BUT choose your words very carefully

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- **Do not discuss or provide copies of your E&O policy** to anyone
- **Do not offer to pay** the claim yourself - *even small amounts!*
- **Do not agree to give a deposition or provide a statement,** even to the customer's insurance company.
- **E&O Carrier procedures:**
    - Report the claim – by completing a claim reporting form – to the E&O carrier, or producing state association, along with details of any conversation or correspondence you have received making a demand for damages
    - Forward all documentation
    - Cooperate fully with the E&O carrier or appointed counsel
- **Internal agency procedures:**
    - Involve your assigned E&O quality assurance staff person, or other appropriate agency personnel
    - Appoint one agency member to serve as the sole point of contact for all matters related to the claim
    - Interview every person involved in the claim—and remember it's not about the "who", it's about the what, when, where, and how
    - Have each applicable person provide a written narrative describing the incident and check the customer's file to determine the chronology of events

Section 4: "If they are not *your* attorney, they are *not* your friend"!

Consider the following scenario:

You have been contacted by your insured or their legal counsel. They just want to review a few facts surrounding (*you fill in the blank*) and have asked you to provide details relating to the situation. They would like you to answer a few questions or possibly send some documentation from your file. The tone of the conversation seems friendly BUT the direction of the questions could potentially result in an E&O claim. This is the time to remember the following phrase: "If they are *not* your attorney, they are *not* your friend!"

The same thing applies with an investigator or an adjuster for an insurance company. If the investigator or adjuster contacts the agency asking questions about how the policy was written, agency staff should consider the potential the agency may be the target of an E&O claim, possibly by the carrier. If the investigator asks for a copy of the agency's customer file or asks to take a recorded statement, ask them why. Chances are they have noticed some issue with the policy as it relates to the claim and need or want to determine if the agency was the cause. Regardless of their answer, the agency should advise them that a staff member will get back to them and immediately contact the agencies E&O carrier to speak to them about the next steps.

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Section 5: Documentation Can Reduce Deductible

Agencies that have a claim and have good E&O risk management procedures along with thorough customer file documentation have the opportunity to save money on their deductible. Some E&O carriers offer policyholders a reduced deductible over time as an incentive to being claims-free. Swiss Re Corporate Solutions offers a Deductible Reduction provision that provides policyholders with up to a 50% reduction of the deductible (up to a maximum of $12,500) for claims alleging failure to procure a recommended coverage where the agency has written documentation in the customer file refuting such a claim. There is no limit to the number of claims the Deductible Reduction provision applies to.

The savings the Deductible Reduction offers can be significant. But you can't lose sight of the need to:

1. Understand the operations and exposures of customers;
2. Implement a best practices approach offering additional coverages and increased limits;
3. And, thoroughly documenting customers' files on all customer interactions, especially the written acceptance and rejection of coverage.

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E&O Risk Management: Meeting The Challenge Of Change

E&O Issues of Certificates of Insurance

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E&O Issues with Certificates of Insurance

Objectives:

- ***Understand the purpose of certificates.***
- ***Review the E&O issues from certificates of insurance.***
- ***Learn steps the agency can take to reduce exposure in their handling of certificates.***

What's Covered:

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INTRODUCTION

Certificates of insurance – how can something so simple on its face be so complicated? For years certificates have been a hot topic in the insurance industry and trying to meet the certificate requests from customers can create E&O exposure. While there are a number of issues that can create E&O claims, one of the most common errors made involves agencies using the certificate of insurance as a way to add additional insureds without formally contacting the carrier to add them by endorsement. In general, other industry issues relating to certificates include: fraudulently including coverage that doesn't exist; onerous contract provisions that can't be met by the insured's policies; and who, if any body, has the responsibility to notify certificate holders in the event of cancellation.

New ACORD certificate forms have been developed and many states have implemented regulations to govern how certificates are handled. This module will review a number of issues surrounding COI's and how an agency can reduce its E&O exposure. Below is a great quote on the evolution of the certificates:

> "Certificate language grows like mold in a damp forest. Mutations arise. Pages are added. If one follows the logical path of such discussions, soon the certificate will be the policy, with the coverage form being a single sheet of paper that says, 'For informational purposes only. Please see applicable Certificate of Insurance for specific coverage provisions, limits and effective dates.'" - Chris Amrhein, American Agent & Broker magazine, June 2008

WHAT IS A CERTIFICATE OF INSURANCE?

A certificate of insurance is nothing more than a snapshot that shows a policy exists at certain limits at a certain point in time. It is for general informational purposes only and confers no rights. The certificate is subject to all of the terms and conditions of the various policies that are shown on the certificate.

Discussion Topics
• ***Who in the agency is responsible for issuing certificates of insurance?*** • ***Who in the agency is authorized to sign as the representative of all carriers?***

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WHAT ISN'T A CERTIFICATE?

A certificate is not a contract:

- It does not extend any contractual rights to the holder not provided by the policy.
- It does not represent compliance with any contracts entered into by the insured with others.
- It does not amend, extend or alter coverages or terms afforded by the policy.

Certificates cannot, in any state, amend, extend or alter policy coverages or terms. The reason is, if the certificate purports to provide coverages or terms different from the policy, it effectively becomes an endorsement that would require filing as such with the insurance department. This "does not amend, extend or alter" disclaimer on the certificate is usually supported by the policy itself. For example, the ISO IL 00 17 Common Policy Conditions form says [EMPHASIS added], "This policy contains ALL the agreements between you and us concerning the insurance afforded...This policy's terms can be amended or waived ONLY BY ENDORSEMENT issued by us and made a part of this policy." Of course, the insurance policy is a contract between the insured and insurance company – the certificate holder is not a party to that contract.

E&O EXPOSURE OF CERTIFICATES

Section 1: Why the increase in agency E&O exposure?

In the past, E&O claims related to certifying insurance coverage to third parties were hardly a blip on the E&O radar screen. In recent years, certificates of insurance and/or additional insured issues have become more prevalent and below are some of the reasons why:

- Dramatically increased demand from third parties for certificates and additional insured status.

- Increased complexity of certificate and related documentation (agent affidavits, compliance checklists, etc.) requests.

- Increased frequency leads to routine which leads to complacency in vigilantly reviewing requests.

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- Lack of agency staff qualifications for more complex requests, particularly requests for specific verbiage on certificates.

- Increased pressure from insureds and third parties to issue misrepresentative certificates under threat that the insured will be denied a job, not paid for a job, or sued for contract default.

- Improved litigation success focused on claims of fraud and detrimental reliance by the third party or insured.

Section 2: Should my agency be concerned?

The City of Atlanta did a survey of certificate activity involving contractors and vendors who did work for the city. They found that 20% of certificates indicated policies that didn't exist and 50% indicated additional insured (AI) endorsements that had not been ordered or delivered. Of certificates that indicated cancellation notice would be provided, 75% had no such right of notice endorsed onto the policy.

An agency management consultant did an agency file review and likewise discovered that 20% of certificates showed policies that didn't exist and 42% showed additional insured endorsements that were never ordered.

A Florida agency conducted its own internal review of 10-11 months of certificate activity and found a 90% error ratio, with 40% of certificates having errors so significant that they posed an E&O threat.

Examples of real-life certificate/additional insured E&O claims:

- The certificate showed that additional insured coverage was provided under a blanket additional insured endorsement. However, there was no contractual requirement for AI status as needed to trigger coverage under the endorsement. Settlement: $445,000.

- An agency CSR failed to order an additional insured endorsement after issuing the certificate. Settlement: $180,000.

- An agency issued 4,000 certificates for an employee leasing company showing workers compensation insurance that was never bound. Settlement: $10,290,000 (yes, $10 MILLION).

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Discussion Topics
• ***Does your agency have a process to review the accuracy of certificates being created?***

CERTIFICATE ISSUES FACING AGENCIES

Below are some of the issues that have been facing agencies when handling certificates of insurance for customers.

Section 1: ACORD Certificates of insurance

Under ACORD's licensing agreement, when a new edition of an ACORD form is published, the prior edition can continue to be used for up to one year. After that grace period, any continued use of the older edition is a violation of ACORD's licensing agreement and quite probably federal copyright law. For that reason, only the latest ACORD form should be used. This may necessitate upgrading the agency's agency management system in order to incorporate updated forms.

Insureds should never be given "blank" ACORD certificates that do not show a certificate holder. Insureds who have such documents most likely intend to issue certificates themselves. These insureds may be well-intentioned and would like to be able to do this to expedite service. However, certificates are issued on behalf of the insurer and only an authorized agent has the right to do this. Certificate rights are usually established by the agency/company contract or

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addendums to that agreement. Make sure all agency staff members are aware of restrictions on certificate issuance.

While ACORD 25 is the most commonly used COI, there are other ACORD forms that may be better suited to certain situations, such as the ACORD 24 Certificate of Property Insurance. Agency staff should be familiar with these forms and always use the proper form.

Certificate Tips for using ACORD forms:

- **Always use the current versions of the ACORD forms.**
- **Never provide customers with a blank copy of the certificate that does not show the certificate holder.**
- **Be sure staff is aware of any restrictions in issuing certificates.**

Section 2: Requests for Specific Language

Agents are often asked to add very specific verbiage to certificates (usually in the Description of Operations field), provide an "agent affidavit" or opinion letter, or complete a "compliance checklist'. The required statements are often broad, vague, ambiguous, or nonsensical. Here is a short list of examples:

- "Insurance is primary and all others are non-contributory." (certificate entry)
- "Primary and noncontributory additional insured coverage provided for general liability, auto, and workers compensation insurance." (certificate entry)
- "Is coverage provided for Contractual Liability (including indemnification provision) assumed by insured?" (compliance checklist)
- "For those policies containing an aggregate, as soon as loss activity (paid or reserve) depletes the aggregate by 50% or more, written notice will be sent to the Contractor by certified mail." (agent affidavit)
- "Should any of the described policies be cancelled or materially modified, the insurance company will mail 30 days prior written notice to the certificate holder." (certificate entry)

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- "Is Occurrence Basis Coverage provided under automobile Property Damage Liability?" (compliance checklist)

- "Comprehensive form of general liability provided which includes personal injury with Employment Exclusion deleted." (certificate entry)

- "Insurer will provide written notice of any reduction of coverage with reasonable promptness." (agent affidavit)

- "Property insurance is provided without limitation." (compliance checklist)

- "General liability insurance includes blanket contractual, broad form property damage, and coverage for independent contractors." (certificate entry)

- Are there any claims (pending or paid) that could significantly reduce the aggregate?" (compliance checklist)

- Additional insured coverage provided in accordance with written construction contract." (certificate entry)

- "We hereby certify that said Contractor is in compliance with all insurance coverage required under this Contract with the Owner reference above. We hereby certify that said Contractor is in compliance with all insurance requirements, whether or not so evidenced on the attached certificate of insurance." (agent affidavit)

- "This confirms that all requirements from XYZ's Project Manual are covered by the Insurance Certificate." (agent affidavit)

- Contractual liability coverage is provided for all indemnity obligations of Subcontractor." (certificate entry)

- Just four of dozens of questions on a compliance checklist that required over 400 entries for completion by the agent:

    - "Is Named Perils Pollution Coverage provided?"

    - "Is building covered at 100% replacement cost?"

    - "Is Business Income limit adequate to cover full recovery of the net profits and continuing expenses of the Hotel for 12 months?"

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- "Does Personal Injury Insurance include coverage for personal property injury sustained by any person as a result of an offense directly or indirectly related to the employment of such a person by the insured?"

Keep in mind, when these kinds of statements are required to be added to the certificate that the ACORD Forms Instruction Guide (FIG) says, "ACORD recommends that the Certificate NOT be used in the following situations...To quote wording from a contract...."

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Certificate Tips for Cancellations:

- **Never paraphrase or condense policy coverage, terms, and condition on the certificate.**
- **Do not include cancellation information in the certificate's "Description of Operations" field.**
- **If certificate holder wants details on the terms of policy cancellations provide the appropriate cancellation endorsement or language separately.**

Section 4: Online Certificate Systems

Some entities have created their own online certificate systems or contracted with third party vendors and require agents to use their systems to issue certificates. In the latter case, the vendor usually sells the system based on the agency paying for it in the form of entry and access fees. One agency wrote the insurance for three vendors at an airport and was charged 25 cents every time the certificates were viewed by someone...the airport authority looked at every certificate every day (DO THE MATH).

When these systems are used, the agency has no control over the information once it is entered into the system. If the agency is sued in later years, they would have no record of their entry if the vendor is out of business unless they double-entered the data into their agency management system…and even then one could argue that the information may be different from that originally entered. One system boasts that the online "certificate" can be customized to include over 200 questions, many of them being of the broad, vague, ambiguous, or nonsensical varieties.

One such system allows the Description of Operations field to be entered by the insured. Only an authorized agent has permission to issue a certificate on behalf of an insurer...the insured should NEVER be allowed to modify a certificate in any manner. Another system allows the certificate holder to add additional insured information for blanket additional insured endorsements. No insurer would permit this on a traditional certificate.

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Section 5: Reviewing Contracts for Insureds

The trend in risk management is to try to transfer all liability (or as much as is legally possible), whether insurable or not. It takes an astute, well-trained, experienced, and qualified individual to undertake the scavenger hunt often necessary to identify exposures in lengthy or complex contracts. Business contracts can be very complicated. Construction contracts, in particular, can be huge and complex. When these agreements are reviewed by individuals who do not have the experience or qualifications to do so, it increases the likelihood of errors and thus exposure to liability.

When it comes to reviewing contracts for insureds such as construction contracts, leases, loan documents, or any other indemnity agreements, the E&O recommendation at one end of the spectrum would be to avoid doing this and refer customers to their attorneys. The reality is that many insureds don't have attorneys or can't afford to hire one to review every construction contract they enter into. Also, while the agency could incur a liability exposure by engaging in some level of contract review, it might also incur liability by failing to assist the insured in protecting itself against contractually incurred exposures.

If the agency, often as a value-added service, assists customers in reviewing contracts for their insurance implications, only qualified agency staff should do this and a disclaimer should be used. For example, here is a sample disclaimer developed by a Louisiana attorney:

> *Our Agency has, upon your request, reviewed the contract indicated above. Specifically, we reviewed only the insurance requirements contained in Section __, Page ___.*
>
> *The scope of our review was to determine if the current insurance program which you have placed through our Agency addresses the types and amounts of insurance coverage referenced by the contract. We have identified the significant insurance obligations, and have attached a summary of the changes required in your current insurance program to meet the requirements of the contract. Upon your authorization, we will make the necessary changes in your insurance program. We will also be available to discuss any insurance requirements of the contract with your attorney, if desired.*
>
> *In performing this review, our Agency is not providing legal advice or a legal opinion concerning any portion of the contract. In addition, our Agency is not undertaking to identify all potential liabilities that may arise under this contract. This review is provided for your information, and should not be relied upon by third parties. Any descriptions of the insurance coverages are subject to the terms, conditions, exclusions, and other provisions of the policies and any applicable regulations, rating rules or plans.*

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You should not use this disclaimer without checking with your own counsel to make sure it fits the needs of your agency and conforms to any legal requirements that may be unique to your state. A more detailed discussion of these issues is available in the certificates of insurance white paper on the Virtual University.

Certificate Tips for Reviewing Contracts:

- **Use a disclaimer when reviewing the insurance provisions of contracts, and lease and indemnity agreements.**
- **Always advise the customer to have their attorney review the insurance requirements of contracts.**

Section 6: Contract vs. Policy Limits

An insured may have a CGL policy with $1M/$2M limits and a $5M umbrella or excess policy. They sign a contract requiring a $2M occurrence limit which can be met with a combination of a CGL and umbrella/excess policy. The insured does not want the agency to reveal their full limits and asks that the certificate of insurance just show $2M in coverage rather than the total of $6M per occurrence they actually have. We suggest that the full limits be shown, not the minimum contract limits, for two reasons:

- The ACORD Forms Instruction Guide (FIG) says, "Enter limits corresponding to those found on the policy declarations page."

- Most state insurance laws, regulations, or DOI directives require that a certificate accurately reflect policy terms and conditions.

An exception to this might be found in one insurer proprietary endorsement which said, "We will not provide limits of insurance to any additional insured that exceed the lower of...the policy limits...or...the Limits of Insurance you are required to provide in the written contract or agreement." Since the policy will not pay more than the minimum contract requirement, it should not be a misrepresentation to show the contract limits on the certificate.

Section 7: Sending Certificates to Insurers

E&O procedures recommend copying insurers on all issued certificates. Where there are discrepancies between certificates and policy coverages and terms, it is sometimes difficult to determine where mistakes were made. By copying the insurer on certificates, the agency establishes that the insurer was provided notice of what coverages were ordered or intended

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to be ordered. The value of this practice is demonstrated by *Marlin v. Wetzel* (WV Sup. Ct., 2002) and *Erie v. NGM* (NY Sup. Ct., 2009) where the insurers attempted to bail out of a lawsuit on the basis that they did not get a copy of the certificate.

In the former case, "The insurance company asserted that it never received the certificate of insurance…[The insurer] does not dispute that its agent issued a certificate of insurance listing the Board as an additional insured. Instead, the insurer argues that it had no knowledge of the certificate's existence, and therefore could not modify the actual policy to include coverage…." Below is some sample wording when sending certificates to carriers:

> *"Our internal procedures and our legal counsel require that a copy of all certificates be sent our carriers. Please do not return them to our office."*

For more sample case law and a state-by-state listing of certificate laws, regulations, and insurance department directives, refer to the Big "I" Certificates of Insurance Resources area of the Big "I" Virtual University.

Section 8: Additional Insured Issues

Many insurers provide their own additional insured endorsements. Some of them are equivalent or even superior to the ISO forms but MANY of them are grossly inferior and might easily put your insured in breach of contract if the coverage and terms afforded do not meet the requirements of the contract. For example, some proprietary insurer AI endorsements only cover ongoing operations. Some only provide coverage for vicarious liability. Some only provide excess coverage. Some are even worse than this. One insurer AI endorsement even said it includes "language equivalent" to the CG 20 10 and CG 20 37. It did but it also included other language that said coverage was vicarious only and the endorsement would pay the lesser of the policy limits or the minimum limits required by the construction contract.

Many contracts call for additional insured coverage that is "primary and noncontributory." These terms are rarely defined...but never fear, the courts will determine what they mean when you're sued. In the ISO CGL policy, primacy is governed by the Other Insurance clause OF THE ADDITIONAL INSURED. In other words, the only way you could state on a certificate of

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insurance that CGL AI coverage is primary and noncontributory is if you have read the additional insured's CGL policy.

Beware of non-ISO Blanket Additional Insured endorsements that provide coverage for anyone requiring additional insured status in a written and executed contract. One agency faced a large E&O claim because it's insured had signed the contract but it had not been signed by the other party at the time of the loss and therefore had not been "executed".

"Primary and noncontributory" terminology should never be used with auto coverage since primacy is subject to several factors, especially ownership of the vehicle. In addition, the ISO CA 20 48 Designated Insured endorsement is often provided in response to request for AI status on commercial auto. The CA 20 48 is not a true AI endorsement since it only provide vicarious liability and, in fact, does not change the business auto policy in any way. Workers compensation coverage can NEVER be provided for an additional insured on a "primary and noncontributory" basis, although we've seen this language on certificates issued by agencies in response to mandated verbiage required by certificate holders.

SPECIFIC STEPS TO DECREASE EXPOSURE

Below is a summary of steps that the agency can do to reduce its exposure to E&O claims from certificates of insurance:

1. Make sure all staff is aware of state regulations and penalties relating to issuing certificates.
2. Be upfront with your customers that the agency will only provide current, accurate information on certificates.
3. Establish a procedure for handling certificates.
4. Consider discontinuing contract reviews for customers and instead asking them to provide insurance requirements within the contract for the agency to review.
5. Always use the current editions of ACORD forms.
6. Never modify ACORD forms in any way without the express consent of ACORD. Remember it may be a filed form in your state as well.
7. Never issue a non-ACORD form without the written approval of the insurer.
8. Always send all of the pages of the certificate.
9. Only indicate coverage that exists at the time of certificate issuance and never specify coverage that does not exist.
10. Be sure qualified staff members handle these important transactions because of their level of complexity.

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SOLUTIONS FOR AGENCIES

All agency commercial lines staff should be intimately familiar with the Big "I" Virtual University Certificates of Insurance Resources area:

https://www.independentagent.com/vu/agency-management/certificates/default.aspx

This page is accessible in the public area of the VU web site. Many of the articles and documents can be viewed or downloaded without logging in, though some features are limited to member agencies only. Feel free to refer underwriters and insureds to this area.

The following are areas in which agencies can improve to reduce their E&O exposure:

- **Education.** A vast amount of insurance for internal training on this subject can be found at the VU link above. In addition, for external customer education, the above resource includes an article and presentation that Big "I" member agents can give to their insureds and local industry groups like homebuilders, lender associations, and civic/business clubs.

- **Procedures.** Agencies should have written procedures dealing with certificates of insurance and related issues. The Independent Insurance Agents of Texas has produced a "Best Practices for Certificates of Insurance" that is available from the VU Certificates of Insurance Resources page linked above. Some of this material is Texas-specific but much of it is applicable elsewhere. In addition, we strongly suggest that agencies consider incorporating, at least by reference, the ACORD Forms Instruction Guide (FIG) that advises how to complete every field in every ACORD. This information, along with every ACORD form, is available online in PDF format for free. You have to subscribe to gain access, but there is no cost. Go to http://www.acord.org and click on the "Join" link in the upper right. Complete the form and indicate that you want access to ACORD forms and FIGs and you'll be provided with a login account.

- **Job restructuring.** Some certificate requests should be deferred to agency personnel with the proper training and experience to respond. Many certificate requests can no longer be handled as a clerical function. This may require the restructuring of some agency staff jobs.

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- **"Service, not servitude."** Most agents want to provide a high level of service to their customers. But keep in mind that you do not have to do everything that you are asked to do, especially if the insistence comes from a third party business relationship of your customer. Needless to say, this is especially true when a third party tries to economically force you to do something that is illegal or unethical.

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