Full Disclosure

Withholding information from the insurer at renewal time is the wrong way to gain a competitive advantage

>> BY CIP SOCIETY

With the economy slowly climbing out of recession, companies of all types and sizes continue to look for ways to cut costs at every opportunity. This often includes insurance costs, too. Consequently, the following scenario may be an increasingly common one for today's insurance broker.

A commercial producer found herself confronted with a situation during what seemed to be a routine service call to a client at renewal time. While many clients were lamenting the difficulties in surviving over the last couple of years, this particular company was the fortunate recipient of several new contracts that will increase its revenue fivefold. The owner of this privately held company advised the commercial producer to "sharpen her pencil" with respect to the renewal premium on his policy because he was already in possession of other quotes that were close to last year's premium. The producer could not understand this because whereas the risk was similar to last year, the increase in revenue should have resulted in a corresponding increase in the portion of the premium attributed to commercial general liability (CGL).

Helping her client understand that the increased revenue is a material change in risk that will, without question, increase premiums to be paid is part of the commercial producer's job. Helping the client understand how to evaluate the best coverage for the best price, and not compare apples and oranges, is also part of the broker role. The broker needs to ensure that she is asking all the right questions, assessing the situation, and managing the client's risks appropriately.

Current Information

In order to clarify the nature of the competitive quotes, the producer inquired about the other applications, as to what amount of revenue had been specified on the other applications. The owner indicated that he obtained the revenue figure from his latest financial statements, which were from 11 months ago. His new financial statements would be available about one month after his insurance policy renews.

Given these circumstances, it was not surprising, then, that the competitive quotes were in keeping with last year's premium. The question then becomes how to help the client understand the premium is not adequate for the operational exposure, which has increased due to the new contracts and increased revenues.

What happens if she chooses to process the renewal based on last year's rates and ignores the fact that there had been a material change in risk? She may be able to convince herself that the client would be covered even if the lower revenue figure was used, and therefore what is the harm? Further, the only real evidence of higher revenues is the new set of financial statements, which are not yet available. Thus, she may feel justified in "doing what the client wants" and feels she can defend her actions. But is she misguided?

In addition to her relationship with the client, her conduct should also be guided by the applicable codes of conduct set out by the provincial regulator and/or the Insurance Institute (if a CIP or FCIP). According to the Institute's Code of Ethics, an insurance professional's ethical obligation is to:

- not wilfully misrepresent or conceal material fact in insurance and risk management business dealings in violation of any duty or obligation;
- not sign or associate themselves with any letter, report, statement or representation which they know is false or misleading, or which is prepared in a manner which might tend to be misleading or to misrepresent the actual situation; and to
- use due diligence to ascertain the needs of their client or principal and shall not undertake any assignment if it is apparent that it cannot be performed by them in a proper and professional manner.

The broker also has a relationship with the insurer and an obligation to practise full disclosure. The "you didn't ask, so I didn't tell" approach is not justification nor a defence. Providing mere bare-bones answers is not a fulfilment of a broker's obligation to the insurer.

Information should be passed on to the insurer exactly as it has been received from the insured. The broker should do her utmost to probe and enquire to ensure that all needs and changes have been ascertained. An ethical broker should not manipulate the information provided by the client to gain a competitive advantage. The obligation of the broker is to ensure that the client has the coverage needed to protect against a loss. Making the client look better than is actually the case is not a sound ethical decision in the long run.

> "The **'you didn't ask, so I didn't tell'** approach is not justification nor a defence. Providing mere bare-bones answers is not a fulfilment of a broker's obligation to the insurer."

Consequences

The broker should advise the insurer of the increased revenue figures. There are two more reasons to do this. First, the policy gives the insurer the right to inspect the insured's books at any time, so the insurer could discover the increased revenue figures on their own, regardless. Second, should the insured suffer a loss and during the subsequent claims investigation it is discovered that the broker failed to report the increased revenue figures, the insurer would have grounds to deny the claim due to misrepresentation.

As a result, the loss would be paid, not by the insured's policy, but by the broker's E&O policy. If this occurred, the broker's reputation in the marketplace would be severely damaged and she could potentially lose not just the account but also her job.

Coverage is not often voided and claims are not usually denied in instances where it is a matter of a premium shortfall. If the insurer would have accepted the risk regardless of the size of the revenue, it is difficult for the insurer to deny coverage based upon revenue misrepresentation, provided that the correct premium owing is paid by the customer. However, for some types of risks, the volume of revenue is a deciding factor in risk acceptance and in this case, some of the client's new contracts could even be for sales outside of Canada. So by participating in the deception the producer is exposing her client to financial harm if a future claim is reported and subsequently denied because the actual revenue is deemed to be a material change in risk.

The broker is wrong to assume that she would automatically lose the account if she reported the increased revenue figures. First, she might be able to leverage the increased revenue figures to negotiate a tangible rate reduction for her client. Second, she could explain to the insured how reporting the increased revenues at renewal would avoid the application of a large and unplanned-for premium adjustment at expiry. In this way, the insured's insurance costs are known up front, allowing them to more smoothly manage their true cost of risk. In both instances, the broker would have demonstrated her value to the client. And unlike her competition, she would not have to compromise her ethics to do so. TB

The CIP Society represents more than 16,000 graduates of the Insurance Institute of Canada's Fellow Chartered Insurance Professional (FCIP) and Chartered Insurance Professional (CIP) Programs. As the professionals' division of the Institute, the Society offers continuous professional development, information services, networking opportunities, and recognition and promotion of the designations. This article is developed from commentary solicited from senior members of key brokerage firms and the CIP Society, and is intended to generate a dialogue about ethics among insurance professionals. We welcome comments and scenarios to the discussion at cips@insuranceinstitute.ca. This series of articles is archived on The CIP Society's website at: www.insuranceinstitute.ca/cipsociety.

ThinkStock

Search insurance companies at www.citopbroker.com/directory