"Hypothetical" Situations

To know or ought to have known

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We've all had them. Those friends or colleagues who start off by saying "I have a friend who was in an accident." Those "hypothetical questions" about a friend's insurance needs can often be a test of the insurer-client relationship. If the broker "ought to know" her client, then such a loose inquiry becomes: can the broker turn a blind eye to a suspected misrepresentation or non-disclosure?

Imagine this scenario:

Shortly before renewal time on a large commercial lines policy, an informal conversation between a broker and a premium-sensitive client took place. The focus of the conversation turned to the salient aspects of the upcoming policy renewal. The client suggested that the nature of his business and the associated risk would be identical to that of years gone by.

After discussing the renewal, the client suggested that he had a "friend" in exactly the same business as his, and this friend would be interested in knowing if his premium would be increased if he warehoused and used a certain volatile substance in his factory. The broker advised that she was confident that it would increase the risk and thus the premium. After the conversation ended, the broker was certain that the client's friend was indeed the client and although she was not expressly informed of the volatile substance, wondered if she should investigate further or inform the insurance company.

Advising "The Friend"

When asked a hypothetical question or a question relating to "a friend's business," the broker should at least discuss, and most likely explore, the issue a little further. She can explain to the client how serious the repercussions "for the friend" would be if the insurer were not told about these activities and that the policy might not respond if there were a claim and the description of business were found to be knowingly misrepresented. The client's question provides an excellent opportunity to talk about what can happen if his friend is not candid, and may face the possibility of coverage being cancelled or having claims denied. Also, the benefit of a loss prevention program should be discussed. Sometimes hazardous materials are reasonably acceptable if the method of storage is appropriate for the product. The goal is to try to discuss such concepts as failure to disclose and material change in risk without sounding alarmist. The party involved may well be his friend and not the client.

If the broker chooses not to follow up on her suspicion by confronting the client, how can she credibly discuss or represent the risk to underwriters with the renewing insurer or any other market?

Most provincial Broker Codes of Conduct require that a broker must evaluate the client's needs, must disclose all material information and act with integrity, competence and utmost good faith. A broker is required to put the interest of the client as the broker's first concern. That concern should include whether or not a client's policy would respond to a claim in the event that a material change was not reported to the insurance company, especially if there is a chance that that information could influence underwriting decisions.

Since failure to report the storage and use of volatile material would most likely fall into this category, the broker should follow up with the client. The broker should inform the client that there is a clause on all property policies that could result in a policy being void and a loss not being paid if the insurance company uncovers information about the risk that was not disclosed and would have influenced how the underwriter assessed the risk. The client should be made aware that even if a loss does not occur, the insurer could still cancel the policy if they uncover any material change to a risk not reported to them.

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The broker should provide copies of the standard clauses for misrepresentation and for material change in risk to the client suggesting the client check with their own operations to ensure that no such substance or other change in operations exist that may not have been reported previously to their insurers.

Does she tell the insurer of her suspicions? If she does not have evidence that the insured has done anything untoward, then crying wolf would put the client in a disadvantaged position without cause. Where the question becomes more interesting depends on how strongly the broker feels that she is being misled or when the broker confirms a breach of a policy condition. For example, perhaps in investigating the client's website she finds information that confirms her suspicions; then the underwriter should be informed. The broker may suggest to the underwriter that an inspection would be appropriate before renewal. In such a case where the client refuses to address the issue and doesn't want to insure their business properly, then withdrawing from the account would likely be an appropriate response, and deferring to legal counsel on this point would be a good idea.

Documentation

A legal risk management solution is to follow up with a very specific letter that not only confirms the policyholder/client's advice about no change to the operations, but also outlines the separate discussion and the resulting advice on the impact the change

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would have on the "friend's" premium. The broker's letter can point out, for the benefit of the "friend" that, in the event a policyholder knowingly withholds information from an insurer, it gives the insurer the legal right to void the policy from the beginning. The letter can close out by inviting the client/policyholder to advise promptly of any changes to the risk, suggesting his "friend" likewise report any such change to his/her broker and that this must be reported promptly to underwriters to ensure continued unimpaired coverage. However, the broker must point out that she cannot give good counsel on his friend's account without direct consultation with the friend.

If the broker's version is in writing, the ethics of the situation and what the broker "ought to know" is clarified and documented. Through the correspondence, the broker has alerted (and is seen to alert) the client to: (1) the representation being made at renewal; (2) the increase in premium which would be required for the increase in risk for the "friend"; and (3) the consequences of materially misrepresenting the risk or failing to disclose the change in the risk to underwriters, all while also providing the underwriter with an uncontroversial basis upon which to determine the coverage issue at a later date if that becomes necessary.

If the client suffers a loss that results in loss of coverage, without written documentation, there may be nothing to stop the client from claiming that the broker simply misunderstood the conversation; that she "ought to have known" he was really talking about the very risk at issue, and that he was asking for but did not receive a clear answer.

This "ought to have known" scenario unnecessarily pits the broker's credibility against the client's and even if the contest looks more than certain from the broker's perspective, no amount of mindful certainty can pay for the increased E&O premium and aggravation of a claim contested with lawyers on all sides. TB

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