



Insurance Warranties

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We had been planning our yearly family road trip for months and the day had finally arrived. The car was loaded with all of our ski equipment and plenty of DVDs to entertain the kids for the ten hour drive from Kansas City to Denver. Thirty minutes into the trip our son tells us the DVD player has stopped working. We call the car dealership from the cell phone to find out the DVD player is still under warranty. Halleluia! The warranty would pay for everything. Thank goodness I had mailed in that warranty card. This did not matter to our 8-year-old; all she knew was that she had to endure 9½ hours across the “scenic plains” of Kansas with no TV. Are we there yet?

Warranties on products can be wonderful when the product breaks. Although warranties in insurance policies are similar to product warranties in the sense that they are based on representations, insurance warranties operate much differently. E&O claims arise when policyholders are left without coverage because of warranties made on applications, or because of a failure to follow a warranty condition in the policy. This article will explain each type of warranty, and give some some tips for avoiding warranty-based E&O claims.

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

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

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* *The above example is provided by the program underwriter Swiss Re/Employers Reinsurance Corporation*



Insurance policies themselves can also contain warranties, which fall into two general categories: “affirmative warranties” and “promissory warranties.” Affirmative warranties promise that the state of the risk reflects particular specific conditions (e.g., a monitored alarm system, or that no flammable materials are stored). Promissory warranties promise that the insured will do or not do specific things (e.g., locking all doors before moving jewellery from the showcases to the safe, or maintaining all required licenses in good standing). Many jurisdictions require that policy warranties be delivered to and separately signed by the insured in order to be effective. Brokers should deliver policies containing warranties as promptly as possible, and return the signed warranties to the carrier as quickly as possible, retaining a copy in the agency file. A carrier that cannot disclaim coverage because of an undelivered or unsigned warranty delivery will look to the broker’s E&O carrier if the broker negligently failed to do what was required to make the warranty operative.

E&O situations also arise when the policyholder claims that the broker did not explain the warranties and that he was therefore unaware of them, or when the policyholder asserts that the broker knew that the warranties were being breached but continued to provide coverage knowing that the warranties were being violated. Brokers should write their clients to remind them that their policies contain warranties and that failure to follow the letter of the warranties could jeopardize coverage. Brokers with knowledge that warranties are being violated should write to the client advising that he should endeavor to cure the warranty breach as soon as possible and alert the broker when accomplished, such letter copied to the carrier. That way, there can be no question but that the insured knew what it had to do in order to keep coverage in place, and the carrier had the choice to cancel the policy.

Warranties on applications and in policies are powerful tools for carriers to use when disclaiming coverage. Brokers must take special care to comply with any delivery and signature requirements, make sure clients are aware of any affirmative and promissory warranties in their policies, and to educate their clients about the need to comply to the letter with any such warranties.

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