All should use greater care handling underwriting information

By Akos Swierkiewicz

One of the tenets of insurance law is that parties to an insurance policy are expected to deal with each other in utmost good faith. Applicants for insurance or their brokers must disclose all relevant underwriting information fully and accurately to prospective insurers. If the application contains any misrepresentation or omits information that could affect the underwriting decision of the insurer, the standard of utmost good faith is not met and the insurer may deny coverage for claims or rescind the policy.

Allegations about misrepresentation or omission usually surface in the course claim investigations by insurers. In many instances the ensuing litigation may result in denial of the claim or rescission of the policy. Even if misrepresentation or omission is not proven, litigation inevitably causes significant delays in claims adjustment and direct and indirect expenses to the parties.

Misrepresentations or omissions primarily originate from negligence by the applicant or broker during the course of the obtaining underwriting information and completing the application.

One of the major functions of brokers is to obtain accurate and complete underwriting information, which requires their active involvement in the process of gathering, preparing and communicating such information to the insurers, rather than just being the conduit to pass information from applicants to insurers. Brokers should also take the initiative and explain major provisions or conditions of the policy to applicants to minimize negative surprises when a claim occurs.
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State insurance laws generally allow the insurer to deny claims or rescind the policy for misrepresentation or omission, including concealment fact or incorrect statement, if:

- it was material either to the acceptance of the risk or to the hazard assumed by the insurer, or

- a reasonable insurer would have acted differently had it known the true facts, e.g. would have charged higher premium, restricted coverage or declined to issue the policy.

While most misrepresentations or omissions are unintentional, the insurer's right to deny claim payment or to rescind the policy is not limited to intentional or fraudulent misrepresentation under a number state laws, when either of the above two criteria applies.

The following are examples are alleged misrepresentations or omissions involving litigation:

- the broker asked the applicant to sign a blank application form, completed and released it to the insurer without providing copy to the applicant;

- the applicant did not review an application prepared by the broker, which contained a misrepresentation or omission;

- the broker did not ask the applicant about past losses and provided the wrong answer in the application;

- the applicant and broker did not communicate clearly about the scope of coverage and limits sought in the application;

- an application question was ambiguous to the applicant and the answer was incorrect;

- the insurer did not seek clarification of an ambiguous response to an application question.

The need for greater care with handling of underwriting information is not limited to applicants and brokers. Insurers should ask all pertinent questions in the application form because, in many instances, the applicant may be aware of important underwriting information but does not disclose it simply because it was not asked.

Application questions should be limited to seeking factual information rather than eliciting the opinion or judgment of the applicant. For example, when the applicant answered “no” to a professional liability application question as to whether future claims were expected, based on the applicant’s opinion or judgment, the insurer concluded that the response was a misrepresentation or omission just because a claim did occur.

In some instances, there may be an appearance of misrepresentation or omission due to the failure by the insurer to clarify responses to application questions. When presented with ambiguous or conflicting information, it behooves insurers to seek clarification prior to binding coverage or issuing the policy. For example, when an applicant found an application question inapplicable to its business, he amended it in a good faith attempt to provide accurate and complete information, and the insurer issued the policy without seeking clarifications. When a claim occurred, the insurer denied it, citing the answer to the modified question as evidence of misrepresentation.

In certain circumstances only litigation can resolve allegations of misrepresentation or omission. However, the exercise of greater care in obtaining and preparing underwriting information by applicants or brokers, and clarification of ambiguous information by insurers can substantially reduce the number of cases requiring litigation and inevitable delays and costs.