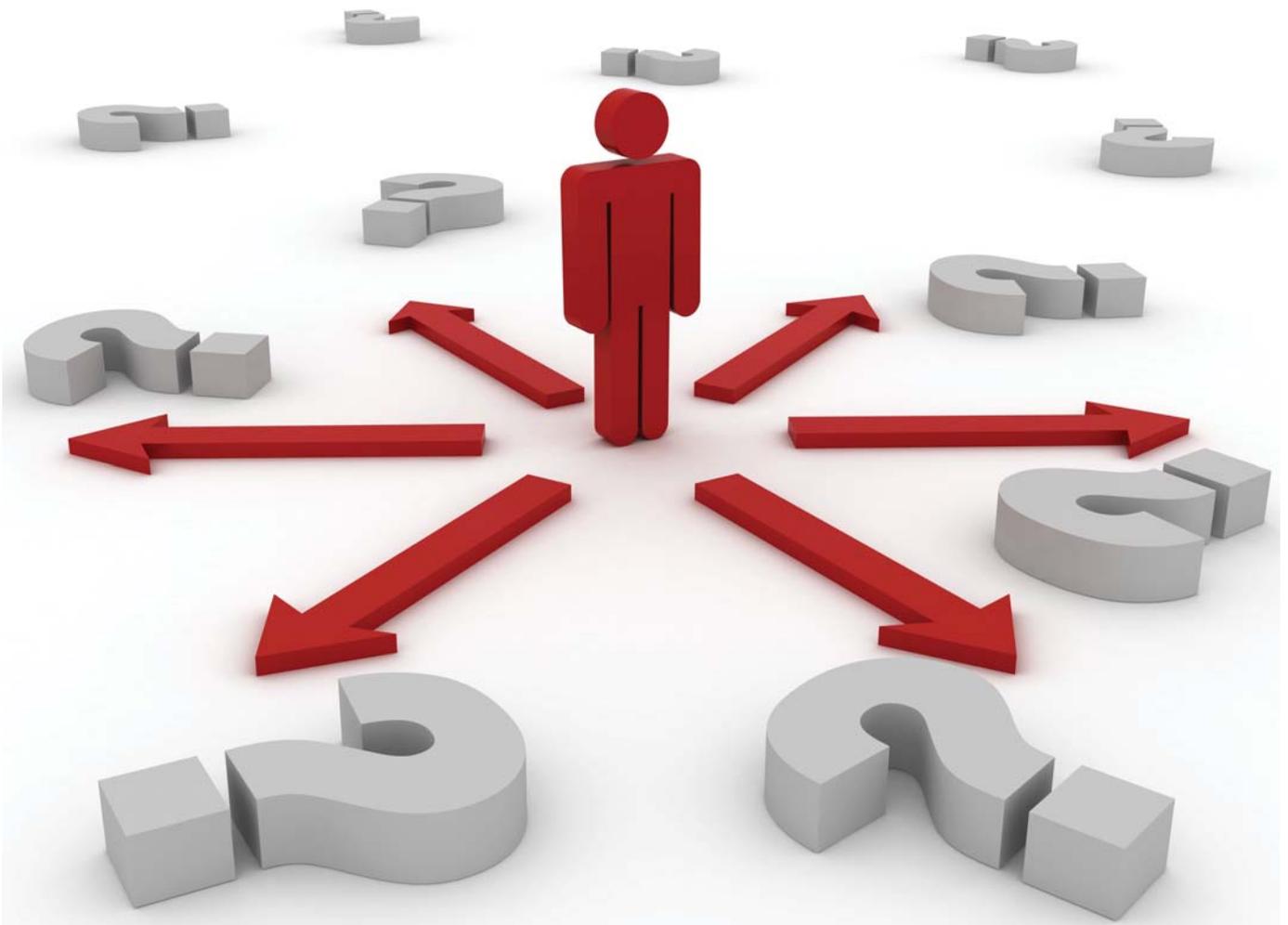


# E&O Risk Management: Meeting The Challenge Of Change

## Understanding Agent Duties



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# Understanding Agent Duties

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**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:**

Introduction ..... 2

Duties to Customers ..... 2

    Section 1: Negligence – Prove it! ..... 2

        To Whom Is A Duty Owed? ..... 4

    Section 2: What is standard of care and why is it important?..... 4

    Section 3: Differing Levels of Standard of Care ..... 4

        Non-professional Standard of Care ..... 5

        Professional Standard of Care ..... 5

    Section 4: Determining Standard of Care and the “Special Relationship” ..... 5

Agency Practices vs. Legal Duty ..... 7

    Section 1: Creating a Duty Where None Previously Existed ..... 7

## 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.

**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.

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"

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.)

- 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."*

- ***“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

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.