Don't Let Homeowners E&S Equal E&O

Over the past year, I have had several friends and neighbors approach me with concerns about their homeowner's coverage. One friend had just been non-renewed because of a third claim. They were destined for an E&S carrier. Another called me late at night wondering whether they should report a claim after their dishwasher malfunctioned and damaged the drywall on the basement ceiling. They had the misfortune of having to file a claim earlier in the year and didn't want to be cancelled. It got me thinking about the E&O exposure agents might generate by placing their client's homeowner's insurance in the non-standard market. The hard market changed many carriers' underwriting appetites and increased the importance of E&S markets. What should you consider when moving your homeowner's client to a non-standard policy form?

First, familiarize yourself with the state laws for writing E&S business. For instance, some states require that before writing a piece of business, the agent must complete a diligent search of the marketplace and must maintain the declinations of admitted carriers in the file. You must maintain your records because the department of insurance can ask to review these files.

Before reviewing the policy form with your client, educate them on implications of placing business with a non-admitted carrier. E&S markets do not fall under the umbrella of the state guaranty fund which means if the carrier goes insolvent, there is no backstop for the claims payment. You must collect a signed disclaimer letter that the insured is aware of the risks and that they want to purchase the coverage being offered.

It is difficult to provide a lot of specific provisions to review and compare between a standard and E&S homeowners policy (see sidebar)—and that's exactly the point. The policies can widely vary so you will need to review the policy and document changes to the client's prior coverage when moving them to an E&S policy form. Request and review sample policy forms from the broker or carriers that you work with so you are prepared to advise your client.

Choosing at good E&S broker is extremely important. As a business practice, brokers will require signed agreements from producers that set the expectations for the relationship. The agreement should outline the responsibilities of the agent and the broker, include a mutual indemnification agreement and make clear ownership of expirations. From a business processing standpoint, a good broker will address the coverage requested as outlined in the applications. It helps if you know the brokers' appetite for risks being submitted. With the flood of applications to surplus lines markets, omissions can happen, so thoroughly review the quotes provided by brokers.

In today's marketplace environment, the E&S market serves an important purpose. When you use an E&S market, the principles of E&O claims prevention don't change—only the level of vigilance increases. States may define an agent's obligation to their client differently, but it's better to err on the conservative side for E&O claims prevention. Evaluate your client's loss exposure, review proposals for accuracy compared with what was requested, offer higher limits and available extensions of coverage and explain deficiencies in coverage. Then let the client make the decision and sign off on coverage options presented but not taken. IA

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Compare the Coverage

Since the standard markets are more highly regulated from both a coverage and pricing standpoint, ensure you and your client understand the E&S policy provisions. Policyholders moving from a HO-3 Specialty form could see significant changes in coverage. E&S carrier starting forms can vary widely from a DP-1 or to an HO-3, but the end product can be vastly different. Be sure to review these areas:

1. Identify if the policy is written on a comprehensive or named peril basis.
2. Review the loss settlement clause for modifications to replacement coverage or actual cash value.
3. Check the percentages of your dwelling amounts for other structures and personal property.
4. Review the cancellation and return premium provisions.

In the near future, Big "I" Markets will offer a non-standard homeowner product from Balboa Life and Casualty Group that is designed specifically for customers unable to qualify for standard programs for various reasons and is written on admitted paper. It will provide a quality coverage form that is subject to state guaranty funds—that's positive from an E&O perspective, and something you should consider in all E&S market purchases.

—D.H.