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Certificates of Insurance, Insurance Agents and Rolling Stone Syndrome

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Abstract

Insurance agents have become increasingly burdened with third-party requests for certificates of insurance, additional insured status, agent coverage "affidavits" or compliance checklists, and other sometimes onerous demands. Those that are cost accounting these demands are learning that they are operating at a loss for many insureds. In addition, regulators are imposing constraints on what agents can legally do in fulfilling these requests. As a result, agents are having to increasingly decline many of them. This article examines the nature of these increasing costs and identifies four basic reasons why agents may be unable to comply with requests from third parties.

Introduction

A certificate of insurance is an informational document issued by or, more commonly, on behalf of, an insurance company. The certificate indicates that an insurance policy exists of a certain type and limits. Certificates are simply snapshots of basic policy coverages and limits at the time of certificate issuance. Certificates are not intended to modify coverages or change the terms of the insurance contract and they convey no contractual rights to the certificate holder.

At least that's the way it used to be.

Unfortunately, today there is an effort to make certificates do more than they were ever intended to do and, increasingly, require insurance agents to do more than has ever been necessary in the past. As evidenced by the evolving nature of certificate demands, agents are all too often viewed as public service agencies and are expected to provide free services to parties with which they have no business relationship and to assume increased risks for the same.

Businesses frequently enter into construction or service contracts, loan agreements, leases, and other contracts that include certain insurance and indemnity requirements that must be evidenced by a certificate of insurance. If the certificate holder desires status as an additional insured under a policy, this can only be done by an endorsement to the policy. A certificate alone will not change the policy.

In fact, not only does the certificate say it doesn't amend or alter the policy, the policy itself usually says this. For example, the ISO IL 00 17 Common Policy Conditions form says, "This policy's terms can be amended or waived only by endorsement issued by us and made a part of this policy."

At least that's the way it used to be.

Today certificate requestors insist on certificate wording or agent warranties that the certificate confers specific policy coverages or rights. Problems often arise when a contract makes demands that are, for all practical purposes, impossible to meet. These problems include: (1) requests for insurance for losses or damages that are uninsurable, (2) requests that agents do not have authority to execute or cannot legally comply with, (3) requests that require inappropriate certificate wording, and (4) requests that are impractical from a markets or coverage availability standpoint. These four broad categories will be examined later.

As a result, insurance agents are sometimes asked to provide a certificate of insurance that cannot comply with the contract an insured has been asked to sign or has already signed. In fact, the insured may have completed the job and needs a modified certificate in order to be paid. This puts a great deal of pressure on agents to do something they should not and, often, cannot do.

The purpose of this article is to first examine the magnitude of the problem in the form of agency costs, then to illustrate how certificate problems can arise, explain why agents cannot always comply with third-party demands, and to explore what solutions are available, in a broad sense, to address the most common problems. The simple fact is, as the Rolling Stones put it, "You can't always get what you want."

Operational Costs

At one time in most agencies, certificates were probably a rarity, particularly outside the construction industry. Today, it seems like *everybody* is on the certificate bandwagon. Just recently, a lender on a commercial building wanted a certificate confirming additional insured status on the property insurance, general liability, *auto policy*, and (no kidding) *workers compensation*.

Industry technology expert Steve Anderson (www.steveanderson.com) estimates the cost to issue a plain vanilla ACORD 25 certificate at $6–$7 and if some customization is required, as much as $15–$18. This could be even higher when you get into requests that some third parties make that involve lists of questions in addition to the certificate. One Nebraska agent was given a 40-question checklist he was required to complete, along with an "affidavit" warranting that coverage was in place and conformed to the construction contract (of which he had seen 2 of 88 pages). This affidavit was to be notarized and witnessed by a disinterested third party and sent to the certificate holder via certified mail — all for free and with great urgency.

An Illinois agency producer and CSR spent a total of two and a half hours on one certificate that had to be redone four times. The last time they had to reissue it because a field on the form was not applicable and they had entered "NA," whereas the certificate holder would only accept an entry of "N.A." — so they had to reissue the certificate and add the two periods after the "N" and "A." The contractor was due $300,000 on a job and the general contractor refused to pay until the certificate met his satisfaction to the letter (or better, punctuation mark).

Many agencies are issuing upwards of 30,000 certificates a year (one medium-sized agency was doing more than 40,000) and sometimes 3,000–4,000 for an individual insured annually, i.e., close to a dozen a day for some accounts. A significant number of agencies have full-time staff devoted to this function.

A Texas agent estimated that 3 percent of their commercial lines revenue went to pay for their certificate operation. That's a big chunk of agency profit being invested in an activity that is being provided to third parties free of charge in most states. It was estimated that their cost of issuing certificates is double the cost just three years ago due to the increase in number and the complexity of requests.

With estimates of the number of certificates issued annually being as high as 100 million, certificate processing represents a *billion-dollar* operation for agencies. Unlike insurers who can increase premiums when expenses rise, agents have no way of passing along these costs unless they can (and are willing to) charge a fee for this service.

In addition to direct operational costs, certificate processing opens agencies to errors and omissions (E&O) claims from their customers and even certificate holders.

E&O Costs

Clearly, for many agencies, certificates have become a costly black hole that takes valuable time away from servicing clients while creating unnecessary expense for the agency, not to mention increasing its E&O exposure. Consider these E&O claim statistics from Swiss Re, the leading writer of insurance agents E&O in the country:

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- In 2007, E&O claim frequency was up 28 percent for certificate-related claims.
- 1 in 25 E&O claims involve certificates (higher in some states).
- 36 percent of these claims involve additional insured status (or lack thereof).
- CSRs are most often responsible for certificate claims.
- Certificates issued on lapsed coverage are more common in larger agencies.

If those don't grab your attention, consider three recent E&O claims reported by Swiss Re:

- The insured requested an additional insured endorsement as required by the construction contract but the agent failed to request it: $180,000 settlement cost.
- An agent used a blanket additional insured endorsement. However, it required that additional insured status requests arise from written contracts. There was no written contract so the blanket endorsement was not triggered: $445,000 settlement cost.
- An account was nonrenewed and the agent could not find another market. The insured found an E&S carrier but the carrier couldn't or wouldn't issue certificates of insurance. As a favor to his former client, the agent used the agency's agency management system to issue 4,000 certificates. As it turned out, the coverage was not actually in force. Following several accidents, including a fatality, an E&O lawsuit was filed: $10,290,000 settlement cost.

So, in addition to incurring often unnecessary, even unconscionable, expenses, agents also undertake significantly higher risks when performing a function for another party that views them largely as guarantors of a business risk that party has assumed. Increasingly, by choice or legal edict, many agencies are refusing to comply with certificate demands. The nature of these demands and denials can be categorized as: (1) uninsurable requests, (2) illegal requests, (3) inappropriate requests, and (4) impractical requests.

Uninsurable Certificate Requests

Often indemnity agreements will attempt to transfer risks and liabilities that are largely uninsurable. For example, a construction contract may require the downstream party to be responsible, under a commercial general liability (CGL) policy, for "***any*** *negligent acts, errors or omissions*" or "***any and all*** *liabilities*" that result in "***any*** *claim, cost, expense, liability, penalty, or fine.*"

Sometimes an indemnity agreement will include a requirement to insure, such as "*contractor must insure all claims, demands, and causes of action* ***of every kind and character, without limit,*** *and* ***without regard to the cause or causes thereof.*** *…*"

Needless to say, such agreements are virtually impossible to insure, yet agents are often asked to sign notarized "affidavits" warranting that the insurance program complies with the contract the insured has signed. Any such sworn statement would almost always be inaccurate, to say the least. In one case, a risk manager required that the certificate include language that the policy would "*… cover contracts without exception that the Subcontractor has signed with Contractor* ***or is going to sign.***"

While insurance policies are very precise, highly litigated contracts where coverage can hinge on the tense of a verb or a punctuation mark, other contracts insureds encounter in the marketplace frequently contain vague, ambiguous and undefined terms.

Yet, again, agents are often presented with checklists that ask whether policies meet the requirements of a contract so poorly constructed that even the drafter does not understand the terms.

One of the most common requests made when additional insured status is requested on a CGL policy is that the certificate of insurance includes a statement from the agent that such coverage is provided on a "primary and noncontributory" basis. The problem with complying with this request is that it is the *additional insured's* CGL policy that governs whether insurance is primary and noncontributory. Therefore, the downstream party's agent cannot make such a statement without knowing what the additional insured's CGL policy says ... which is almost never the case.

In addition, contracts often require notice of things like "material change" and ask for this to be shown on the certificate or endorsement, yet terms like this are never defined. One certificate request included a questionnaire that asked, "Does Personal Injury Insurance include coverage for personal property injury sustained by any person as a result of an offense directly or indirectly related to the employment of such a person by the insured?" When asked, the requestor had no idea what this question meant, yet the agent was expected to reply in the affirmative that the insurance coverage complied.

The end result is that any attestation by the agent that such notice will be provided is simply a guess as to what "material change" or other terms mean. Even with the common request for notice of cancellation, few contracts stipulate whether this notice must be provided if the *insured* cancels, though you can be assured in some cases that this is exactly what the certificate holder will say was intended after the fact.

Finally, the contracts being used are often mutations of contracts that have been used for decades. They may request coverage be provided by a "Comprehensive General Liability Policy" or that cross liability coverage be endorsed or that a "broad form" property damage endorsement be provided. These are all antiquated terms no longer used in the industry.

"Illegal" Certificate Requests

Increasingly, states are enacting certificate-specific statutes or regulations or their insurance departments are issuing regulatory directives that govern the use of certificates of insurance.

Kansas and Minnesota are two states that have legislated how certificates can (or can't) be used. Louisiana recently enacted criminal statutes that include up to five years in prison at hard labor for the issuance of a fraudulent certificate. Alabama is a state that addressed certificate problems by regulations that govern the filing of certificates and the issuance of erroneous "agent affidavits."

More commonly, though, most states are taking a regulatory directive approach via insurance department bulletins as a first measure in combating onerous requests and certificate abuses. A current listing of states that have certificate-specific statutes, regulations or directives can be found at http://www.iiaba.net/VU/NonMember/WilsonCertLawsRegs.htm.

In addition to these efforts, many states have existing unfair trade practices and insurance fraud laws that govern certificates of insurance broadly or even by name. For example, Nebraska's insurance fraud law applies to anyone who, *"Knowingly and with intent to defraud or deceive issues or possesses fake or counterfeit insurance policies, **certificates of insurance,** insurance identification cards, or insurance binders. …"*

As a result, common requests to strike the "endeavor to" cancellation language from the ACORD 25 certificate of insurance, enter a number of days notice that is

not granted by the policy itself, or otherwise modify the language of the certificate are increasingly illegal in many states.

Also keep in mind that ACORD forms are copyrighted and their use is licensed. These forms are, for the most part, designed to be completed, not altered. One can potentially encounter federal copyright law violations, particularly when proprietary certificates are being used. In one case, a form provided by a requestor looked exactly like an ACORD form except that it had added four words: *"This certificate does not amend, extend or alter the coverage afforded by the policies below* ***except as shown below****."* It is important to note that alteration of certificates may violate federal copyright law, state insurance laws, a licensing agreement, or the agency/company agreement, which specifies what policy processing forms can and cannot be issued by the agent.

Inappropriate Certificate Requests

Contracts commonly specify that the certificate of insurance provide for a notice of cancellation to the certificate holder. The problem is that **no** "ISO standard" additional insured endorsements provide for cancellation notice to an additional insured. In fact, under ISO's Commercial Package Policy, only the first named insured is entitled to notice of cancellation. Yet, insurers or their agents are expected to extend this policy right to dozens of additional insureds or even lowly certificate holders.

Under the laws or regulatory authority of a number of states, a certificate of insurance cannot make a promise of notification unless notice of cancellation is provided for in the policy or endorsement. In those states, not only are such requests inappropriate, they're illegal.

However, our focus in this section is more on requests that agents get that are simply unreasonable and inconsiderate demands. To illustrate, a CSR in an Iowa agency had 13 requests for certificates from 13 different banks in the first hour of a Monday morning. Why? The banks were all being audited and it was easier to call the agency for copies of the certificates previously issued than locate them in their own files.

Shortly after this series of requests, a contractor stopped by the agency to pick up a certificate that he had picked up the previous week and hand delivered to a general contractor. Why? The general contractor said they were setting up a new file and didn't want to make a copy of the certificate. They refused to pay him until he gave them another original certificate. These requests cumulatively took the CSR out of commission for a half day simply for the convenience of the certificate requestors.

In a construction contract for a Georgia insured, an HVAC subcontractor with two employees, the insurance requirements were ten pages long and specified that, *"For those policies containing an aggregate, as soon as loss activity (paid* ***or reserve****) depletes the aggregate by 50 percent or more, written notice must be sent to the Contractor by certified mail."* Agents are usually not aware of reserve activities at this level.

A Wisconsin agency insured a hotel. The hotel received demands from two trucking companies and a railroad to be named on the hotel's CGL policy as additional insureds because their employees stayed there on business. The threat of noncompliance was that these companies would take their business elsewhere. Imagine if all hotels were required to add every guest's employer as an additional insured and you were the agent for those hotels.

To further illustrate that point, it is very common for the mortgagees on condo units to request additional insured (or even mortgagee) status on the condo master policy. A Maryland agency insures a condo association with 800 units. Imagine if 800 mortgagees want to be named on the condo master policy ... until they sell the mortgage to another lender who wants the former mortgagee to be removed and their name added. Imagine

further that you're this agency and you also insure 694 other condo associations that are being bombarded with these types of requests.

Sometimes, in order to retain a valuable client, an insured must overhaul its entire insurance program to comply with requests. In one case, a furniture store's best customer decided they needed additional insured status including products and completed operations. The furniture store was written on a Business Owners Policy and the available additional insured endorsements only covered ongoing operations. The policy was loaded with "bells and whistles," including 12 months of otherwise unlimited business income coverage, at a very low price. In order to add the insured's customer as an additional insured, the account had to be rewritten on a Commercial Package Policy that provided less coverage at a greater price.

These are not rare examples. They occur daily in agencies across the country and cost cumulatively billions of dollars in direct expenses and lost opportunity costs.

Impractical Certificate Requests

Construction contracts may require the removal of exclusions for pollution liability, care, custody or control, faulty workmanship, etc., that simply cannot be effected by any insurer the agent represents, at least for that client. There may be instances where a particular insurer can make an accommodation for an important customer but not "Joe the Plumber." In other instances, no insurer can modify a filed form to meet a contract requirement.

One thing that many contractors, owners, lenders, and others do not understand is the highly regulated nature of the insurance industry. Insurers often cannot modify filed forms and manuscript endorsements on the fly. An insurance policy is not like an indemnity agreement or lease that the parties can modify as they see fit.

Third parties are asking for coverages that are not readily available, appropriate to the risk, or affordable. For example, one three-man plumbing operation signed a construction contract that required the provision of Employment Practices Liability insurance. The reason given was that there are an increasing number of workplace sexual harassment lawsuits because of the changing makeup of construction workers.

More commonly, outdated insurance requirements cite policy forms that are no longer available, such as the November 1985 version of ISO's CG 20 10 additional insured endorsement. In some states, some insurers may have this form available, but most insurers in most states do not. Current ISO additional insured endorsements don't cover the sole negligence of the additional insured, yet contracts are still being used that demand this, even in states where prohibited by anti-indemnity laws.

Finally, some requests are just downright impossible. A frequent one is the demand that coverage on a business auto policy, like the CGL, be provided on a "primary and noncontributory" basis. The Other Insurance clauses of auto policies typically do not work as they do with CGL policies. Even more outrageous are the occasional demands for additional insured status on workers compensation policies.

Lenders all too often want to be additional insureds or loss payees on every policy the insured possesses whether that policy has anything to do with the loan or not. They want that status on business income forms not because the coverage is relevant to their insurable interest in the property, but because it is a financial resource that backs up the loan.

Summary and Conclusions

Certificate and additional insured requests have escalated exponentially out of control. Some agencies are devoting full-time staff to the certificate processing

operation. Literally billions are being spent by all parties in issuing and monitoring certificates and endorsements, not counting the lost opportunity costs of agents who could be spending their time more productively servicing their own customers.

In addition to being increasingly and often unnecessarily burdened by requests for endorsements and certificates of insurance, agents are increasingly faced with professional liability lawsuits from certificate holders. Perhaps most important, agents are increasingly asked to assume risks, perform tasks for which they are unqualified (e.g., contract review), and provide uncompensated services whose benefits accrue largely to parties with which they have no business relationship. In doing so, agents are increasingly hamstrung by legal and regulatory restrictions.

There is a need to improve education and understanding of certificates of insurance issues among the parties requesting them - contractors, project owners, lenders, attorneys, risk managers, government entities, large corporations, and others. This need exists within our own industry as well. Where do many of these onerous requests originate? From carriers and brokers who benefit by having their insureds transfer as much risk downstream as possible. What is too often created, though, is a vicious cycle where these processing operations become an end in and of themselves.

There is a great need for standardization, for acceptance of ACORD and ISO standard forms and for policy rights such as cancellation as outlined by law and standard forms. Automation can play an important role in streamlining the need for information. By returning to reasonableness in our business relationships and using technology to streamline the necessary processes, certificate requestors should find that they can get the coverage assurances they desire without excessive and onerous demands.

As the Rolling Stones put it, "You can't always get what you want ... but if you try sometime, you just might find, you get what you need."

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