

UNRATED SECURITY – JUST HOW SECURE IS IT?

INTRODUCTION

The recent high-profile collapse of the Danish-based motor fleet specialist Alpha Insurance has served to highlight, once again, the dangers of using unrated security. It has garnered much mainstream press attention, not least because of the number of taxi drivers finding themselves uninsured overnight. Alpha is, however, only one of many unrated insurers to have suffered a similar fate in recent years, with Gable and Enterprise Insurance being just another two.

RISKS V REWARDS

Insurance brokers are under no legal obligation to choose security that is rated and indeed insurers have no obligation to seek such a rating. Brokers should not be liable simply because security is unable to pay, but they do have an obligation to exercise reasonable skill and care when recommending security to their clients. The fact that unrated security may be the most competitively priced may produce a happy client in the short-term but will not alone be sufficient to justify its recommendation. Regardless of any health warning accompanying a cheap quote, the client will be entitled to presume that its broker will only use a market likely to be around long enough to pay its claims.

If an unrated insurer has been doing business in the UK for a number of years, and it is felt that it should not be ignored as a market purely because it does not have a rating, then that is something that, along with all other relevant information, can be taken into account by a Member's security committee when deciding whether it should be used for its clients' business. Nevertheless, in many cases the risks associated with using unrated security are likely to outweigh any perceived benefits.

CLIENT DISCLAIMERS/ 'CHICKEN LETTERS'

We recognise that cases do arise where a risk is particularly difficult to place and that can be for a variety of different reasons. In those circumstances Members do sometimes consider placing business with security which is not on the approved security list and which is not of a calibre that would, in the usual course, gain approval. Any such unapproved security should only ever be used as a last resort, since it will always create a potential exposure for the broker. It is vital that an appropriately worded letter is sent to the client and they should be invited to sign and return a copy to signify their agreement. We can provide a sample letter that can be used for this purpose.

Where a producing broker is involved, we recommend that the letter is amended to invite their confirmation that they, in turn, have received their client's agreement to the use of the security proposed, or that they are prepared to sign the letter on their own behalf, having satisfied their own procedures.

Even where such a letter is signed, it will still not be watertight, and the broker will always be open to challenge. BIBA obtained counsel's opinion on this area some years ago and the potential vulnerability of the broker was highlighted, even where the client's agreement to the use of the security had been obtained. The effectiveness of such a letter may depend on matters such as the circumstances surrounding the unapproved security being used, and the degree of sophistication or understanding of the client agreeing to it.

BEYOND RATINGS

The rating of any insurer alone should not, of course, guarantee automatic approval or otherwise for any market. A number of factors will also need to be considered such as the classes of business underwritten, territories covered and reputation as far as claims payments are concerned. Some consideration should also be given to whether problems have been experienced with any other company which may form part of the same business empire as that of the insurer. The market is constantly evolving and the security list should be kept under regular review, to ensure that any information about an insurer which enters the public domain is properly considered and acted upon, as appropriate.

RISK MANAGEMENT MESSAGE

Griffin recommends taking the following steps to minimise the potential E&O exposure in this area:

- Consider a number of factors, as outlined above, before deciding whether a market should appear on the Member's security list and ensure that this process is documented;
- Treat the security list as a living document and keep it under regular review;
- Where information about security on the list is considered by the security committee and the decision reached that the security remains acceptable, make sure this is clearly documented;
- Take particular care when dealing with any unrated security and clearly record the reasons why such security is included on the approved security list;
- Where security which is not on the approved list is being used with the understanding and consent of the client, ensure that an appropriately worded disclaimer letter is signed and returned by the client. Where a producing broker is involved seek confirmation that they have obtained their client's agreement. We can provide a suitable template although, as already indicated, this approach should be considered a last resort.

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