

Insurance Intermediaries: Fulfilling the role of an Insurance Expert

Do you know your client's business?

COX & PALMER

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INTRODUCTION

Customers expect a lot from their insurance broker or agent and these expectations have grown dramatically over recent years. As there is a direct correlation between customers' reliance on a broker and liability, the potential for broker negligence has also grown. When insurance brokers engage in a commercial relationship with customers, the law imposes certain duties on brokers that require them to adequately perform the services that they offer.

The following discussion is intended to provide insurance intermediaries, both brokers and agents, with an overview of potential areas of liability in negligence. Although much of the discussion is aimed at insurance brokers, the points which are raised may be applicable to both brokers and agents. It is hoped that all insurance intermediaries will take pause to consider whether their practice meets the increasing scrutiny that courts are placing on intermediaries today.

1. BROKERS ARE EXPERTS IN THEIR FIELD

Insurance brokers undergo more professional training than in years past. Because of this specialized training, and the heavy reliance customers place on the advice of a broker, the law now views insurance intermediaries, as professionals or experts in placing insurance. As such, a higher duty of care is being imposed on brokers by the courts. As an expert, the insurance broker has a duty to determine the customer's needs and place appropriate coverage. Gone are the days when a broker could rely upon the insured's own knowledge of their insurance needs. The broker may be required to ask questions of the customer, and seek out additional information and documentation before placing insurance. The broker will be expected to provide advice as to the risks which ought to be insured, proper limits, specific exclusions, insuring options and premiums.

The overall duty imposed on insurance intermediaries was described by the Supreme Court of Canada in *Fletcher v. Manitoba Public Insurance Co.*, [1990] 3 S.C.R. 191, at paragraph 57:

In my view, it is entirely appropriate to hold private insurance agents and brokers to a stringent duty to provide both information and advice to their customers. They are, after all, licensed professionals who specialize in helping clients with risk assessment and in tailoring insurance policies to fit the particular needs of their customers. Their service is highly personalized, concentrating on the specific circumstances of each client. Subtle differences in the forms of coverage available are frequently difficult for the average person to understand. Agents and brokers are trained to understand these differences and to provide individualized insurance advice. **It is both reasonable and appropriate to impose upon them a duty not only to convey information but also to provide counsel and advice.** [Emphasis added]

One of the most difficult questions faced by insurance intermediaries is how far they must go beyond the sometimes vague and often general instructions provided by the customer to determine appropriate coverage. The broker or agent will have to inform him or herself about the business of the client and the risks they wish to insure. The expectation of a broker was stated by the Court in the seminal and often cited decision of *Fine's Flowers*, (1977), 81 D.L.R. (3d) 139, at page 149:

[Where] the client gives no such specific instructions but rather relies upon his agent to see that he is protected and, if the agent agrees to do business with him on those terms, then he cannot afterwards, when an uninsured loss arises, shrug off the responsibility he assumed. If this requires him to inform himself about his client's business in order to assess the foreseeable risks and insure his client against them, then this he must do. [Emphasis added]

Generally, in order to satisfy the duty of care owed to the insured, an insurance intermediary is required to:

- inform him/herself about the client and/or the client's business;
- assess the foreseeable risks; and
- obtain the appropriate coverage or inform the client that the coverage is not available.

Based upon this duty of care, and the higher standard expected of brokers and agents, both are increasingly exposed to liability. The purpose of this article is to bring awareness to the insurance intermediary of what steps a court may expect a broker or agent to take to fulfill their ever increasing duty to their clients.

2. BASIS FOR LIABILITY

The legal basis for which insurance intermediaries may be held liable has widened over the years. There are four grounds which most commonly give rise to broker liability: warranty of authority, contract, tort or equity. Each is addressed below.

2.1 Warranty of authority

It is important to recognize that, as an insurance broker, customers accepted that the broker has the requisite authority to offer coverage on certain types of insurance. It is an underlying term of the representation that, the Insurer/carrier has provided the broker with sufficient authority to discuss the customer's insurance needs and to extend the coverage required.

When a customer hires an insurance broker to procure insurance, in essence the broker also becomes an agent of the customer. The principles of agency law provide that if A states to B that A has the authority to represent C in dealings between B and C, and if A does not actually have that authority, A is liable to B for any loss B suffers because of their reliance on A's assertion. A is said to have given B a warranty that the requisite authority existed.

Brokers must be aware of the limits of their authority to bind an insurer and to ensure that this is effectively communicated to the customer. Breach of such authority may result in the broker's direct liability to the insured for the losses. If in doubt, obtain confirmation of the binding authority in writing.

2.2 Contract

There may at times be a contract in place between the broker and the customer. This contract obligates the broker to provide certain services to the customer, namely, finding appropriate insurance coverage. If the agent/broker fails to live up to the obligations incurred, a breach of contract takes place. The ability to sue on the terms of the contract is limited to the parties to the contract: the broker and the customer.

The most important issue in determining liability in contract is the nature of the obligation undertaken. Judges tend to merge the contractual obligations assumed by an intermediary with those imposed in tort. Thus, when an agent or broker agrees to procure insurance, s/he is often held to have agreed to exercise *reasonable care* to ensure that the coverage obtained is appropriate cover.

2.3 Equity –trust and reliance

In some situations, courts have found brokers to be in a position of trust and authority in regards to the insurance needs of the customer. When a customer has placed his or her reliance on the broker because of the broker's expertise, the broker may be recognized as having a special type of relationship with the customer. When this special type of relationship is found to exist, the relationship of the broker and customer may be characterized as "fiduciary" in nature which imposes additional obligations of the broker.

The three components of a fiduciary relationship are:

1. The fiduciary has the scope to exercise some discretion or power;
2. The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interest; and
3. The beneficiary is at the mercy of the fiduciary holding the discretion or power.¹

A fiduciary relationship may be recognized where the broker is placed in a position to make choices on behalf of the customer. The customer is vulnerable in the sense that he or she could be left unprotected, or inadequately protected, if the broker fails to act in a trustworthy manner.

If a broker is found to be in a fiduciary relationship with a customer, the broker has an obligation to avoid any conflicts of interest and to exercise reasonable care when making decisions on behalf of the customer. A conflict of interest could arise, for example, where the insurance option yielding the most commission to the broker may not coincide with the needs of the customer. The broker cannot let this information color his or her determination as to what the best option is for the customer.

2.4 Tort

The fastest growing and widest area of insurance intermediary liability is tort, which commonly includes negligence, or, in exceptional cases, fraud. As such, the various duties which have been imposed by courts upon brokers and agents under negligence law require detailed comment. It is hoped that armed with this knowledge, brokers and agents may minimize their potential exposure and avoid finding themselves on the defending end of a negligence claim.

¹ *LAC Minerals Ltd. v. International Corona Resources*, [1989] 2 S.C.R. 574

2.4.1 Standard of care

At the outset, it is important to understand that it is no longer sufficient for professionals to blindly rely on "industry practice". The assertion that "all the brokers do it this way" is not a defence. *The test is whether the broker has provided the customer with reasonable advice expected of a reasonable and informed broker or agent, considering all of the circumstances.*

2.4.2 Common areas of liability

The following discussion covers specific duties and areas which have given rise to broker and agent liability. The duties which apply to insurance brokers stem from case law arising from duties of insurance intermediaries generally, (i.e. agents and brokers). The case descriptions below reflect the court's often interchangeable use of the two terms. As previously stated, the point of the following discussion, however, is to raise awareness of potential liability. As an insurance broker, one must ask, what steps do I take in similar situations? Would my practice have passed the court's scrutiny? If not, what steps do I need to take to ensure my brokerage firm meets the duty and standard of care expected?

2.4.2.1 Duty to provide appropriate insurance and advice – what are the customer's insurance needs?

Any discussion on broker or agent liability must begin with the foundation case of *Fine's Flowers Ltd. v. General Accident Assurance Co., supra*, wherein the Ontario Court of Appeal considered the duty arising from request of the insured, who owned a horticultural business, to the agent to obtain "full coverage". This request was found to imply an agreement to procure "coverage against all foreseeable insurable risks of the plaintiff's business." However, the insurance placed did not cover damage resulting from the breakdown of a heating system due to normal wear and tear of the pumps. A pump failure occurred and extensive damage was caused to the insured's plants. The Court of Appeal identified two types of situations where agents or brokers are asked to provide coverage and described the corresponding duty owed in each situation.

(i) Where the agent or broker is asked to provide specific coverage

The duty on the agent or broker is to *use a reasonable degree of skill and care in obtaining the coverage*. If the coverage is unavailable or the broker is unable to obtain it, the agent or broker must inform the customer so that he or she does not rely on the agent or broker for successful completion of the transaction.

(ii) Where the agent or broker is asked to provide "full coverage"

The duty on the agent or broker is more onerous in that the agent or broker must make sure the customer is aware of all insurance coverage available so that he or she can be protected against all foreseeable risks. The agent or broker must inform him or herself on the client's business in order to determine all foreseeable risks. An agent or broker who does not have the skills to understand the customer's business should not offer to provide full coverage insurance.

Thus, the agent would have discharged the required duty if he had informed the plaintiff that certain types of losses were not covered by the policy. He should have advised the insured to purchase additional coverage for the pumps if he really wanted "full coverage". The Court stressed the agent owed a positive duty to warn the client.

The duty of care owed to a customer was further elaborated in *G.K.N. Keller Canada Ltd. v. Hartford Fire Insurance Co.* (1983), 1 C.C.L.I. 34 (Ont. H.C.) (confirmed on appeal at (1984), 4 C.C.L.I. xxxvii (Ont. C.A.)). It was held in that case that where the customer adequately describes the nature of his or her business to the agent, the onus is then on the insurance intermediary to review the insurance needs of the customer and provide the full coverage requested. Should an uninsured loss occur, the liability will be found unless the insurance intermediary has pointed out the gaps in coverage to the customer and advised him or her how to protect against those gaps.

The broker must take steps to ensure the coverage is appropriate and adequate. Where a customer seeks particular coverage and the broker agrees to provide it, *the broker will be under a duty to procure the insurance requested*. If the broker is unable to do so, the client must be advised the coverage is not available and the alternative options must be explained.

A situation that frequently arises is the request for a comparative quote. A potential client is shopping around and provides a broker with a quote from another company, and asks for a comparison. This situation arose and became the subject of an action in *232 Kennedy Street Ltd. v. King Insurance Brokers (2002) Ltd.*, 2007 MBQB 291. The customer purchased a building and received a quote from another insurer for the cost of insuring the building with replacement cost insurance. The customer sent the quote to the broker and asked for an "apples to apples" comparison. The broker provided insurance at a cheaper premium, but the insurance only covered the actual cost, not the replacement value, of the building. The customer proceeded in obtaining insurance from the broker. The building was destroyed by fire and the customer received \$400,000 for the actual cost of the building. The replacement cost of the building was \$1.4 million.

The Court held that the broker ought to have understood that the client was requesting replacement cost coverage by providing the first quote. The Court concluded that the broker had failed to provide the coverage the customer had requested, despite the fact that the client admitted that he had never specifically requested replacement cost insurance. The broker was found negligent because he knew or ought to have known that the customer could have obtained significantly more coverage for almost the same premium. The broker was found liable for the difference between the actual cash value of the building and the replacement value.

Therefore, when the customer is provided with comparative insurance coverage, the broker must explain any differences or exclusions in the coverage they offer as compared to the coverage in the quote. The onus rests on the broker to ask the necessary questions to understand the extent of the coverage the customer is seeking.

Although the duty is high, a broker will not have to explain each and every clause in an insurance policy to the customer in order to fulfill their duty of care. Where the meaning of the clause is clear, the broker will not have to explain the clause. For instance, in *More Marine Ltd. v. Axa Pacific Insurance Co.*, 2010 BCSC 88, the

customer alleged that their broker was negligent because he had not explained a clause allowing a deductible to be charged in the event of the total loss of their vessel. The Court held that the wording of the contract was clear in that the deductible applied to all claims unless specifically excluded. There was no evidence that the customer had sought to exclude total loss claims from the reach of the deductible clause. It was therefore found that the broker was not obligated to explain the meaning of the clause. There was no evidence that alternate insurance coverage excluding total losses from the deductible was available.

2.4.2.2 Duty to make inquiries – be inquisitive!

Sometimes the broker will be required to obtain information from other sources to ensure proper coverage is placed for the customer. This may appear to be a very onerous duty on a broker, but it is a judicially recognized duty. This was the case in the New Brunswick decision of *Sotiropoulos v. Bernard Freedman Insurance Ltd.* (1982), 44 N.B.R. (3d) 319 (Q.B.) where the Court stated:

The vital importance of naming the correct insured is well known. **Casual questioning is not always sufficient. The agent must make sufficient inquiries, perhaps in some cases from an independent source or by inspection, to satisfy himself that answers given are indeed correct.** This inquire would vary in each situation. Factors to be considered include the nature and complexity of the coverage requested, the sophistication of the insured, whether the coverage was new or the renewal or extension of existing coverage, previous dealings between insured and agent, and whether or not the insured was suffering from any disability. [Emphasis added]

In *Strougal v. Coast Capital Insurance Services Ltd.*, 2008 BCSC 17, an insurance broker was found negligent for failing to make adequate inquiries to ensure the correct value of the property insured under a homeowner's policy. The broker used incorrect information to calculate the replacement cost and underestimated the value of the home at \$186,000.00. The replacement cost of the house was actually \$357,655.00. Content coverage was set at \$186,000.00, as it was the broker's practice to provide the same coverage for personal property as for the house. The Court found the broker had breached its duty of care in determining the replacement costs and had failed to ensure he had the necessary information. The Court held that the broker was not negligent with respect to the *content coverage*, as there was no reason for the broker to suspect that the value of the contents of the house would have exceeded \$186,000.00. In this situation, had the broker obtained the correct information to calculate the value of the home, he would not have been found negligent.

In *Rosenblat v. Reliable Life Insurance Co.*, 2003, MBCA 6, the customer had asked the agent to obtain travel insurance for her. The agent reviewed the policy application with the customer and asked her if there had been any changes in her medical condition. The customer told the agent there had been no change. No additional questions were asked despite the fact that the agent knew the customer had a heart condition. The customer neglected to mention that in the last 12 months, she had been diagnosed with atrial fibrillation. Based on the information the customer had provided him, the agent obtained the highest coverage level from the insurer, which required the lowest premiums. The customer was insured during her trip, but was denied coverage on the basis that she had materially misrepresented her condition

by not divulging medical treatment in the past 12 months. The agent was found liable for the customer's loss on the basis that he had a duty to make additional inquiries regarding her health. The agent could have avoided liability by asking additional and more specific questions in regards to the customer's health.

More recently, in *Fleet v. Federated Life Insurance Co. of Canada*, 2009 NSCA 76, an agent was held liable to indemnify the insurer for the claim made by the customer. In that case, a couple approached the agent to replace their previous life insurance policies with a new policy. The husband told the agent his wife's health was alright "as far as I know", although the wife took medication for blood pressure. The agent completed the application indicating no health issues for either spouse. The wife died less than two years later and the husband claimed the benefit of the policy. The insurer denied the claim on the ground of material misrepresentation. The husband brought a claim against the insurer and agent, the insurer cross-claimed against the agent. The husband's claim against the insurer was successful, as was the cross-claim. The Court concluded that the insurer's loss was caused by the negligence of the agent.

In summary of the above, the broker must ask sufficient questions to ensure accurate and complete information is obtained. If a piece of information is missing, take the initiative to seek out adequate and accurate answers.

2.4.2.3 The duty to know your customer's business – be a busybody!

The courts require a broker or agent to take the time to know and understand the customer's needs and expect them to ask the appropriate questions or conduct the appropriate investigations to obtain the necessary information to properly assess the risks of the customer. The extent of the questions to be asked or the investigation needed will depend on the circumstances of each case.

This duty is especially relevant to the broker of CGL policies as became evident in *Johnson v. W. G. Barton Ltd.* (1986), 21 C.C.L.I. 73 (B.C.S.C.), wherein a British Columbia Court found an agent partially liable for failing to ascertain changes in the customer's business, which gave rise to changes in the customer's insurance needs. The agent had acknowledged that "it was his responsibility to review the coverage and find out whether any significant changes had taken place during the previous year." Partial liability was found when the agent did not recognize the fact that the construction contract, for which the insurance was originally purchased, was complete, and therefore the insurance needs of the customer had changed. The owner was also found partially liable because he had failed to read his own policy and make himself aware of the scope of his insurance coverage.

Knowing one's customer and its business may also come into play more when placing personal lines of insurance. In the case of *King v. Sullivan Insurance*, [1993] P.E.I. No. 73, a man and woman asked their agent to obtain the best rate for them on auto insurance. They advised the agent that they had been living together for three years, but were not married. The agent suggested that to obtain the best rate he would list them as spouses. Insurance was obtained and the next year the woman visited the agent for renewal of the policy. The agent talked to her about tenant insurance, which was obtained only for her belongings, not on her spouse's. When the couple's car was later broken into and their respective possessions stolen, the Court found the agent negligent for failing to place the tenant coverage in both names. The agent had a duty to advise the woman that the goods of her spouse were not insured, even though she did not make such a request.

2.4.2.4 Duties regarding renewal, cancellation and updating – have a system!

Like it or not, customers frequently rely on brokers to remind them that their policies are due for renewal. The view of many brokers is that it is the customer's sole responsibility to be aware of the expiry date of their policy; they consider any information they provide to the customer in regards to upcoming renewals is done as a courtesy. However, in recent years there has been a significant change in how courts view the duty of a broker with regard to renewals of insurance policies. Where there has been a history of the broker arranging renewals, some courts now consider a duty to arise to notify the customer of an impending expiry, a proposed non-renewal or a cancellation. While it was once thought that the duty of the broker with regard to servicing an existing policy was less onerous than the central duty of procuring adequate coverage, this is no longer the case.

As noted previously in *Johnson v. W.G. Barton Ltd, supra*, there is also an emerging duty to update the policy in accordance with the customer's changes.

In summary, liability may arise when the broker's conduct amounts to an undertaking which is reasonably relied upon by the customer. However, although the customer's reliance may be reasonable, that fact alone does not totally displace the obligation of the customer to protect his or her own position. While a broker may be found to be negligent for failing to inform a customer of an impending renewal or cancellation, the customer is often found to be contributorily negligent for failing to be more alert to his or her own policy.

2.4.2.5 Cancellation – explain the consequences!

There are also obligations in relation to the cancellation of a policy. In *Brisee v. Royal Life Insurance Co. of Canada* (1994), 26 C.C.L.I. (2d) 89 (N.B.Q.B.), the New Brunswick Court held that the agent was liable for failing to fully explain to his client the consequences of cancelling his life insurance policy before its replacement took effect. In the British Columbia decision of *Engel v. Janzen* (1990), 41 C.C.L.I. 284 (B.C.C.A.), an agent who advised a client to cancel an automobile insurance contract for two months was held liable when the customer was injured by an uninsured motorist in circumstances that would have entitled the customer to claim under the uninsured motorist portion of the cancelled policy.

In order to avoid liability, brokers should therefore explain to a customer the consequences of the decision not to renew or to cancel an insurance policy. This is particularly important where there is going to be a gap in time between coverage or where the customer may have difficulty getting new insurance as a result of having a period of no coverage.

2.4.2.6 Duty to convey accurate information

Another aspect of servicing a policy that may give rise to liability is the passing of information from the customer to the insurer and vice versa. This information may relate to changes in the risk or in amending conditions. The obligation can also arise at the formative stage of the insurance contract with regard to information that would constitute a material non-disclosure if not transmitted or, if transmitted inaccurately, to misrepresentation.

Where a broker breaches its duty to the customer to properly convey information, the broker may be held liable for the damages. An example of this is the decision of *B.P.Y.A. 1693 Holdings Ltd. (c.o.b. Kootenay Honda) v. Innovators Insurance Agencies Ltd.*, 2001 BCSC 836. In that case, the customer owned a car dealership and had agreed to provide a car as a prize for a hole-in-one competition in a golf tournament. The agent agreed to obtain insurance in the event that the car was won. The insurance was to be provided by the insurer; however, the agent did not have the authority to bind the insurer. The agent faxed the insurance form to the insurer on the day of the tournament. The form was not received because the agent had used an incorrect area code. The agent also sent a fax to the customer informing them that the insurance had been obtained. The prize was won but the customer was unable to collect on the insurance because it was not in force. The Court held that the agent was liable for the loss suffered by the customer *because the loss was caused by their failure to properly convey information to the insured*. Additionally, the agent breached its contract to obtain insurance coverage and negligently misrepresented that the insurance was in force when it was not.

As these cases illustrate, it is important for a broker to ensure that they promptly and accurately convey all information from the customer to the insurer and vice versa. A failure to do so will leave a broker vulnerable to a finding of liability should a loss occur.

The above summary of areas where courts have found duties on brokers is by no means exhaustive. These summaries are intended to force the broker to stop and consider the daily practices undertaken at that insurance brokerage. Such practices should be considered in light of the level of expert advice that a court requires brokers to provide the customers.

3. POSSIBLE DEFENCES

3.1 Causal link to damages

Even if the broker is negligent, the insured must show a causal link between the broker's negligence and the inadequacy of the coverage. For instance, where the alleged negligence is the failure to obtain a requested coverage, there is no liability if the customer cannot establish that the requested policy would have covered the loss that occurred. Where the broker's default is the failure to advise about the unavailability of coverage or about gaps in the available coverage, the customer must show that he or she would have reacted differently had the broker properly informed them of this fact, possibly by seeking other insurance or modifying business practices to minimize the uncovered risk.

3.2 Contributory negligence

As referenced earlier, there may be cases where a customer may be contributorily negligent for the loss. An example of this is a broker's default in connection with the renewal of an insurance policy. A customer is likely to be found to have been contributorily negligent for failing to check the policy for the expiry date. Similarly, a customer may be held contributorily negligent when a broker is alleged to have failed to procure adequate coverage if the inadequacy of the coverage could have been detected had the customer read the policy.

A customer may also be contributorily negligent as a result of having given vague instructions to the broker.

4. CONCLUSION

The liability of brokers is widening. The best defence is to avoid a claim in the first place.

Liability is being imposed from circumstances arising from the initial contact by a customer to the circumstances arising at the time of cancellation of a policy. The trend now requires brokers to service policies, especially in regards to renewals where there is a history of having done so. In the future, customers may demand more and more of brokers, requiring updated advice and recommendations regarding the limits of liability.

The increasing reliance of customers on brokers and the corresponding increase in a broker's exposure to liability is consistent with the view that, *insurance brokers are experts in their field and are viewed as professionals*. This professional status has imposed a higher duty of care which brokers must satisfy. Consequently, many brokers have opted to carry errors and omissions insurance to shield them from inadvertent acts that may expose them to liability.

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publication is intended to
provide information of a
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5. CHECKLIST TO AVOID LIABILITY

- Confirm accuracy of information obtained from the customer – ask questions!
- Consider whether you need to seek additional information from other sources?
- Document all steps/activity on your file.
- Know the type of coverage the customer wants and needs.
- Ensure adequate familiarity with the customer’s business.
- Advise the customer if the insurance coverage they seek is unavailable and explain what other options are available.
- Advise the customer of consequences of improper disclosure or misrepresentation.
- Know the limits of your binder authority.
- Explain any exclusions, gaps or limitations regarding the coverage to the customer.
- Be sure any comparative quotes are actually “comparative” – if they have different coverage, explain and document your explanations.
- Do not offer advice on the basis of self interest (i.e. high commission rate).
- If desired, express exclusion of tort claims in the contract.
- Client requests “full coverage”? **Red alert:** *Approach with caution – must be familiar with their business!*
- Appropriate insurance? Is it available to the client? Explain options.
- Renewal? Cancellation? Updating? Is the coverage still adequate? Annually review the policy and contact the customer to determine if their circumstances or insurance needs have changed.
- Convey all material information to customer and/or insurer – e.g. check fax numbers!
- Be aware of third parties e.g. beneficiaries of a life insurance policy,
- Send the customer reminder notices of upcoming renewals.
- Advise of any proposed non-renewal or cancellation.
- Discuss all possible implications to the customer before completing a cancellation, termination or non-renewal notice.
- Consider getting Errors and Omissions Insurance coverage.
- Don’t forget your duty to the insurer!

** This checklist is not intended to cover all possible situations or areas of potential liability.*