

Thanks to some high-profile corporate scandals involving accusations of fraud and other intentional wrongdoing, severability, as a professional lines insurance coverage enhancement, has become a critical component of the policy. Even those familiar with the concept and how it works may want to reexamine severability, given the pivotal role it can play in certain claim situations.

Severability is a feature in professional lines insurance that is designed to protect innocent insureds from losing coverage due to the bad actions of others. An easy way to remember what severability means is to think about cutting out or severing coverage for people who act in a way that could jeopardize coverage for everyone else. Severability applies with respect to two areas in professional lines insurance: A policy's application and a policy's exclusions. In this article, we'll examine each of those areas individually. Severability will also apply differently for the individual insureds and the corporation.

### The Application

When the insurance carrier accepts an application, they require the information contained therein to be true. In fact, this is usually established by an explicit affirmation to that effect in the application form. The carrier relies upon the application's information while underwriting the account and, in those instances when it occurs, for issuing the quote and binder. Thus, carriers take the position that it's critical the information in the application be accurate. Keep in mind that most carriers specifically define their application to include financial statements and other disclosures that are in addition to the standard questions on the application form itself. The various attachments, such as financial statements, become an issue if that information changes between the time coverage is bound and a claim occurs. For example, if a public company restates its reported financial performance and it leads to a claim, the underwriters may consider the restatement an admission that the information included with the application was not true and accurate. The restatement of financial statements is a leading trigger of D&O claims. For this to also be a factor in making a determination that coverage shall or shall not apply is a dangerous situation.

A carrier who relies upon false information in the application process may be justified under the law in rescinding a policy based on the assertion that if they knew the correct information, they would never have quoted and bound that particular account. Alternatively, the insurer may contend that it would've bound the policy pursuant to different terms, conditions and exclusions, including higher retentions and at a higher premium. It is important to note, ignorance and lack of deceptive intent on the part of the applicant is irrelevant; even simple negligence in failing to provide accurate information can be a basis for rescission.

When applied to professional lines insurance products, such as D&O liability insurance, rescission of a policy based upon misrepresentations in an application may have a particularly draconian, and seemingly unfair, effect when innocent insureds lose coverage due to the acts of others. For example, if the person completing the application knowingly submits false financial information, the carrier may rescind the policy in its entirety, thereby negating coverage even for innocent insureds that had no idea that false financial information had been provided to the insurer. The concept of "severability of the application" was developed in order to remedy this problem.

### The Exclusions

Similar to the application severability, the exclusions can also be an issue. Would you want the acts of one insured to influence coverage for non-participating innocent insureds? The remedy is to have severability of the key policy exclusions to be certain that the conduct of one insured is not imputed to others during a determination of coverage. The severability of exclusions is most commonly applicable to the "conduct exclusions". For example, let's assume a D&O policy contains an exclusion that withholds coverage for any claim based upon the receipt of an illegal personal profit or gain, a fairly common provision in most policies. If a lawsuit is filed against a number of individual insureds alleging a variety of wrongful acts, including the receipt of insider trading profits, with a severability feature in the policy only an insured who received such illegal personal profit or gain would lose coverage pursuant to that exclusion. Coverage for the other innocent insureds would be unaffected by the exclusion.

The severability concept may not apply to other types of exclusions because it may not be relevant to the other exclusions. For example, another common exclusion under a D&O policy withholds coverage for any claim arising from or based upon the Employee Retirement Security Act of 1974 ("ERISA"). If a lawsuit is brought against the insured alleging ERISA violations, there would be no need to apportion (or sever) it in any way, since it would just be totally excluded from the outset.

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If you do not have a contact at AmWINS to help with your financial services risks, [click here for a list of brokers on our website](#).

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### What is Severability and Why is it Important?

#### The Different Types of Severability

There are two variations of severability applicable to an insurance policy: limited severability and full severability. Each can be applied with respect to both the application and the exclusions.

**Full severability** means that the bad acts or knowledge of any person (or persons) will not be attributed to (or imputed to) any other innocent individual insureds for purposes of rescinding the policy or denying coverage. Only the people who actually participated in, or knew about, the misrepresentations will be penalized. Thus, if the CFO knowingly submits false financial statements to the carrier in connection with the application and the CEO also knows of this transgression, only the CFO and CEO would be subject to rescission of the policy's coverage. In effect, it's as if a separate insurance policy had been issued to each individual insured and behavior which can negate coverage (e.g., lying on the application) will only affect the coverage of the person (or persons) who are at fault.

**Limited or partial severability** of the application or exclusions, on the other hand, withholds severability (thereby making everyone accountable for the actions or knowledge of some key executives) if the misrepresentations are made by certain specified individuals. These can include, for example, the person signing the application, the CEO, the CFO, the general counsel, the insurance risk manager and/or any other specifically-designated people. As you would imagine, specifics can differ from account to account.

Thus, hypothetically, if the CEO purposely conceals information that was sought on the application about an outstanding lawsuit, under a limited severability grant his actions may be imputed to all other insureds (including the corporate entity if there is entity coverage under the policy), justifying a rescission of the policy or denial of coverage with respect to all insureds. But if someone not specifically identified as being subject to the limited severability grant should intentionally conceal information on the application, their dishonesty would not be imputed to others and only they would lose coverage.

Obviously, full severability of the application is preferred over limited severability from an insured's standpoint.

Severability is a very important feature for most professional lines insurance policies and can very often dictate the difference between a claim being fully covered, totally excluded or something in between. Unfortunately, there are a myriad of approaches to the issue of severability and they can be quite confusing at times.

Severability is not generally a premium bearing item. It is something negotiated by a qualified insurance broker for no additional charge. Your AmWINS broker is always ready to help you sort through the options and obtain the best coverage possible for your client's individual needs.

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*This article was prepared exclusively for AmWINS Group, Inc. by Larry Goanos, CEO of Andros Risk Services, an independent insurance consulting firm.*