

CLIENT ADVISORY

What is a Warranty Letter, and Why is My Client Being Asked to Sign One?

Although more common in “hard” insurance markets, where underwriters hold the upper hand, there are carriers that require insureds to sign warranty letters even in today’s insurance climate. Warranty letters can make the difference between a claim being fully covered or totally denied. Therefore, it is critical that brokers fully comprehend and explain the general purpose, as well as the specific provisions, of warranty letters before asking their client to sign.

There is a difference between a warranty and a simple representation. Jeff Grange, senior vice president and chief underwriting officer of Global Professional Lines for Torus Insurance explains: *“The difference between a representation and a warranty is significant. Although it varies slightly by jurisdiction, generally speaking, in order to deny or rescind coverage based on a false representation, the insurer must prove scienter (knowledge or conscious ignorance of the statement’s falsity), intent to induce reliance and justifiable reliance. However, in order to deny or rescind coverage based on a false warranty, the insurer need only prove that the statement was false.”*

The distinction between a false representation and false warranty is important.

While most warranty letters in use today focus on known situations that may lead to a future claim under the proposed coverage, a carrier can ask your client to provide a warranty about virtually any relevant issue. For purposes of our discussion, we’ll focus on potential claim situations.

When your client signs a warranty letter, he or she is making definitive declarations to the carrier. If any of those statements prove to be false in a material way, it can make rescinding the policy, or denying a specific claim, easier for any insurer who received and relied upon those warranted-but-untrue facts in underwriting the policy.

However, a false “representation” contained in an application, would not justify rescission unless the carrier could prove that the insured knew the representation was false and intended on the carrier relying on that statement in underwriting the policy. Keep in mind though, as Mr. Grange pointed out, these are general principles and may vary in different jurisdictions, so know the specific law governing your client’s policy.

Here’s an illustration how these principles might work in a real world situation: Company A has annual revenues of \$900,000. If the company enters its annual revenue figure as a “representation” on a D&O application and a typo causes the number to read as \$600,000, this would most likely be considered an innocent error and would not justify rescission by the carrier under the law. However, if in a warranty letter Company A declares that its annual revenues are \$600,000 and the carrier relies upon that false statement in underwriting the policy, rescinding the policy will be made easier because Company A “warranted” something that was incorrect. There is no need to inquire as to whether it was an innocent mistake or not.

Warranty letters are most commonly required by carriers when an applicant is purchasing a particular type of coverage for the first time and when an insured buys higher limits. The requirement also varies by the type of coverage. It is somewhat customary for an E&O insurer to have the insured sign a new warranty as part of the renewal application each year. In D&O, it would be highly unusual to sign a new warranty as part of the renewal.

When an applicant is purchasing a particular type of coverage for the first time the carrier will almost always want to know that the prospective insureds are not aware of any situation that may give rise to a claim under the new policy. The reasoning behind this is that since there was no coverage of this type in place previously, the applicant may be motivated to buy a policy because he wants coverage for a situation that he believes is likely to give rise to a claim in the near future.

To learn more about how AmWINS can help you place coverage for your clients, reach out to your local AmWINS broker or marketing@amwins.com.

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The carrier has a similar motivation for asking for a warranty letter when an insured seeks to increase their limits. Insurers sometimes become suspicious of an insured purchasing more limits because they think that the insured may know of a significant claim that is about to be filed. Thus, the carrier will ask for a warranty letter to provide assurance that the insured is not aware of anything that will give rise to a claim impacting the newly-purchased layer.

An alternative that should not be confused with a warranty is a “No Known Loss Letter”. These letters generally confirm that the applicant is not aware of any actual - rather than potential - loss that would constitute a covered claim under the proposed coverage. As with all insurance-related provisions, it’s important to closely review the language involved.

Since every warranty letter differs, depending upon the preferences of the carrier drafting it and the specific circumstances involved, we can’t provide a comprehensive guide to every situation. However, there are two important points which bear noting.

First, you must pay very close attention to which party (or parties) are being asked to warrant the information set forth in the warranty letter. Sometimes only the risk manager, CEO, or other individual signing the letter is asked to vouch for the information contained therein on his own behalf.

Second, a warranty may inquire into the knowledge of potential claims that is possessed by everyone listed in the letter. The warranty may seek a broader affirmation by stating something like “*After inquiring of the CEO, CFO, general counsel and all members of the company’s board of directors, the undersigned hereby warrants on behalf of all of the aforementioned that...*” Obviously, this is much more far-reaching than just asking for the assurance of a single individual.

“We believe that the requirement to ‘poll’ other executives within a company for purposes of a warranty letter is something that must be taken very seriously by insureds,” says veteran insurance defense attorney Christopher Betke of Boston’s Coughlin Betke, LLC. *“It may have legal ramifications later, so no insured should just sign the letter without actually making the full inquiry of the designated parties.”*

Another critical issue is how the warranty language is framed. Some warranty letters use language that requires the applicant to warrant that they are not aware of “...*any act, error, omission or other fact or circumstance reasonably likely to give rise to a claim under the proposed coverage.*” The key here is that such situation must be reasonably likely to lead to a loss. This means that a situation that’s only perceived to possibly lead to a covered loss, but not reasonably likely to do so, doesn’t have to be disclosed and is not within the purview of the warranty letter.

A more onerous version of the operative language says that the applicant is not aware of “...*any act, error, omission or other fact or circumstance which might give rise to a claim.*” In the world of creative and aggressive plaintiffs’ attorneys, almost anything might give rise to a claim. This statement should be avoided, or carefully considered and discussed with the carrier to understand their full intent, before your client agrees to warrant that they have no such knowledge. Many insureds have hastily signed warranty letters containing such broad language, only to regret it when a costly claim arises and the warranty letter is called into question.

Warranty letters, like many aspects of professional lines insurance, come in many flavors and raise many unique issues. There’s no “one-size-fits-all” solution, unfortunately. But, as always, your AmWINS broker stands ready to lend you her expertise on this and any other insurance challenges which you may have.

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