

# *Virginia*

## *Regulatory Hot Tip 2012 – 2*

*Professional Insurance Agents Association of Virginia and DC, Inc.*

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### CERTIFICATES OF INSURANCE 102

In a recent 2011 Hot Tip, we explained the basics about certificates of insurance and outlined current problems arising from the interaction of an insured person and/or his authorized representative with a third party. In this follow-up article, we will take a more in-depth look at these third-party problems and discuss the solutions that some states have implemented. In addition, we will examine the approach of the National Conference of Insurance Legislators' ("NCOIL") in its proposed draft Certificates of Insurance Model Act ("Model Act"). Finally, we will discuss what is happening here in the Commonwealth of Virginia.

Problems with certificates of insurance develop when third parties don't understand the purpose of the certificate. A certificate of insurance is merely a snapshot of a property and casualty insurance policy, reflecting the basic coverage of the insured person at the time of the certificate's issuance. It is NOT a coverage form. When a third party treats a certificate of insurance as something other than an informational tool that cannot modify or expand the insured person's policy, it starts a snowball effect that may cause an avalanche of troubles for all concerned parties.

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The first snowflake begins to fall when a third party demands that an authorized representative issue a certificate that does not comply with the underlying policy terms.<sup>i</sup> Often, the third party insists on significant word changes to the certificate as a prerequisite to hiring the insured person, who is often a contractor. For example, the third party may want the certificate to provide for notification if there are any changes to the insured person's policy even though the policy itself does not provide for notification to the third party. If the insured person cannot convince his authorized representative to make these changes, then the insured person does not get the job.<sup>ii</sup>

In this scenario, the third party mistakenly believes that by changing the language of the certificate, the insured person's policy must conform to the new language on the certificate.<sup>iii</sup> This, however, is not the case for several reasons. First, the insured person's policy is a contract between the insured person and the insurance company. The third party is not a recognized party to the policy and cannot alter or modify the policy in any way. Second, as mentioned previously, the certificate is only evidence of the existence of the policy, not a contract that can be modified or expanded.

Snowflakes continue to fall when a third party creates and issues its own "Certificate of Insurance" form. To satisfy the third party and secure the desired job, the insured person wants to have his authorized representative complete, execute, and notarize the third party's version of the certificate.<sup>iv</sup> Often, the third party's certificate requires the authorized representative to legally warrant that the insured person's insurance policies are and will remain in effect and will conform with and perform to the meaning and instructions of the third party's insurance policy throughout the period of the job.

The snowflakes will multiply quickly when a third party creates its own certificate. First, a certificate does not and cannot guarantee that a policy will remain the same after issuance of the certificate, much less remain in effect for a certain period of time. Second, the authorized representative is not privy to the third party's insurance policy and therefore has no way of knowing whether the insured person's policy will conform to the third party's policy. Third, even if the third party informs the authorized representative of the obligations set forth in the third party's insurance policy, there is no guarantee the third party's policy will remain the same throughout the period of the job. In fact, such policies more likely than not will require amendments.

Third party involvement with certificates of insurance currently creates an Arctic blizzard of legal problems. The third party is not an authorized person engaged in the business of insurance and therefore has no legal authority to create, issue, or use an insurance form.<sup>v</sup> The insurer issuing an insurance policy and the insured person own the policy, not the third party. Only the insurer and the insured

person are mutually obligated to each other by the policy language, terms, and conditions.<sup>vi</sup> Therefore, no third party, including a government entity, has a legal right to expect, demand or impose himself into the insurance contract between other parties. The third party cannot create such a legal right by written contract.<sup>vii</sup>

A third party has no legal authority to instruct, direct, or require warranties from the authorized representative of the insured person. When a third party exceeds its legal authority regarding a certificate of insurance, the result is a document containing a mixture of legally-binding language and language that appears to be binding but is not. This produces much confusion and great danger of misinterpretation of the certificate.

Snowflakes turn into a blizzard which then produces an avalanche when the following factors combine: (1) a third party believes he is addressing his rights and interests successfully, but in fact he is not; (2) a third party violates insurance law by engaging in unauthorized insurance activities; (3) an insured person loses a job opportunity when his authorized representative complies with insurance law; and (4) an insured person seeks a new authorized representative who is willing to ignore the law concerning issuance of certificates of insurance.

To prevent the blizzard and ensuing avalanche, several states and insurance associations are proposing and implementing legislation to clarify the purpose and effect of a certificate of insurance. In 2010, Louisiana made it illegal to demand or issue a certificate that did not reflect the terms of the underlying policy. In addition, certificates must be filed with and approved by the Louisiana Department of Insurance. Several other states have enacted, or are in the process of enacting, similar legislation.<sup>viii</sup>

NCOIL is considering issuing a Model Act similar to Louisiana's legislation. The purpose of the Model Act is to "affirm the proper effect and status of certificates of insurance used for property and casualty, clarify the limitations on their use, and prohibit fraud and misuse." The current draft of the Model Act provides standards for certificate forms, mandates "information only" disclosure, and prohibits altering a certificate or using false or misleading data. The draft of the Model Act also bans any reference to third-party contract requirements and emphasizes that a certificate confers no rights beyond what the underlying policy itself provides.

The PIA National supports the draft of the Model Act and is working with NCOIL on certain amendments to its language.<sup>ix</sup> The National Association of Insurance Commissioners has expressed renewed interest in this issue and the PIA National is hopeful that regulators will consider issuing a model bulletin that would complement the NCOIL Model Act.<sup>x</sup>

Here in Virginia, both the Senate and the House of Delegates are tackling the issue of certificates of insurance. The Senate proposed Senate Bill No. 47 which amends and reenacts Section 38.2-515 of the Code of Virginia and adds new Section 38.2-518 relating to unfair insurance trade practices regarding certificates of insurance. Introduced by Senator Watkins, the Bill summary follows:

Prohibits any person from (i) issuing or delivering a certificate of insurance that attempts to confer any rights upon a third party beyond what the referenced policy of insurance expressly provides; (ii) knowingly demanding or requiring the issuance of a certificate of insurance from an insurer, insurance producer, or policyholder that contains any false or misleading information concerning the policy; (iii) knowingly preparing or issuing a certificate of insurance that contains any false or misleading information or that purports to affirmatively or negatively alter, amend, or extend the coverage provided by the policy; or (iv) issuing or delivering a certificate of insurance that does not contain a statement regarding such matters. In addition, a certificate of insurance may not represent an insurer's obligation to give notice of cancellation or nonrenewal to a third party unless the giving of the notice is required by the policy.

As of the time of this writing, the Senate passed Bill No. 47 unanimously and the Bill has now crossed over to the Virginia House of Delegates and been referred to its Committee on Commerce and Labor. You can find a .pdf version of the bill at <http://lis.virginia.gov/cgi-bin/legp604.exe?121+ful+SB47S1+pdf>.

Meanwhile, in the House of Delegates, there were two bills concerning certificates of insurance, House Bill Nos. 960 and 867. House Bill No. 960 was nearly identical to Senate Bill No. 47, except that it did not propose to amend Section 38.2-515 of the Code of Virginia. Although the House of Delegates tabled this Bill on February 2, 2012, House Bill 867 is still alive and well. This Bill was identical to Senate Bill No. 47 when it was first introduced on January 11, 2012. As it made its way through the House of Delegates' Committee on Commerce and Labor and the House itself, its substance remained unchanged, although there have been a few textual changes. House Bill 867 has now crossed over to the Senate and been referred to its Committee on Commerce and Labor. The .pdf version of this engrossed bill is available online at <http://lis.virginia.gov/cgi-bin/legp604.exe?121+ful+HB867E+pdf>

As of February 15, 2012, it looks promising that the General Assembly will pass a bill governing certificates of insurance. Depending on the results of this session of the General Assembly, you may see a Certificates of Insurance 103 coming your way soon.

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<sup>i</sup> National Association of Professional Insurance Agents, Certificates of Insurance Webinar, July 19, 2011.

<sup>ii</sup> *Id.*

<sup>iii</sup> *Id.*

<sup>iv</sup> *Id.*

<sup>v</sup> *Id.*

<sup>vi</sup> *Id.*

<sup>vii</sup> *Id.*

<sup>viii</sup> *Id.*

<sup>ix</sup> *Id.*

<sup>x</sup> *Id.*