

Risk Transfer

Real Estate Agent &
Broker Environment

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Why should a real estate agent buy errors and omissions insurance for themselves instead of relying on their broker to do it for them?

Three reasons: It's portable, personal, and permanent. And its affordable too.

Portable - Your own coverage follows you wherever you go. Coverage is not at risk when agents change brokers, or transact business "on the side". Individual coverage solves the pre-affiliation problem.

Personal - Unlike broker-procured policies, Agents with their own coverage do not share their limits with anyone else. Many firms only buy a few thousand dollars per agent in coverage!

Permanent - Brokers go out of business, pass away, or are otherwise unable or unwilling to obtain continuous protection for past deals. Agents with their own coverage are masters of their own insurance fate.

Affordable - Many agents pay more than they should for insurance and risk management. The vast majority of agents are low risk, yet when buying bulk insurance, everyone pays for the one bad apple.

Most companies buy insurance protection for the company itself. The coverage extends to the employees of the organization. Real Estate brokerages do the same thing—Brokers buy coverage that "protects" the agents. But there are two features of the real estate industry make this a bad idea.

First, the relationship between the real estate agent and broker is typically classified as that of an independent contractor.¹ That makes the broker responsible for the [real estate] agent's liability under principal-agent principles.² This mechanism means a broker, as principal, is responsible for the torts (mistakes, errors, omissions) of his/her agent if the agent's activity is within the scope of the principal-agent relationship. This means a principal, may avoid responsibility by proving the agent's activity was outside the scope of the agency. This is sometimes referred to as *ultra virus*. And guess what? If the broker proves that, then their insurance won't protect you.

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¹ www.realtytimes.com/rtpages/20120214_employee.htm

² www.en.wikipedia.org/wiki/Law_of_agency

Unlike most 9 to 5 employees, real estate agents often act in a wide variety of roles. Some of these roles might not be within the scope of the Broker-Agent relationship. Say the agent manages a property for a friend on the side, or refers a mortgage deal to a friend. A broker's insurance company might say that it isn't within the scope of the agency.

The second feature of the real estate relationship that is unusual is the type of risk transfer (insurance) available in the marketplace for real estate professionals. You see, insurance companies like stability and predictability, so they are worried about changes in laws and exposures that affect their liability. They are pretty well settled for, say, auto accidents, and even for things like products liability. But they aren't for real estate professionals. So the insurance companies issue a special kind of policy to give them a quicker reaction time — It's called Claims Made Insurance. ³

Claims made insurance means the policy in effect at the time the claim is brought against you is the policy that responds. Claims are commonly made between 1 and 5 years after the close of escrow. Sometimes a claim comes in 10 years after closing! ⁴ The agent is at the mercy of whatever protection their broker (or in many cases former broker) elected to buy.

What if they reduced coverage to save money? Forgot to pay their insurance bill? Closed up shop? Used up all the insurance on other claims? Died?

Sound unlikely? It happens all the time.

The answer is portability. Portable coverage follows you, not your employer or principal. You decide if you let your coverage lapse or change terms. Only you have access to the coverage limit. Work for 5 firms in 10 years? Portable coverage follows you all the way.

Congress was so concerned about lack of portability in the health care arena, they passed the Health Insurance Portability and Accountability Act of 1996 to require insurance companies to let individual coverage follow the insured.

Other professionals that need a "sponsor" carry insurance at the base professional level. Surgeons, for example, need privileges from a hospital to operate. But they don't trust the Hospital to arrange their malpractice insurance.

Just as a doctor should have medical malpractice insurance, a real estate agent should have errors and omissions insurance. This insurance protects you against claims and lawsuits if you inadvertently make a mistake. The operative word here is inadvertently. If you purposely commit fraud or negligence, your insurance company may not cover you.

³ www.irmi.com/online/insurance-glossary/terms/c/claims-made.aspx

⁴ **We received a claim call last month that related to a transaction that closed in 1998!**

Why real estate agents should buy insurance for themselves?

Real estate brokers buy Errors and Omissions insurance to protect themselves, because they are vicariously liable for the actions of their agents (Principal-agent liability). That means you mess up and owe a remedy to a buyer/seller, then they do too.

Vicarious liability is completely derivative of an agent's liability. There is no independent mistake on behalf of the brokers.

So why do brokers buy insurance? To protect themselves. Agents are at the mercy of the broker.

- ● ● **Individual coverage is portable.**
- ● ● **It is discrete.**
- ● ● **Your policy limit is not shared with other agents.**
- ● ● **\$1,000,000 in insurance on a firm with 200 agents only gives \$5,000 in coverage per agent!**

Buy a policy online at: cresinsurance.com/individualagent.html

CRES Insurance Services has protected more than 500,000 professionals nationwide since 1996, and is the largest writer of Errors and Omissions Insurance and Risk Management Services for the Real Estate Community.

Our mission is to help you manage financial risk so you can focus on your success. Visit us at: www.cresinsurance.com

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