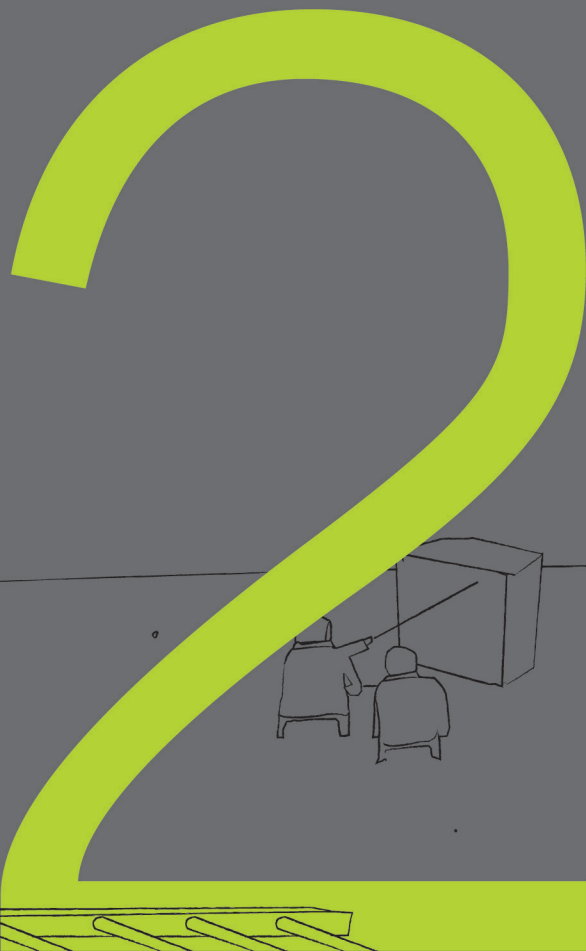




THE CHARTERED INSTITUTE  
OF LOSS ADJUSTERS

## CH 2 Introduction to Claims Handling

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# INTRODUCTION TO CLAIMS HANDLING

by

**Malcolm Hyde**

BSc (Hons) Dip (Fr) FCII FCILA



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A Division of Witherby Publishing Group Ltd

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First published in 2011 by Witherby Publishing

ISBN: 978-1-85609-447-4

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**British Library Cataloguing in Publication Data**

A catalogue record for this book is available from the British Library.

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Printed and bound in Great Britain by Bell & Bain Ltd, Glasgow



Published by

**Witherby Publishing Group Ltd**

Navigation House,  
3 Almondvale Business Park,  
Almondvale Way,  
Livingston EH54 6GA,  
Scotland, UK

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## Introduction

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This learning material has been designed with two main concepts in mind:

1. That it is easily understandable
2. That it engages the learner, promoting questions such as why, who and how does this affect me?

The learner could simply read and learn the material, but the concept of adding “Activities” and “Putting it into Practice” is designed to help the learner explore the subject to a greater depth.

Those who adopt a positive, proactive approach will benefit as they will enhance their learning, becoming ever more useful in the workplace; the resulting rewards for this are immense.

There are deliberately no suggested answers to either the Activities or the Putting it into Practice questions. These are set for you to explore.

CILA would like to acknowledge the assistance of Luke Exford and Alison Gamble in the production of this book.

## About the Author

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1

INTRODUCTION TO THE INSURANCE POLICY





# 1. INTRODUCTION TO THE INSURANCE POLICY

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## Contents

- 1.1 What is an Insurance Policy?
- 1.2 The Promise or Operative Clause
- 1.3 The Agreement
- 1.4 The Property Insured
- 1.5 Loss or Damage
- 1.6 Value of Property
- 1.7 Key Points
- 1.8 Definitions
- 1.9 General Conditions
- 1.10 Key Points
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- 1.12 Key Points

## Introduction

The Insurance Policy is probably the most important reference point when dealing with claims as it is this document that details the cover provided. When handling a claim it is essential to refer to the individual Insurance Policy in each case and this requires that you are familiar with the format of an Insurance Policy.

This section provides an outline of the various sections of the Insurance Policy and explains the elements that you will need to understand and be aware of when handling any claim.

### 1.1 What is an Insurance Policy?

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The Policy is the contract between the Insured and their Insurance Company. You will recall that Book 1 outlined the essentials of the contract between the Insured and the Insurance Company. An Insurance Policy is a written document that details the extent of cover being provided by the Insurance Company to the policyholder.

The various sections of the Insurance Policy are usually, but not always, as follows:

- The Promise or Operative Clause
- Definitions
- Perils (covered in Section 3 of this book)
- General Conditions
- General Exclusions.

## 1.2 The Promise or Operative Clause

---

The dictionary definition of “operative” is “working”. This can be taken to mean that the operative clause is the part of the policy wording which confirms the factors that must be in place for the policy to be in operation or working.

This clause is also referred to as ‘the Promise’, as it is this series of words that forms the agreement between the Policyholder and Insurer. It outlines what each party promises to do. A claim will only be covered if the insurance policy is in force and has been accepted by both parties. The operative clause is therefore an essential part of the policy as without confirmation that both parties have fulfilled their promise no contract exists between the parties.

The following is an example of an operative clause:

***“The Insurer agrees (subject to the terms, definitions, exclusions, provisions and conditions of this policy) that if after payment of the first premium the Property Insured described in the schedule be lost destroyed or damaged by . . . (perils outlined). . . during the period of insurance (or any subsequent period for which the Insurer accepts a renewal premium) the Insurer will pay to the Insured the value of the property at the time of the loss or its destruction or the amount of the damage or at the Insurer’s option reinstate or replace such property or any part of it”.***

As you will appreciate this is a complicated piece of text, but it will be broken down to highlight the parts relevant to claims handling.

## 1.3 The Agreement

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The Operative Clause generally starts with the phrase “The Insurer agrees” or something similar. This is the Insurer’s acceptance of the fact that they will provide policy cover once the payment of insurance premiums has been received (subject to the terms of the policy definitions, perils, general conditions and general exclusions which are all discussed later in this section). The Policyholder promises to pay the agreed premium in exchange for the policy cover provided.

As an example, let us consider the importance of the agreement detailed in the operative clause and what it means. If Mr Smith, a policyholder, has been online and taken out an insurance policy for his three bedroom detached house and he has a fire a few weeks later, try to consider how the wording of the operative clause could affect the claim. What steps should be taken to check that the Policyholder has fulfilled his promise?

Checking that premiums have been paid is vital. If the Policyholder has not paid the insurance premium by the date agreed by both parties, they have broken their promise and the agreement has not been met. In this case the Insurer does not need to issue payment for the claim as the policy was not actually in existence as the policyholder has not fulfilled their part of the agreement by fulfilling their promise of making payment of premiums. This could mean that a very large claim for fire damage will not be paid by Insurers.

However, if it is confirmed that the policyholder has paid the premium then the policy was activated. The next stage is to assess whether payment should be issued in respect of the claim.

## 1.4 The Property Insured

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The operative clause states that Insurers will make a payment for loss or damage to the Property Insured as described on the policy schedule. This means that they will only pay



for damage to the property detailed on the schedule, in our example a three bedroom detached house. When Mr Smith took out the policy, he would have been asked by the Insurance Company for details of the property that he intended to insure. The premiums being charged would have been set by the Insurance Company based upon the information Mr Smith provided about the property. In our example Mr Smith did this online, as is often the case now with household policies, and he would have provided this information at the time of completing the application form online.



### Activity

List some questions you would ask to check that the damage was to the property insured in the following examples:

- Mr Smith's home
- An item of jewellery
- An outbuilding.

*The key point here is that the operative clause confirms that Insurers will only pay for loss or damage to the property insured. This means that it is imperative that you make the necessary enquiries to establish that the property which has been lost or damaged is the same property defined in the policy or policy schedule.*

## 1.5 Loss or Damage

This part of the operative clause confirms that Insurers will only pay for an item/property that has been lost (this includes destroyed) or damaged. The cause of the loss or damage and policy coverage are discussed later in this section. At this stage, we are concerned with making enquiries to check that the item/property has been lost or damaged.

Apart from a Loss Adjuster's visit and inspection, a number of other sources are available in the first instance to confirm that a loss or damage has occurred, for example photographs of the damaged item, independent reports from surveyors or Loss Adjusters and crime references/police reports. Validation that the item claimed for was lost or damaged is discussed in greater detail in Section 4.



### Activity

What steps would you take to establish that the following items had been lost/damaged in the following examples:

- A policyholder notifies his insurance company of a stolen watch
- A house has been reported to Insurers as being damaged by fire
- A carpet has been water damaged.

## 1.6 Value of Property

The final part of the operative clause that is relevant to claims handling is the section that confirms that Insurers will pay the value of the property at the time of the loss. This means that the Claims Handler will need to establish the value of the lost or damaged item; Insurers will pay no more than the item's value at the time of the loss. Validation of the replacement cost or repair cost will be explored in detail in Section 4.

## 1.7 Key Points

The operative clause is an essential part of the insurance policy wording. It details the agreement entered into by the Insurer and the Policyholder. The operative clause is not always referred to on a case by case basis, but it is important to have an understanding of the relevant parts to help establish whether the Policyholder is entitled to be indemnified for their claim and for confirmation that a contract exists.



### Activities

*Find your company's policy wording library. Look at three different policy wordings and locate the operative clause in each. Compare and contrast the operative clause in each wording.*

*Discuss the operative clause with your colleagues. Has anyone ever had a situation where the premiums have not been paid but a claim notified? How did Insurers ask for the claim to be handled?*

*At the beginning of this section, we provided a 'typical' operative clause. Review this and re-write the operative clause in your own words making it as understandable as possible to someone without insurance or legal knowledge.*

## 1.8 Definitions

The definitions section of a policy sets out exactly what an Insurer means by the words used in their policies. This is why it is sometimes entitled the 'Meanings of Words' section. You will recall that a number of items and parties are detailed in the operative clause. The Definitions section of the policy wording should clarify what is meant. Words that are defined in the policy may appear in bold type or capital letters whenever they are used in the policy wording.

An example could be that the operative clause confirms that the Insurer will pay for loss or damage to the property insured. In the case of a household policy for Buildings, the property insured will be the building. However, each Insurer will include different aspects as part of their definition. In the case of a household policy, the definition is normally the home followed by a list of other items included such as swimming pools, patios, outbuildings etc. If you are dealing with a claim for damage to a building, it is imperative that you refer to the specific policy definition of building to make sure that the feature being claimed for is covered by the policy.

The definitions section of the policy should be referred to on each occasion when dealing with a claim, as each Insurer has different definitions. The following are examples of definitions that could be found in a household policy, but some policies may provide many more definitions:

- **Buildings:** This will normally define the home and any number of other features that form part of the description of the Building. These can include swimming pools, gates, fences, service tanks, drains, pipes, cables and tennis courts. This definition extends the cover from just the house itself to physical aspects within the boundaries of the home. From this you can see that the extent of cover is vastly increased when you review the description. The definition may also include the nature of the construction materials, eg built of brick, stone etc.
- **Contents:** This will normally be defined as household goods, personal possessions and other articles. An important part of the Contents definition is that it may state that Contents are defined as articles belonging to the policyholder for which they are

responsible, or that belong to any members of their family permanently residing at the premises.

- **Business Equipment:** This could include computer equipment and telephone equipment.
- **Money:** This could include cash, cheques, stamps, vouchers and various other forms of money.
- **Personal Possessions:** These are personal belongings and valuables normally worn or carried. Each policy will differ and may include more items.
- **You:** A household policy will often refer to 'you' throughout the policy wording, and this is normally defined as the named policyholder.
- **We, Us, Our, the Company:** This will be the named insurance company providing the policy.

It is helpful to keep in mind that each policy will be different when you are dealing with a claim and you should refer to the specific policy wording on a case by case basis. Where a particular aspect is not defined by the policy, the Financial Ombudsman Service confirms that the everyday meaning of the words is accepted.



### Activities

*Obtain three different policy wordings. Review the definitions section and find out whether the policies include the following under the Buildings and Contents description:*

- *Garage*
- *Computer equipment*
- *Swimming pool*
- *Satellite dish.*

*Review one policy wording. Does this policy include cover for belongings of domestic staff under the Contents definition?*

*Review some policy wordings and list three other definitions you have found apart from those already discussed in this section. Consider the implication of the definitions when claims handling.*

## 1.9 General Conditions

Each policy will contain a General Conditions section containing general conditions applicable to the whole policy. There are some conditions found in most policies but some may be specific to the policy in question.

It is helpful to have an understanding of the General Conditions that could be applicable to the whole policy and to bear them in mind when dealing with a claim.

The following are some general conditions that are sometimes referred to as Claims Conditions as they affect the handling of claims:

- **Notification of Claim:** This condition requires that the policyholder notifies the Insurer immediately of the loss or claim. Some policies will give a specific timescale for notification of a claim.
- **Notification to Police:** In the event of theft or malicious damage, this condition will normally state that the police should be notified immediately.

- **Preventing Loss:** This condition often requires that the policyholder must take all reasonable steps to prevent loss or damage and maintain the property in a good condition and state of repair. This can also mean that the policyholder must take action to mitigate the loss.
- **Fraud:** This condition highlights the fact that Insurers can cancel the policy and that cover will be ended if any claim or part of a claim is found to be fraudulent or false.
- **Contribution and Average (underinsurance):** The principles of this condition will be discussed in detail in Section 9.

The following is an example of a general condition that does not directly relate to claims handling. However, Insurers will need to be informed if the policyholder has not met the condition:

- **Changes that must be notified to Insurers (material facts):** This condition confirms that it is the responsibility of the policyholder to notify Insurers of any changes to the risk. The importance of material facts is discussed in Section 6 in Book 1.

The reader should remember that the above is not an exhaustive list of Conditions and reference should always be made to the specific policy document.

An important General Condition is the requirement for the policyholder to mitigate their loss, ie to take steps to avoid or reduce further damage. Consider the case where a policyholder has an escape of water but has failed to stop the leak before contacting his Insurers. The initial damage may have been limited to a small section of a ceiling, but if the leak is left to continue in the policyholder's knowledge, then the extent of damage could be far worse requiring an extensive drying programme and repairs. As the policyholder has failed to prevent further damage, the cost of repairs will have increased considerably from the cost that may have been involved if the policyholder had stopped the leak as soon as it was located. This scenario is one that you will often come across. As policyholders sometimes require assistance, they should be told at the earliest opportunity that it is their responsibility to mitigate their loss. Mitigation is discussed in detail in Section 7.

## 1.10 Key Points

General Conditions are applicable to the whole policy and are normally a requirement for the policyholder to do or not to do something, eg notify Insurers of changes to their property. If a condition has not been met, Insurers need to be made aware of this as they have the right to cancel the policy and cease providing any further cover (although in practice this does not usually happen).

If you think that a General Condition has not been adhered to, you should refer the matter to Insurers. They may wish to discuss the situation with their underwriting department for clarification before the claim proceeds.



### Activities

*Review three policy wordings and note any further general conditions you may find.*

*Consider why you think one of the general conditions is that the police must be notified about theft or malicious damage? You may find it helpful to discuss this with a colleague.*

*List some issues that you think may arise if a policyholder fails to inform Insurers about a claim as soon as they become aware of it.*

## 1.11 General Exclusions

General Exclusions apply to the whole policy and are normally located in their own separate section in the policy wording. These exclusions are different to the specific exclusions found in the Perils section of the policy.

General Exclusions are used to reject cover for specified reasons.

Examples of General Exclusions are listed below together with the reasons for each exclusion:

- **War Risks:** This exclusion is often outlined in the following way “*Damage occasioned by war, invasion, act of foreign enemy, hostilities (whether war be declared or not) civil war, rebellion, revolution, insurrection or military or usurped power*”. The reason for this exclusion is that individual insurers would be unable to sustain the cost of damage likely to occur as a result of war. The exclusion was first introduced in 1937 when the Second World War was imminent. The Government agreed to accept the risk in the *War Damage Act 1941 and 1943*. Any damage caused by war is excluded as the claim should be dealt with by the Government.
- **Riot:** “*Damage occasioned by riot and civil commotion (unless specified in the policy and then only to the extent specified)*”. This has traditionally been excluded due to the fact that there has been a variable risk of riot at different places and at different times. However, be aware that this risk may be covered by the policy and the individual policy wording should be reviewed.
- **Northern Ireland:** This exclusion was worded as “*damage in Northern Ireland occasioned by or happening through or in consequence of: civil commotion, any unlawful, wanton or malicious act committed maliciously by a person or persons acting on behalf of or in connection with any unlawful association*”. An unlawful association, in terms of this exclusion, means an organisation involved in terrorism and any organisation defined in the *Northern Ireland (Emergency Provisions) Act 1973*. The reason that this exclusion was introduced was that Insurers incurred a high claims cost during the conflict in Northern Ireland. Insurers were paying claims then recovering their losses from the Government. Scope for compensation from the Government was then defined in the *Criminal Damage (Compensation) (Northern Ireland) Order 1977*. As a result of this, Insurers took the opportunity to exclude all damage where the Insured had a right of recovery from the Government. This exclusion was incorporated into the Terrorism Exclusion.
- **Terrorism Exclusion:** This exclusion confirms that the policy does not cover damage caused by fire and explosion occurring as a result of terrorism. However, there is a special provision available to provide cover for terrorism. The reader is encouraged to look at a policy wording to review the special provision for terrorism.
- **Pollution:** “*Loss or destruction caused by pollution or contamination but this shall not exclude destruction of or damage to the property insured not otherwise excluded caused by a) pollution or contamination which itself results from a peril insured against, b) any peril hereby insured against which itself results from pollution or contamination*”. This exclusion means that any damage caused by pollution will not be covered unless the pollution has been caused by an insured peril, eg escape of oil, or where the pollution results in an insured peril, eg fire. It would be beneficial to review this exclusion once you have studied the sections on Perils and Proximate Cause.
- **Marine Clause:** This exclusion confirms that if at the time of the loss the property was insured by a marine policy then the property policy will not react to cover the claim. This is because a marine cargo policy will consider any damage sustained en route to the warehouse, but if damage occurs at the warehouse then the damage should be picked up by the property Insurer unless the marine policy also provides cover for damage at the warehouse. If this is the case, both Insurers share the cost.



- **More Specifically Insured:** *“Any property more specifically insured by or on behalf of the insured”*. The reader may come across the importance of this exclusion where a policyholder has a number of different policies covering the same item, for example a mobile phone. If the Insured has cover under their household insurance policy but they also have a specific insurance policy for the mobile phone, this exclusion under the household policy would mean that the claim should be dealt with by the mobile phone Insurers.
- **Consequential Loss:** *“Consequential loss or damage of any description except loss of rent where such loss is included in the cover under the policy”*. The dictionary definition of consequence is “the result, effect, that which naturally follows” and this helps us to understand what is meant by a consequential loss. To explain this further, a consequential loss is a loss that flows from the original loss or damage. For example, if a fire has occurred at the policyholder’s property they may be unable to attend an event for which they have paid for tickets. They may ask if they can claim for the cost of the tickets but this exclusion confirms that this not covered. This exclusion may be difficult to explain to a policyholder especially if they are upset by the fact that they have lost further money.

You may find that you never have cause to apply the riot, war and terrorism exclusions in view of the fact that these events rarely occur. However, you should be aware of them. The pollution exclusion may need to be considered in greater detail and an understanding of the perils and proximate cause may assist. In the case of the marine exclusion, close analysis of the movement of goods will be required. The exclusions for consequential loss and property more specifically insured will be relevant frequently in the handling of domestic and commercial claims.



### Activities

*In the following cases consider whether one of the General Exclusions is relevant:*

- *A policyholder has submitted a claim for theft of property which occurred at their home. They would also like to know if the policy will provide cover for the cost of their weekend break in a hotel which they were unable to attend due to the theft*
- *A laptop has been damaged for which the Insured took out a policy at the time of its purchase*
- *A policyholder has noticed a strong smell of oil in the garden and dark patches on the lawn.*

## 1.12 Key Points

General exclusions are applicable to the whole policy and should be considered in each claims situation. The exclusions outline types of damage and/or property that the policy does not intend to provide cover for.

Each individual insurance policy will vary in its content and detail and as a result the policy wording should be referred to on each occasion that a claim occurs. It can be helpful to send the policyholder a copy of the relevant section of the policy wording when communicating a decision regarding a claim, particularly if a claim is being repudiated.



POLICY CONDITIONS AND WARRANTIES

2







## 2. POLICY CONDITIONS AND WARRANTIES

### Contents

- 2.1 What is Meant by a Condition
- 2.2 Types of Conditions
- 2.3 Other Policy Conditions
- 2.4 Difference Between Conditions and Warranties
- 2.5 What Happens when there is a Breach of Warranty
- 2.6 Key Points to Remember

### Introduction

The purpose of this section is to help you to understand the conditions of an insurance Policy and in particular how they relate to the handling of insurance claims. The following aspects are covered:

1. What is meant by a condition
2. Types of conditions
  - a. Express conditions
  - b. Implied conditions
  - c. Conditions precedent to policy liability
  - d. Conditions subsequent to policy liability
3. Examples of Policy Conditions
4. Contracting parties' options in the event of a breach of condition
5. Difference between a condition and a warranty.

### 2.1 What is Meant by a Condition

A condition is "A future event which is uncertain, the happening of which creates rights or obligations or enlarges rights or obligations or destroys them". In simple terms, this means that if something happens in the future the duties and rights may change, or if "x" happens then one party will may have the right to "y".

So a contract condition is a contractual term that requires one of the contracting parties to do something, or not to do something. For example, a contractual condition could be that Jack will wash Harry's car for £5 providing Harry delivers the car to Jack before 9.00 am. (If Harry delivers the car, ie a future event that may or may not happen, then Jack will wash it for a fee of £5.)



#### Activity

*Take a contract, perhaps your contract of employment, and look for the conditions that it sets out. Alternatively look on the internet for "standard conditions of trade". Observe the nature of the conditions. Also think about how fair and reasonable the conditions are from the perspective of all parties to the contract.*

## 2.2 Types of Conditions

### Express Conditions

Express conditions are those that are stated in the contract, so this simply means that they are *expressed*.

### Implied Conditions

Imagine a contract where absolutely everything had to be expressed. For instance does your contract of employment state what currency you will be paid in? Some conditions are so obvious they do not need to be expressed. That does not mean that they cannot be expressed and it is good practice to express anything that could be open to interpretation.

Sometimes there are contractual terms that are implied by law. The Supply of Goods (Implied Terms) Act 1973 is an example of such a law.

### Conditions Precedent to Liability

Conditions can be divided into two further categories - precedent and subsequent.

#### Conditions Precedent

A condition precedent to liability is a condition which, if breached, means that there is no liability on Insurers to meet the claim. For example, a Policy condition could be that the premium must be paid. If the premium is not paid, Insurers might have no liability for any claims.

#### Conditions Subsequent

These conditions are those that apply after a loss has occurred. For example, let's say in the previous example that the premium has been paid, a loss occurs and the Policy says that in the event of a loss the Policyholder must cooperate with any attempt to recover the money from the person causing the damage.

Should the Policyholder fail to do so there would be a breach of condition after there had been a liability under the Policy to pay, in other words a breach of condition subsequent to liability.



#### Activity

*Take a Policy and look at the Policy Conditions. Identify conditions that apply before there is a liability under the Policy. Then look for conditions that apply after there is a policy liability. A clue is to look for a "Claims Condition".*

### Examples of Policy Conditions

Policy conditions vary from Policy to Policy, but there are a number of conditions that can be expected to be found on most if not all Policies. These include:

- Reasonable care
- Insurer's rights following a claim
- Subrogation
- Arbitration.

We will consider two of these conditions in more detail as follows:

### 1. Reasonable Care Condition

In general terms, this condition requires that the Policyholder must exercise reasonable care to prevent losses.

A common way of describing this obligation is to suggest that the Policyholder should act as if they were not insured. Clearly we take out insurance policies because we know that occasionally things do go wrong, and when they do we want some security that we are protected. The Reasonable Care condition does not require that the Policyholder takes absolute care to prevent loss but rather that they take reasonable steps.

The Financial Ombudsman has considered many cases about the Reasonable Care condition and the suggested guideline is to judge whether the Policyholder has been reckless, as only then should the Reasonable Care condition be applied.



#### Putting this into practice

*Tommy is a footballer and plays for a major premier league team. He walks out onto the pitch one day and the referee points out to him that he is wearing an earring. Tommy rushes over to his coach and asks that he takes care of the earring, which is diamond encrusted. His coach agrees and places the earring in his pocket. Later, Tommy scores a hat trick and at the point of scoring the last goal the coach reaches into his pocket to pull out his scarf. The earring is mistakenly flung into the air and is lost forever. The question arises, did Tommy exercise reasonable care? The answer is yes, he did not act recklessly and he did not court the danger of losing the earring.*

*Compare this to a situation where Tommy realises that he is still wearing his earring and hands it to an opposition supporter, asking that he meets him in a bar later that evening to hand back the earring. The earring is not returned. The question again arises, has Tommy exercised reasonable care? The answer is no, he has acted recklessly.*



#### Activity

*Consider a theft claim that you have dealt with and concentrate on the Reasonable Care condition. What questions did you ask or what aspects of the claim did you consider in order to judge whether the Policyholder had met this condition?*

### 2. Insurer's Rights after a Claim

Following a claim, the Insurer needs the right to carry out a reasonable investigation to establish that the loss is covered by the Policy. To complete such an investigation, the Insurer will typically require access to the damage and information from the Policyholder. The Insurer's Rights after a Claim condition usually states that the Policyholder must provide reasonable proofs and allow the Insurer to appoint persons to carry out reasonable investigations. Should the Policyholder refuse, the Insurer could in turn refuse the claim on the basis that the Insurer's Rights after a Claim condition had not been complied with.



### Activity

*Take a look at three Policy wordings and find the condition in each that gives the Insurer the right to investigate a claim.*

*On occasion you may need to bring this condition to the attention of a Policyholder and so it is useful to know where to find it within a Policy and how it is commonly worded.*

## 2.3 Other Policy Conditions

There are several other Policy conditions, including Subrogation and Arbitration, and it is worth familiarising yourself with each of them to ensure that you understand the Insurer's rights and the duties of the Policyholder. The Policy conditions are usually grouped together so they should be easily found.



### Activity

*Make a list of the Policy conditions that are common to three Policy wordings. Ask your senior colleagues if they have encountered a breach or issue with these conditions. Find out how these claims were resolved.*

## 2.4 Difference Between Conditions and Warranties

A warranty relates to something that is ongoing. Think about when you purchase a new MP3 player. In addition to the MP3 player, software etc, you will be given assurances in the form of a guarantee or warranty that if something goes wrong within say 12 months of purchase the equipment will be repaired or replaced. This is an example of a warranty. It is not a condition of the sale that applies only at the time of sale, but rather it continues to operate.

To an extent, an insurance warranty is similar as it is something that continues after the Policy is sold. An example might be that the warranty requires that the Policyholder locks the external doors at the close of business. This means that after the contract has been made there is an ongoing obligation to lock the doors as prescribed by the warranty.

So in effect a warranty is a condition of the Policy, but Insurers make adhering to a warranty more fundamental. Warranties are worded in such a way that makes them Conditions Precedent to Liability. They go to the root of the contract and in fact a breach of warranty can make the Policy void from the date of the breach.



### Activity

*Ask colleagues for copies of some warranties. Note the wording of the warranties and look for similarities. Make a list of the different subjects of the warranties, such as locks, alarms, fire precautions etc.*

### 2.4.1 Points to Remember about Warranties

- Warranties go to the root of the contract.
- Warranties are conditions that are ongoing.
- A breach of warranty may make the policy voidable at the injured party's option.

### 2.4.2 Insurers' Right to Void the Policy

Warranties are used by Insurers to control and reduce risk. Using their experience, Insurers recognise the features of a risk proposed to them that make it a higher risk.

For example, consider a warehouse storing computers and printers which are packed in cardboard boxes. Now imagine there is a flood due to heavy rain and water covers the floor of the warehouse. The boxes on the floor are saturated and the cardboard soaks up the water, contaminating the row of boxes above those on the ground. Insurers could be faced with a large claim. The first two rows are affected so that they cannot be sold, and how would you feel about buying from the third row?

So how could this risk have been reduced? Well Insurers could have added a warranty, an ongoing condition that said that all stock must be stored on racks, say 15 cm from the ground. This would have prevented the damage to the bottom two rows and would have avoided any doubts about the third row.

### 2.5 What Happens when there is a Breach of Warranty

Historically this was simple. Insurers could simply void the Policy and make no payment.

However, there are rules that now apply particularly in Household Insurance. The FCA requires that the retail Policyholder is treated fairly. Would it be fair to void a Policy for a breach of warranty when the breach had no bearing on the loss?

In fact the FCA states that an Insurer should not reject a claim due to a breach of condition or warranty that is unrelated to a claim.



#### Activity

Consider the following two cases.

*You are dealing with a claim for theft. Victoria, the Policyholder, forgot to lock her house front door. There are two locks on the door, but it is a requirement in the form of a warranty that the lock conforming to BS3621 is locked.*

*In fact thieves gained entry to Victoria's shed and stole her Trek 5000 racing bicycle which is covered by the Policy. The failure to lock the front door in no way assisted the thieves. Would it be fair to refuse to deal with the claim on the basis of this breach of warranty?*

*The second case relates to a Policyholder, Bradley, who has many antiques and silverware. He is a local celebrity as he used to play lead guitar for a well-known rock band. There is a warranty on Bradley's policy stating that he must use a burglar alarm each and every time he leaves the premises. Bradley employs a cleaner, Chris, and quite often when Chris arrives the alarm is not set even though Bradley is out. One evening Chris is drinking in a local public house. A vague acquaintance asks Chris about Bradley's house. Chris, due to his "merry" state, describes Bradley's house as an Aladdin's cave and even goes on to say that frequently the burglar alarm is not set.*

*The information falls into the wrong hands and the house is broken into, albeit on a day when the alarm had been set.*

*Is it fair that the claim is repudiated on the grounds that the risk had been increased?*

Treating the Customer fairly when making decisions is judged by the FCA as follows:

Signs of retail Customers being treated fairly	Signs that retail Customers may not be being treated fairly
Decision making at all levels reflects the fair treatment of customers. The firm uses staff, customer and other external feedback where appropriate, with timely action. The interests of customers are properly balanced against those of shareholders (and other customer groups).	Minimal evidence that decisions reflect any consideration of the impact on customers. The firm is slow or unwilling to react to customer/staff feedback. Conflicts between the interests of shareholders and customers are consistently and inappropriately resolved in favour of shareholders.

It is important to remember that the FCA regulations apply to retail customers and not those acting in a business capacity. However, it is becoming increasingly the case that Insurers wish to demonstrate that they are treating all customers fairly, whether retail or business customers.

## 2.6 Key Points to Remember

- Conditions exist in all insurance Policies. They place duties on parties or change their rights in certain scenarios.
- Failure to meet a condition is called a breach of condition. If a condition precedent to liability is breached by a Policyholder, Insurers may not have a liability to pay their claim.
- While some conditions are common to most Policies, it is always important to check the specific requirements of each Policy. It should also be noted that not all conditions are actually expressed in the Policy but rather some are implied.
- Warranties are conditions that are ongoing. They go to the root of the contract such that a breach of warranty may make the policy voidable at the injured party's option.



THE PERILS

3







## 3. THE PERILS

### Contents

- 3.1 Fire
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- 3.7 Riot
- 3.8 Malicious Damage
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- 3.10 Accidental Damage to Underground Services
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### Introduction

As a Claims Handler, you may become all too familiar with the fact that the general public often believe that their insurance policy provides them with cover for any eventuality and any damage that occurs. However this is not the case. Property insurance policies provide cover for damage caused by specific events or causes of damage, and these are known as perils.

This section reviews the following perils and discusses the effect they have on claims handling:

- fire
- explosion
- lightning
- flood
- storm
- escape of water
- riot
- malicious damage
- theft
- accidental damage to underground services
- accidental damage.

Each policy wording may slightly alter the description of the peril and the specific wording should be considered in each case.

The reader will need to be mindful of proximate cause (discussed in Book 1), as it is the proximate cause of the damage that will determine whether a peril has operated.



### Activities

*Review the perils detailed in a policy wording that you use regularly.*

### 3.1 Fire

Fire was the first peril that was insured against as initially property insurance policies were established to deal with the cost of fire damage to properties.

It may appear that the fire peril is self-explanatory, but it needs to be explored further as claims for damage caused by smouldering or scorching can be presented as fire claims. It is important to be able to distinguish whether the cause of the damage is something that could be considered under the fire peril.

The term fire is used in the policy in its everyday sense. The key points are that there must be:

- actual ignition
- something on fire which should not have been on fire
- no connection between the insured and the fire, ie the insured did not wilfully set fire to the insured property. However, if the insured's negligent actions resulted in the fire, this will be considered.

The first point outlined above is that there must be actual ignition. This is best described in simple terms to a policyholder that there must be flame for there to be a fire within the definition of the policy.

Smoke damage would appear to be covered as long as the smoke resulted from a fire (because in that instance fire would still have been the proximate cause of the damage).

Damage to property caused by scorching or smouldering would not constitute fire damage as no ignition has occurred. However, the cause of this damage may be accidental and therefore may be covered by the accidental damage peril.

The second point requires the Claims Handler to consider the original use or purpose of the insured property. This was explored in the case of *Harris v Poland (1941)*, where jewellery was placed under a fire grate and forgotten about. A fire was subsequently started and the jewellery was damaged. The judge ruled that the claim could be considered under the fire peril as the jewellery was not supposed to be on fire.

The third point requires the cause of a fire must be investigated and verified. If an insured has deliberately started a fire, then the incident was not accidental on the part of the insured and this would go against the basic claims principles. Also if an insured has deliberately started a fire and then attempted to cover this fact up, there may be a fraudulent claim.

The risk of fire can be increased by, among other things, the nature of any chemicals stored, the construction of the property and proximity to other flammable properties.



#### Activities

Locate details of the following case and consider their importance in respect of a fire claim, *Tempus Shipping v Louis Dreyfus & Company (1931)*.

Consider what sources are available to you to establish the cause of a fire. List three.

Review two policy wordings and note any differences in the wording of the fire peril.

### 3.2 Explosion

This section will review explosion which occurs independently of another peril. The reader should be aware that the fire peril will cover loss from an explosion caused by fire or from a fire caused by an explosion.

A policy may only provide cover for fire and not explosion damage, and the exact cause of the loss must therefore be established.

In *Commonwealth Smelting Ltd v Guardian Royal Exchange Assurance (1984)* it was held that an explosion meant an event which was “*violent, noisy and caused by rapid chemical or nuclear reaction or the bursting out of gas or vapour under pressure*”.

In *Aegis Electrical and Gas International Services Company Ltd v Continental Casualty Company (2007)* the court held that what was required for an explosion was “*manifest violence and a shattering destruction*”.

The above two cases provide a good explanation of what is meant by explosion in terms of an insurance policy.

The reader may associate explosion with bombs used in battle and war, but this type of loss is excluded. This is discussed in greater detail under the General Exclusions section of the insurance policy section.



### Activities

List two examples of explosions that would fit within the description of explosion outlined in the two cases explained.

Discuss explosion claims with your colleagues and find out their experiences of dealing with these types of claims.

## 3.3 Lightning

A lightning strike may lead to an outbreak of fire. In general, claims presented following a lightning strike concern damage to electrical appliances and wiring.

It is often difficult to prove that the fault within the appliance or apparatus results from a lightning strike. When a Loss Adjuster inspects damaged appliances, they may find that the items no longer work, but a report from an electrical expert may be required to establish the cause of the damage. It is useful to obtain weather records to confirm whether there was a lightning storm in the area on the date in question.

Of course, a lightning conductor might be a requirement to reduce this risk.



### Activities

List three appliances that are most likely to be damaged by lightning.

Review two policy wordings and note any differences in the wording of the lightning peril.

## 3.4 Flood

Flood is often found alongside storm in a policy wording, and if this is the case then the difference between storm and flood is irrelevant. It can be unclear what the cause of the damage is. For example, surface water drains unable to cope with the quantity of rain during a storm back up and flood a premises. This leads to the question of whether the damage has been caused by escape of water, storm or flood. If the policyholder has cover for all three perils then the cause is irrelevant, and this could provide great assistance to the Claims Handler when handling the claim.

However we still need to outline what flood means in a policy. In *Young v Sun Alliance and London Insurance Ltd (1976)* the Court of Appeal held that the word ‘flood’ means a

rush of water brought about by severe weather conditions. In *Rohan Investments Ltd v Cunningham (1998)* the policyholder's flat was damaged by an ingress of water resulting from heavy rainfall lasting over a period of some days. This case demonstrates that a flood does not have to be a violent rush of water occurring in a short space of time, but can be due to an abnormal volume of rainfall.

The FOS has indicated that it favours the broader definition of flood in *Rohan* rather than that in *Young v Sun Alliance*.

The FOS considers that the ordinary householder's expectations of what constitutes a flood should be accepted. This is following on from a complaint which was escalated to the FOS in October 2001. In this case, an Insurer had repudiated a policyholder's claim for damage to a cellar which had filled with around 4 inches of water. The FOS considered that the claim should be accepted as flood damage. Much concern is given to the risk of flood and the protection that might be required, such as storing stock at a certain level above ground.



### Activities

Carry out some research into the case of *Tate Gallery (Trustees) v Duffy Construction Ltd (2007)* and make a note of the judge's comments regarding the factors required to consider a flood.

The floods in the summer of 2007 are notorious within the industry. Ask one of your colleagues who handled some of these flood claims about their experiences.

## 3.5 Storm

Storm claims can often be very problematic to handle due to the fact that a policy wording will rarely define what is meant by storm conditions, although some policies may contain definitions. As previously highlighted, policyholders often believe that their policy provides cover for all eventualities and this is certainly put to the test with the presentation of storm claims.

Insurers often have their own internal definition of what constitutes storm conditions and it is helpful to obtain copies of the relevant claims handling guidelines and refer to them.

Case law can provide some guidance when looking for a definition of storm. In *Oddy v Phoenix Assurance (1966)* the Judge held that "*Storm means storm and to me connotes some sort of violent wind usually accompanied by rain or hail or snow*". The Judge expressed the clear view that a storm must involve violent wind.

This was followed in the case of *S&M Hotels v Legal & General Assurance Society (1972)*. In that case, Thesiger J said that: "*A storm must be something more prolonged and widespread than a gust of wind*".

Due to the very problematic nature of storm claims, a number of cases exist which provide guidance on the issue. In view of this, it is useful to consider in more detail the FOS approach to storm claims.

The FOS have indicated that they will employ a two tier test. It will employ the 'but for' test to determine the proximate cause of the damage followed by a common sense review of the evidence. Consider the example of tiles falling from a neglected roof during strong winds. The 'but for' test indicates that the claim should be paid, ie "*but for the strong winds, the damage would not have occurred*". However, the FOS will then review all of the evidence and if it can be demonstrated that the roof would have suffered damage sooner or later because of poor maintenance, common sense will indicate that the proximate cause of the loss was not storm.

The two tier test applied by the FOS is a useful tool to determine whether or not the loss or damage that is the subject of the claim is proximately caused by storm. This is particularly useful when considering claims where there is a dispute as to whether the damage results from an exclusion such as wear and tear or a peril such as storm.

One particular type of storm claim to be aware of is a claim for damage to a flat felt roof. This type of roof has a short life span and may start to leak when it reaches the end of its life. It is common for a Policyholder to submit a claim for storm damage to their flat felt roof when it begins to leak. This takes us back to the FOS ‘but for’ test. If the roof was at the end of its life span, it would need to have been replaced sooner or later anyway and would therefore not be considered. In view of the short life span of these types of roofs, simply asking the age of the roof can help to determine the cause of the damage.



### Activities

*Look on the FOS website (<http://www.financial-ombudsman.org.uk>) for more guidance on storm claims.*

*List the types of evidence a policyholder could provide to demonstrate the age and condition of their roof.*

*Consider other types of property that could suffer storm damage other than roofs.*

## 3.6 Escape of Water

A large proportion of property claims relate to damage that has occurred due to an escape of water. Insurers will often have their own internal procedures for dealing with such claims.

It is important to understand what is meant by an escape of water. Each policy wording will be different, but the peril will normally be described as an “escape of water from” followed by the words “any tank apparatus or pipe”. There may be any number of descriptions of the type of water apparatus. Water apparatus will encompass a large array of appliances and equipment that use or store water.

An important point to remember is that the escape of water peril will often exclude damage to an unoccupied property; each policy will provide a definition of unoccupied. The reason for this is that if a property is unoccupied for a long period of time then an escape of water may occur unnoticed and cause substantial damage.

Claims can be submitted for dry rot to properties and some Insurers will consider these claims if the cause of the dry rot is due to an escape of water. It is often in these cases of dry rot that consideration will need to be given as to how long the leak has been ongoing and whether it would have been reasonable for the policyholder to have discovered the leak and stopped further damage before the dry rot occurred.

The key points are that the exact cause of the leak will need to be determined, the Policyholder must provide confirmation that the leak has been repaired and the Claims Handler needs to be satisfied that the Policyholder attempted to repair the leak as soon as they were aware of the problem.



### Activities

*List five types of water apparatus that may leak resulting in an escape of water claim.*

*Consider what evidence a Policyholder could provide to demonstrate that a property was not unoccupied at the time of the escape of water.*

*List three sources that would assist in confirming that an escape of water has occurred.*

### 3.7 Riot

Claims involving riot do not arise very often, but it is helpful to understand what is meant by riot.

The Public Order Act 1986 defines riot as comprising the following elements:

1. Where twelve or more persons who are present together use or threaten unlawful violence for a common purpose and the conduct of them (taken together) is such as would cause a person of reasonable firmness present at the scene to fear for his personal safety, each of the persons using unlawful violence for the common purpose is guilty of riot.
2. It is immaterial whether or not the twelve or more use or threaten unlawful violence simultaneously.
3. The common purpose may be inferred by conduct.
4. No person of reasonable firmness need actually be, or be likely to be, present at the scene.
5. Riot may be committed in private as well as in public places.

This provides the definition used by insurers to decide whether or not the peril has operated.

There is a second important statutory provision in the context of riot and that arises from the Riot Compensation Act 2016. This Act provides that, where certain property is damaged, destroyed or stolen in the course of a riot, compensation is payable by the local policing body.

Claims for riot damage must be made to the police within 42 days.

The Act sets out a whole range of provisions concerning who may claim, the fact that Insurers having paid a claim can claim from the police authority, the limits and process.



#### Activities

*Consider the definition of riot under the Public Order Act 1986. Can you think of any incidents reported recently that would constitute a riot under this definition?*

*List three types of property that you think may be damaged during a riot and that would be covered by an insurance policy.*

### 3.8 Malicious Damage

Malicious damage means damage that is caused deliberately or even perhaps accidentally by trespassers.

Insurers generally limit their exposure and the malicious damage cover usually excludes damage caused by malicious persons or damage caused by malicious acts while the premises are let to tenants or if caused by other persons legally on the premises, eg invited visitors.

The policy may state that the damage must be reported to the police, and this confirms the fact that the damage must have been caused by trespassers or unlawful persons on the property. A straightforward example of malicious damage is graffiti damage to property carried out by unknown persons or persons not lawfully on the premises.

A number of claims are submitted by landlords for damage to their property caused by their tenants. This could be damage to the property or even unauthorised decoration of



the property. The reality is that the landlord has given authority for the tenant to be there and it is difficult to demonstrate that the type of damage that has been caused by the tenants was carried out with malicious intent against the landlord.

Malicious damage cover is also restricted when buildings are unoccupied and you should always check the wording for the definition of “Unoccupied”.



### Activities

List three types of damage that would be considered as malicious damage in terms of an insurance policy.

## 3.9 Theft

Theft is one of the few perils that has an actual legal definition. Section 1(1) of the Theft Act 1968 defines theft as follows:

*“A person is guilty of theft if he dishonestly appropriates property belonging to another with the intention of permanently depriving the other of it; and “thief” and “steal” shall be construed accordingly”.*

As defined, theft must involve “dishonest appropriation”. If a person takes an item and they do not believe that they are taking the item dishonestly then this cannot be considered as theft.

For example, if my neighbour asks me to feed their cat during their absence and I take a bottle of milk from their fridge, it could be argued that I have stolen the milk. However, if I honestly believe they would not have had any objection, then I can argue that the appropriation was not dishonest and accordingly did not amount to theft.

In the case of *R v Ghosh (1982)*, the test of what is considered to be dishonest appropriation was explored. Following on from this case, the test to be applied is:

1. whether the person acted dishonestly by the standard of ordinary and honest people, and
2. if he so acted, whether he himself must have realised that what he was doing was by those standards dishonest.

Not every theft claim that is presented can be considered a theft according to the definition. It may be the case that a debt collection agency has removed goods following repossession as the policyholder has failed to pay for them. In this instance, the goods do not belong to the policyholder but the original retailer and the collection agency has the right to remove them. This is not theft. It could even be the case that, as part of a marriage break up, one party takes goods purchased together and the claim is presented as theft. This is not necessarily theft if the party taking the items believes that they own the items and therefore has the right to remove them from the home.

In the light of the definition of theft, it is very important to obtain full particulars of the event in order to determine whether a theft has indeed occurred.



### Activities

Review two policy wordings and note any exclusions you can find under the Theft section.

### 3.10 Accidental Damage to Underground Services

Ordinarily there is cover under a household policy for “*accidental damage for which [the policyholder] is legally responsible to underground service pipes and cables supplying [the policyholder’s] home*”.

It is important to consider carefully the individual policy wording as the cover varies. For example, some specifically include, following a blockage, the cost of breaking into and repairing a pipe.

There are three aspects to underground services that should be understood: a drain, a private sewer and public sewers.

A drain is an underground pipe taking foul or surface water from a single property. A drain is therefore the responsibility of the private owner of the property.

A private sewer is an underground pipe taking foul or surface water from two or more properties, ie shared private drain pipes. Any sewer built after 1<sup>st</sup> October 1937 is the responsibility of the owners of the properties it serves. Any sewer built before this date is the responsibility of the local water authority.

Public sewers are those adopted and maintained by a local water authority (or local authority on their behalf) and are therefore the responsibility of the local authority.

Cover for accidental damage was primarily intended to deal with the consequences of sudden and unforeseen events. However, the FOS has made decisions that have supported the argument that an accident need not be sudden. It can occur in “*slow motion*”. This can result in insurers accepting, for instance, claims for damage caused by gradual ground movement.

The FOS has also decided that delamination of pitch fibre pipes by the action of sewerage or water and the subsequent degradation of pitch fibre pipes by water ingress itself represents accidental damage.

Claims Handlers will often be presented with a drainage report provided by either the policyholder’s drainage company or the Insurer’s nominated drainage contractor. These reports normally provide details of the location of the damage and sometimes they will offer an explanation as to the cause of the damage. These reports are invaluable in determining which party is responsible for the damaged drain, pipe or sewer and determining the cause of the damage.



#### Activities

*Review three policy wordings and note any differences in the cover detailed for damage to underground services.*

*Obtain a drainage report and review whether the damage identified would be covered by a policy wording you use.*

### 3.11 Accidental Damage

Most household and some commercial policies provide cover for accidental damage. This is in addition to cover under perils such as accidental breakage of fixed glass, accidental damage to underground services etc.

The difficulty with accidental damage cover, so far as loss adjusters are concerned, is that the policyholder will routinely expect almost everything to be covered under accidental damage if not covered under any other peril.



Accidental is defined in the dictionary as something that happens which is unforeseen or unexpected, a chance mishap, not an inevitable happening and not deliberate. To be considered as accidental damage, we are looking for something that occurred by chance and as a result there must have been some kind of damage to the property covered by the policy.

The part of the definition of accidental that may cause the greatest difficulty for the reader is that the damage must be unexpected or unforeseen from the point of view of the policyholder. In some circumstances, it can be difficult to determine that the damage that has occurred was unexpected to the policyholder.

Another factor which often presents problems is that the damage must not be inevitable. For example, if the policyholder was aware that the water tank in the loft was very old and unstable, then one day the fixings finally failed and the water tank fell through the ceiling, this would not constitute accidental damage. The policyholder was aware of the problem and it was foreseeable that the fixings would eventually fail and the tank would fall through the ceiling. However, the reader should be mindful that Insurers may take a lenient view on this type of incident.

The accidental damage section of a policy will normally contain a number of exclusions which can greatly assist when handling a claim.



### Activities

*Find six exclusions in the accidental damage section of a policy wording.*

*Consider whether the following examples can be considered accidental damage:*

- *A policyholder decides to paint a table then decides that they do not like the colour. They are unable to remove the paint so wish to claim for a new table*
- *The policyholder drops the iron onto their carpet leaving a scorch mark*
- *A dog scratches a leather sofa a number of times.*





INTRODUCTION TO CLAIMS VALIDATION

4



## 4. INTRODUCTION TO CLAIMS VALIDATION

### Contents

- 4.1 What is Claims Validation?
- 4.2 Key Points to Remember

### Introduction

Claims validation is a fundamental aspect of the claims handling process. Your ability to validate claims will undoubtedly be a key performance measure in whatever sector of claims handling that you work in.

This section outlines what is meant by claims validation and explains the elements you will need to consider in the handling of any claim. There is much to learn on the subject of claims validation and the topic is covered in much more detail in the later CILA Certificate courses. This section will however give you an insight into the subject.

### 4.1 What is Claims Validation?

The Oxford dictionary definition of validate is “make valid, ratify, confirm”. Claims validation is about checking the validity and the value of the claim that has been presented by the Policyholder.

There are essentially four elements of claims validation and these are as follows:

1. Validation of the cause of the loss or damage
2. Validation that the item claimed for existed
3. Validation that the item said to be lost or damaged is actually lost or damaged
4. Validation of the monetary value of the damaged or missing item.

#### 1. Validation of the cause of the loss or damage

A claim is only covered by an insurance Policy if the cause of the loss or damage is one of the perils listed in the Policy and no exclusions apply. It is therefore understandable that Insurers want to check the cause of the claim before agreeing to make a payment under the Policy. (We will look at perils and exclusions in more detail in the later CILA Certificate courses.)

At the time of notifying Insurers of a claim, Policyholders will be asked to confirm what they believe has caused the loss or damage. They will typically describe the circumstances leading up to the incident and suggest a particular cause, for example fire. Claims validation is about checking the circumstances that have been presented by the Policyholder. In the majority of instances, it is relatively easy to confirm the actual cause of loss or damage by a few simple enquiries.

As an example, let us consider the Storm peril and just one aspect of Buildings, a three layer flat felt roof. How can we satisfy ourselves that the damage claimed resulted from Storm? Well, we could make the following enquiries:

- Obtaining weather records - if there were no storm conditions at the time the damaged occurred, the Policyholder will find it difficult to argue that the damage was as a result of a storm. When checking the weather records, the wind speed, gusts and the direction of the wind should be noted, as well as the amount of rain, snowfall etc. The records should be checked for several days either side of the alleged events and you should ask the Policyholder how they know when the

damage happened as this makes it less easy for them to change the date to fit the circumstances

- Reviewing the estimates for the repair of the roof - the nature of the damage and the proposed repairs will tend to indicate how the damage has occurred
- Obtaining a report from someone who has inspected the roof, such as a Loss Adjuster.



### Activity

*Decide what enquiries you would make to validate the cause of loss or damage in the following scenarios:*

1. *Water damage to a kitchen ceiling. The Policyholder has advised that the water came from a burst pipe in the bathroom above.*
2. *Paint damage to carpets. The Policyholder has advised that the carpet was accidentally damaged by her husband whilst he was decorating.*

## 2. Validation that the item existed

It is fraudulent to make a claim for loss or damage to an item that did not exist. To avoid paying such claims, Insurers ask Policyholders to demonstrate the existence of the item(s) being claimed for.

In some scenarios, such as water or fire damage, the items may still exist albeit in a damaged state. Insurers will sometimes ask Policyholders to provide photographs of the damaged items or arrange for them to be inspected. However, in the event of extensive damage or in theft or accidental loss claims, these options will not be available to Insurers.

Validating the existence of an item involves obtaining information that supports its existence, for example purchase receipts, instruction manuals, photographs etc. Be aware that although we tend to think of this type of validation in relation to contents claims only, it is not unheard of for Policyholders to claim for the destruction of a building such as a garage that did not exist.



### Activity

*Consider a claim for jewellery items that have been acquired by the Policyholder over a number of years.*

*Think about all the possible documentation and proofs you could request from the Policyholder to support the existence of jewellery. Ask colleagues what they would request from the Policyholder. Remember to consider the different scenarios by which jewellery is acquired, for example gifts or inheritance.*

## 3. Validation that the item claimed for was lost or damaged

Generally speaking, if you are dealing with a claim for damage rather than loss then the damaged item(s) can be seen. Validation that the item claimed for was damaged will simply involve obtaining photographs from the Policyholder or arranging an inspection by another party, such as a Loss Adjuster.

However, depending on the nature and severity of the claim, the items may have been totally destroyed or so badly damaged that they cannot be identified. In such scenarios, Insurers typically appoint Loss Adjusters to inspect the site of the loss, to discuss the claim with the Policyholder and to take enquiries as far as possible. Reasoned judgements may have to be made. For example, if the claim includes a

television that has been destroyed by fire and the Policyholder is able to provide a purchase receipt for this item, along with a photograph showing the television within their home, it is likely that the television was destroyed in the fire that occurred within their home.

With regard to claims for lost or stolen items, validation starts with asking the Policyholder to describe the circumstances surrounding the loss. Such discussions can reveal discrepancies which may suggest that the item(s) were not actually lost or stolen.

Insurers typically require Policyholders to report losses to the police and, as part of the validation process, it is useful to ask the Policyholder for the crime reference number or indeed make enquiries with the police.



### Activity

*Following a flood, a Policyholder has submitted a claim for kitchen units and a bread maker. What enquiries would you make to ascertain whether these items were indeed damaged by the flood waters?*

#### 4. Validation of the value of the affected item

Validating the value of an item starts with understanding as much as possible about the features of that item. For example, the value of a camera can range from £30 up to £3,500. The difference in value will depend on the make, model and capabilities of the camera. The features that influence the value of items differ by product type. If you are asked to validate the value of a gold ring, you would need to establish what carat gold the ring was, the weight and size of the ring, and other features such as engraving etc.

Having gained an understanding of the item, the next step is to establish the value and this can be done by a variety of methods, from simple checks on the internet through to the appointment of specialist parties, such as fine art dealers.

By way of example, the following information would assist in valuation of a racing bicycle:

- i) What the frame is made out of, eg carbon fibre, aluminium, titanium
- ii) The make of the forks
- iii) Make and model of the wheels
- iv) The chainset and gear mechanism
- v) The make of the brake levers
- vi) The make and model of the brakes
- vii) The make and model of the bicycle.

Another example is a laptop computer, and the features that could affect the cost include:

- i) The size of the screen
- ii) The processor make and speed
- iii) The operating system
- iv) Size of memory
- v) Size and type of hard drive
- vi) Software.



### Activity

Review the following items and list the features that would affect the replacement cost of each:

1. MP3 player
2. Television
3. Sofa.

Finally, Fraud is an important issue and validation in this respect is subject to a section of this course in its own right.

## 4.2 Key Points to Remember

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- Claims validation is not just about establishing the repair or replacement costs of a claim. It involves a much wider consideration of the claim that has been presented by the Policyholder.
- Claims validation starts with the Policyholder. Why do they believe they have a valid claim and how can they support their claim?
- Claims validation will not always follow a standard process and nor should it. Your enquiries will differ depending on the cause of the loss, the nature of the items claimed for and the specific circumstances of the Insured.
- Having validated an item, the basis of settlement specified in the policy must be applied.





CLAIMS HANDLING – NEGOTIATION

5



## 5. CLAIMS HANDLING – NEGOTIATION

### Contents

- 5.1 Win or Lose?
- 5.2 Preparation
- 5.3 Communication
- 5.4 Key Points to Remember

### Introduction

Negotiation is a key element of claims handling and you will need strong skills in this area to be successful in any claims role. Whether you are dealing with colleagues, third parties, policyholders, suppliers or indeed anyone else, it is important that you are able to obtain a fair result for you and the person you are negotiating with.

This section discusses how you can prepare for negotiation activities and provides some tips for successful communication.

### 5.1 Win or Lose?

It is important to note that negotiation should be aimed at obtaining the best equitable agreement possible. It should not be treated as a win or lose situation and those who indicate that they are looking for victory are unlikely to actually achieve the best outcome from the negotiation. That is not to say that we might believe we have achieved a successful outcome or be pleased with the result of a negotiation.

### 5.2 Preparation

Preparation is key and good preparation is about understanding what would be a successful outcome for all the parties involved.



#### Activity

*Think about the last time you were involved in a negotiation. Did you understand what the parameters were for a successful outcome? Write a list of the outcomes that were available and identify which would have been the best for the long term relationship of the parties concerned.*

To help in your preparation for negotiation, there are a number of questions you should consider:

#### 1. What are the parameters of an acceptable outcome?

- a. Best possible outcome
- b. Acceptable outcome
- c. Unacceptable outcome

In order to identify the best, acceptable and unacceptable outcomes, you must consider the implications of each outcome. The best possible outcome might be the most appealing but it may not be in the best interests of the long term relationship. This outcome may in fact be detrimental to subsequent negotiations.

## 2. What are the alternatives?

Often there are alternative outcomes that might be acceptable to both parties. This is illustrated by the practice of proposing options such as “we will compromise on the method of settlement if we can agree that the settlement amount will not exceed X”.

Far too often negotiators become fixed in the mindset that there can only be one type of agreement but this is rarely the case. Understanding alternatives will pay dividends when you are seemingly at an impasse and you need something to break the deadlock.

## 3. What are the needs of the other party?

Do your best to find out what the other parties desire and what is most important to them. If you understand this, you can then focus on solutions that will appeal to the other parties even if not all their needs are met. Your objectives may well be different but an excellent bargain can sometimes be reached simply by understanding what the other party is actually looking for.



### Activity

*The next time you are required to negotiate make a list of the following:*

1. *Acceptable outcomes*
2. *Possible alternatives*
3. *The most important aspects as far as the other party is concerned.*

## 5.3 Communication

Communication is fundamental to negotiation activities and some tips for successful communication are listed below:

### 1. Identify the most effective method of communication for the circumstances



### Activity

*Consider the advantages and disadvantages of using the following methods of communication for negotiating settlement of a jewellery claim:*

1. *Letter*
2. *E-mail*
3. *Telephone*
4. *Face to face*
5. *Video conference*
6. *Instant messaging.*

### 2. Remember the importance of listening

It is vital that you listen to the other party during any communication. We learn little when we speak or when we just think about what we will say next while the other party is speaking. We learn by listening.

Having listened, it then helps to clarify your understanding by putting the other party's points to them in a different way and asking them to confirm that you have the correct understanding. For instance, you might say “Are you saying that you will accept the

replacement television from our supplier but because your ring had such sentimental value you will only accept a cash payment for this item?”.

### 3. Know your case before you put it forward

You should always be able to support your case with rationale. Before entering into any negotiation, you should have a clear understanding of this rationale and have available any supporting documentation. It is also useful to rehearse the possible arguments against your case.

How many times have you heard the argument “That is just the way we do it” or “That is the system, we cannot change it”. While these arguments may be “correct” there will be a rationale behind them. The rationale will most likely be in our case due to the Policy wording or the principles of insurance. If you do not understand the rationale, it will be incredibly difficult for you to persuade another person to accept it.



#### Activity

Consider the following items and write down the rationale for why they are not typically covered by insurance policies:

1. Plumbing repairs to pipework that caused an escape of water claim
2. Failure of a flat roof due to wear and tear
3. Undamaged bathroom furniture when a matching sink has been cracked.

Keep your notes and refer to them when you encounter such items in practice.

### 4. Ask the other party what they will accept

The quickest way to establish the expectations of the other party is to ask them. You can manage such discussions by first explaining the parameters of the negotiation, for example the policy wording or the insurance principle that applies. Having checked that the person understands, you can then ask questions such as “Having understood that payment under the Policy is limited to the reasonable cost of alternative accommodation, what do you consider to be reasonable cost?”

### 5. Identify who you are best able to negotiate with

There may be different parties involved in a claim and you may find it easier to negotiate with one party compared to another. Alternatively, there may be others in your team more able to communicate with particular individuals. Discuss approaches with your colleagues or even suggest tackling issues as a team, for example “let me deal with Joe Grundy and you deal with Peggy Mitchell”.

### 6. Ensure that you set expectations as soon as possible

If there are major difficulties to overcome, for instance significant underinsurance, a large excess or a single article limit, make sure all parties are advised as soon as possible. It is often advantageous to put Policyholders on notice of potential issues when they are first identified. Although they may have an anxious wait while you investigate the issue, it avoids a nasty surprise later in the claims process.

### 7. Agree the agreeable

Identify what can be agreed immediately and agree all those aspects. This approach will strengthen your position because it will highlight your intent to make agreements wherever possible.



### Activity

*Ask senior members of your team to tell you about any complex, difficult negotiations that they have been involved in. How did they achieve compromises and agreements?*

*Ask whether you can accompany them to a meeting or listen to a telephone conversation when a contentious issue is likely to be discussed.*

## 5.4 Key Points to Remember

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- Successful negotiation is about reaching an agreement that is acceptable to all parties.
- Before entering into negotiations, it is useful to identify what is the best possible outcome, an acceptable outcome and an unacceptable outcome. It is also helpful to think about what other outcomes might be available and to consider the needs and desires of the other parties.
- Successful negotiation requires good communication skills. You will need to select the best method of communication for the circumstances. You must understand your position and be able to explain and support it. Remember to listen to the other parties and do not be afraid to ask them what they will accept.



REASONABLE CARE

6







## 6. REASONABLE CARE

### Contents

- 6.1 Reasonable Care within the Policy
- 6.2 What does Reasonable Mean?
- 6.3 FOS View on Reasonable Care
- 6.4 Key Points to Remember

### Introduction

Insurers expect their Policyholders to take reasonable care and this is usually made clear by a clause within the policy, for example “It is a **Condition Precedent to Our** liability that **You** have taken reasonable care”. Loss Adjusters and Claims Handlers are therefore required, as part of the handling of a claim, to establish whether the Policyholder has indeed taken reasonable care.

This section outlines how reasonable care is incorporated into insurance policies and explains how reasonable care should be evaluated in practice.

### 6.1 Reasonable Care within the Policy

Reasonable care may be required with regard to the policy as a whole or with regard to specific aspects of the policy. For example, on a Buy to Let policy, the Policyholder may be specifically required to take reasonable care in the acceptance of tenants. Indeed, moving along the scale towards commercial policies, the Policyholder may be required to exercise reasonable care in the selection of staff.



#### Activity

*Review the conditions within a policy wording and identify those that demand reasonable care by the Policyholder. Now review the entire policy and look for other occasions when the word “reasonable” is used. You will probably be surprised how frequently it appears in practice.*

### 6.2 What does Reasonable Mean?

Insurance policies are taken out to protect the Policyholder in the event of a loss. Sometimes the losses that we seek to protect ourselves against result from a mishap of one kind or another. Insurers could argue that such mishaps would not have occurred if the Policyholder had exercised reasonable care. However, Insurers cannot give cover on one hand and simply take it away with the other.

Consider a claim where a Policyholder was carrying a birthday cake with lighted candles. He slipped and fell causing the candles to fall and leave burn marks on a sofa.

Two questions arise when evaluating whether the Policyholder exercised reasonable care:

1. Who is the judge of the adequacy of reasonable care?
2. What degree of reasonable care was required?

With regard to the first question, the answer is the Courts and arbitration services such as the Financial Ombudsman Service (FOS).

With regard to the second question, reasonable implies that the care need not be absolute. In the scenario, absolute care would have required that fire extinguishers were in easy reach, that someone walked in front of the person carrying the cake to ensure nothing got in the way, that a bucket of water was on hand and, to reduce the risk further, only one candle was used. These precautions appear to go well beyond what is reasonable.



### Activity

*Accidental damage claims can often arise when the Policyholder is undertaking DIY within the home, for example paint spills on a carpet. Ask a sample of your colleagues what they consider to be reasonable care when undertaking DIY. Now ask a sample of your friends and family for their view.*

## 6.3 FOS View on Reasonable Care

The FOS has considered many cases concerning reasonable care and in general has used the logic that the Policyholder has not exercised reasonable care if he has been reckless and in some way “courted” the danger.

The nature of the reasonable care exclusions within the Policy are also important and the FOS is critical of exclusions that:

- a) dramatically reduce the range of cover actually provided from that set out in the cover section of the policy
- b) exclude cover unless Policyholders exercise a degree of care over their possessions or well-being which goes significantly beyond the degree of care most of us actually exercise.

When dealing with such exclusions, the FOS will consider whether the Policyholder was led to believe that cover would be provided for something that the Insurer never intended to cover, in other words the customer had been misled.

Alternatively, the FOS will consider whether the degree of care required by the Policy goes beyond what could have been anticipated by the Policyholder. However, if the issue relates to a specific exclusion that was brought to the attention of the Policyholder, the FOS may deem the exclusion enforceable.



### Putting this into practice

*By way of an example, let's say that Fiona, a barmaid, inherits a diamond necklace worth £25,000. Fiona insures the necklace and the Insurer specifically states that no cover will be provided unless the necklace is being worn or is in a locked safe. The exclusion is made very clear to Fiona, both verbally and in writing.*

One evening, while working in the bar, Fiona's boyfriend Martin asks if he can show the necklace to his friends. Fiona gives Martin the necklace and the item gets passed around Martin's friends one by one. The necklace is eventually handed back to Fiona who is busy and places it on the bar. Some thirty minutes later, Fiona realises that the item is missing.

The questions that arise regarding the exclusion are:

1. Has Fiona been careless?
2. Was she reckless?
3. Did she court the danger?
4. Had she been misled about the Policy cover?
5. Had the exclusion, that was strict, been brought to her specific notice?

While some of the answers could be debated, the majority can be answered yes and therefore the exclusion is likely to be upheld. The only question that we can answer no to is question 4.

In contrast, let us consider another example. Brian is given a watch by his daughter Debbie. The watch is only worth £50. He visits a public house, the Bull, where his acquaintance Eddie spots the watch and asks to take a look. Against his better judgement, Brian hands the watch to Eddie whose father Joe arrives. Eddie shows the watch to Joe and Brian is distracted by his former business colleague Matt. Knowing that Matt has been in prison for fraud, Brian is keen to get his watch back. Unfortunately Joe has dropped it and Eddie has stood on it rendering it irreparable. The policy has the typical clause requiring reasonable care but there is an additional exclusion that states that there is no cover for damage resulting from the item being dropped if this occurs in a public house. This was not brought to the attention of Brian and all the general cover details suggest that the cover is “All Risk” and comprehensive. The questions arise once again:

1. Has Brian been careless?
2. Was he reckless?
3. Did he court the danger?
4. Had he been misled about the Policy cover?
5. Had the exclusion, that was strict, been brought to his specific notice?

In this case, the answer is probably no to questions 1, 2 and 3. It could further be argued that he had been misled about the Policy cover and the specific exclusion had not been brought to his attention. On this basis, it is unlikely that the exclusion would be upheld.



### Activity

*Ask your senior colleagues for examples of when reasonable care has been a potential issue on a claim. Find out how those claims were concluded and the rationale for the decisions that were made in relation to reasonable care.*

## 6.4 Key Points to Remember

- Insurers expect their Policyholders to exercise reasonable care so that unnecessary claims can be avoided or at least the extent of loss kept to a minimum.
- Reasonable care is a requirement that often appears more than once within a policy wording. It can apply to the policy as a whole or as a specific requirement against a certain section.
- Reasonable care does not mean absolute care.
- The FOS view is that the Policyholder needs to have been reckless or “courted the danger” in order for a reasonable care exclusion to apply.
- The FOS are unlikely to accept reasonable care exclusions that:
  - dramatically reduce the range of cover actually provided from that set out in the cover section of the policy
  - exclude cover unless policyholders exercise a degree of care over their possessions or well-being which goes significantly beyond the degree of care most of us actually exercise.
- You should consider whether the Policyholder may have been misled about the policy cover and whether specific exclusions were brought to their attention.





MITIGATION





## 7. MITIGATION

### Contents

- 7.1 Mitigation Measures for Household Contents
- 7.2 Evaluating the Benefit of Repair or Restoration
- 7.3 Controlling Mitigation Spend
- 7.4 Key Points to Remember

### Introduction

The word “mitigate” means to reduce the severity and in the context of insurance claims the term “mitigation” is used to describe the actions that are taken to reduce the severity or negative effects of a claim. Claims Handlers and Loss Adjusters are expected to play a key role in the mitigation of losses.

This section explains the factors that influence what mitigation measures are undertaken and how the cost of mitigation can be controlled. It also highlights the effects of allowing mitigation costs to get out of hand.

### 7.1 Mitigation Measures for Household Contents

First, we should consider the different types of household contents that may be damaged, for example:

- Soft furnishings
- Carpets
- Soft furniture
- Wooden furniture
- Audio visual equipment
- Jewellery and other precious items.

Second, we should consider the potential nature of damage to these items:

- Saturation by clean water (water from domestic plumbing)
- Debris from damaged building components
- Smoke/soot deposits
- Contamination by foul water (eg water from a flood)
- Oil contamination
- Contamination from acidic by-products from the burning of plastic (hydrocarbons)
- Contamination from asbestos.



#### Activity

Take two types of household contents from the list above and consider how they would be damaged by a) smoke/soot deposits and b) foul water contamination. Now write a list of the possible actions you could take to reduce the effects of the damage.

## 7.2 Evaluating the Benefit of Repair or Restoration

There are two potential benefits of repair or restoration:

1. Making savings against the replacement cost
2. Restoration of an item that has sentimental value.

The main consideration must be economic, ie is the cost of restoration higher or lower than that of replacement? This decision can be influenced by the following key factors:

- The basis of settlement, ie the cost of repair may be cheaper than replacement as new, but if the policy provides for a different basis of settlement then this must be taken into account
- Whether the repair or restoration will be effective and acceptable
- The long term effects on the item concerned.

We can look at each of these factors in a little more detail:

- 1) **The basis of settlement.** This is an important factor to be aware of when deciding whether to proceed with repair or restoration. Clothing is a good example of when the basis of settlement can have a significant influence on your decision. Consider a fire claim where shortly after the incident you are presented with an estimate to clean clothing. On the face of it, this might seem to be an appropriate settlement method. However, the basis of settlement for clothing may take account of wear and tear and it is therefore essential to establish the age of the items. Be careful that you do not agree to restoration works that will exceed the amount of the policy liability.
- 2) **Effective and acceptable restoration.** You must ensure that any repair or restoration costs to be incurred will result in actual successful restoration of the items concerned. You should also consider whether restoration is an acceptable option and this may depend on the nature of the damage. If for example a child's toy is spoiled with sewerage due to a flood or perhaps blood from an intruder, it is quite understandable that any amount of cleaning would not warrant the cleansed toy being accepted.
- 3) **Long-term effects of damage.** You can encounter a scenario where the restoration company confirms that they are able to restore an item in the short term but the item may no longer be reliable in the long term. For instance, imagine smoke deposits on a computer. The computer may be restorable but the smoke deposits might include acidic particles which over a period of time would adversely affect the components of the computer.



### Activity

*Contact a restoration company that is used by your organisation and ask about their services. Find out what types of items they attempt restoration on, the restoration methods that they use and the level of success they achieve.*

## 7.3 Controlling Mitigation Spend

When handling claims, it is very important that you control the amount of expenditure associated with mitigation works, as with any other part of the claim.

This is underlined by the fact that, in the event that the sum insured is exhausted and uneconomical, mitigation works are part of the expenditure that the FOS has previously decided the Insurer should pay over and above the sum insured. For instance, if there were a house fire and clothing was cleaned but not adequately restored, the FOS may



decide that the Insurers are liable not only for the cost of the cleaning but also the replacement of the items.

You must also carefully consider mitigation costs in the event of a total loss, particularly if the sum insured is likely to be paid out. The Policyholder may prefer to use the insurance money to buy replacements rather than having remedial works done. It is therefore important that you do not prejudice the Policyholder's position by instigating expensive mitigation works at the outset.

## 7.4 Key Points to Remember

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- Mitigation is about controlling or reducing the effects of damage which in turn should minimise claim costs.
- It is important to investigate and understand the nature of the damage when contemplating what mitigation measures to undertake. You must also think about the nature of the damaged items and how they will respond to the various mitigation measures that are available.
- Act promptly when instigating mitigation measures, but review the position regularly and adjust your approach if necessary to minimise overall claim costs.
- Give clear instructions to restoration/mitigation companies about what work should be undertaken. Set boundaries in terms of scope or cost and ask them to revert back to you immediately if these boundaries are likely to be exceeded.
- Discuss mitigation measures and decisions with the Policyholder. Be aware that the Policyholder may have a sentimental attachment to items and not just an economic interest.
- Remember that the cost of restoration plus potential storage costs can sometimes exceed the amount of the Policy liability for the item(s).
- Evaluate the likelihood that the sum insured will be exhausted and, if so, involve the Policyholder in the discussions about the best course of action - you may be spending their money.





GRADUALLY OPERATING CAUSE

8





## 8. GRADUALLY OPERATING CAUSE

### Contents

- 8.1 Gradually Operating Cause as a Policy Exclusion
- 8.2 Identifying a Gradually Operating Cause
- 8.3 Other Considerations
- 8.4 FOS View on Damage to Underground Services
- 8.5 Key Points to Remember

### Introduction

This section deals with the term Gradually Operating Cause, or simply GOC. Most policies seek to exclude loss or damage resulting from a gradually operating cause and in this section you will learn why Insurers do this and how the exclusion is applied in practice.

### 8.1 Gradually Operating Cause as a Policy Exclusion

When considering any exclusion, it is important to remember that, in the event of a complaint being made, the FOS will usually only support exclusions that would be expected or are specifically drawn to the attention of the Policyholder.

Insurance policies are intended to cover unexpected events not things that are bound to occur. On this basis, it can be argued that something that happens gradually is **not** unexpected and therefore need not be drawn specifically to the attention of the Policyholder. That being said, it is always essential to ensure the customer is treated fairly.

There are of course policies that are sold as extended warranties and Life Assurance could be said to be covering the ultimate inevitable event. However, such policies are outside of the scope of this text book.



#### Activity

*Refer to a policy wording and locate, either in the General Exclusions or the peril specific exclusions, any comments relating to damage occurring over a period of time. Now refer to a policy prospectus, perhaps on the Internet, and consider how clear the exclusions are concerning Gradually Operating Cause.*

You may well have found a General Exclusion along the lines of “this policy does not cover loss or damage which develops gradually or is not caused by a specific or sudden incident”. Additionally, you may have found GOC exclusions in relation to specific perils. This should demonstrate to you that even if the damage is as a result of one of the insured perils there is unlikely to be any cover if the damage has occurred gradually.

### 8.2 Identifying a Gradually Operating Cause

We will now consider two scenarios where GOC and indeed the GOC exclusion might apply.

Josh is preparing a casserole and he leaves the stove on low, slowly cooking some beef. Josh takes a phone call and is invited out to see a band that evening. He decides to take up the chance and in his excitement he leaves the stove on when he leaves. Over a period

of several hours, the beef dries out and begins to smoke. Eventually the beef ignites and the heat causes a tea towel, which had been hung close by, to fall onto the stove. The tea towel then catches fire. Fortunately Josh returns home at this point and extinguishes the fire before too much damage is done. The question is whether the damage is as a result of a gradually operating cause and therefore excluded by Josh's home insurance policy.

Before giving an answer, consider another scenario. Sarah has regular barbeques during the summer months. She also typically keeps her patio doors and windows open while cooking on the barbeque. At the end of a long English barbeque season, Sarah notices that her whitewashed walls have turned somewhat grey. Sarah looks at her home insurance policy and notices that there is a "smoke" peril. Does this mean that Sarah will be successful in making a claim for the damage under her home insurance policy?

By contrasting the two scenarios, you can formulate a view as to whether either, both or neither of the causes are gradually operating.

You could argue that the first scenario is a GOC as it happened over a period of hours. However, the actual event was a "one off". There was at some point ignition and this caused the damage. It would be very difficult to convince the Policyholder, the FOS or indeed the Courts that the GOC exclusion should apply in this instance.

By contrast, the second scenario was not a "one off" event. It is clear that the damage has occurred over a period of time and as such will be excluded by the policy, either by a General Exclusion or by a peril specific exclusion.



#### Activity

*GOC issues predominately arise in escape of water and storm claims. Review a sample of such cases and look for evidence that the damage may have been as a result of an ongoing gradual incident. Now find out how the claims were eventually concluded and whether the GOC exclusion was applied in practice.*

### 8.3 Other Considerations

When considering GOC, the following should also be taken into account:

- Whether the Policyholder could have known that the damage was occurring
- The action the Policyholder took when it became apparent that damage was occurring
- Any other exclusions that might apply.



#### Activity

*Refer to your colleagues and identify the common types of damage that can occur without being immediately apparent to a Policyholder. Now look at a policy wording and establish how Insurers encourage Policyholders to regularly check their property and to take action when damage is discovered. Consider a rented property and the measures that could be put in place by the Landlord to ensure that any damage is identified and acted upon at the earliest opportunity.*

### 8.4 FOS View on Damage to Underground Services

A final point to note is that the FOS, in reference to claims for underground services, has said that accidental damage can occur "in slow motion". Claims for underground services

and the FOS stance require further discussion outside of this section, but it is worth noting that the FOS does not appear to have made a decision along these lines with regard to any other perils.

## 8.5 Key Points to Remember

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- Insurance policies are designed to cover unexpected, “one off” events. They are not designed to cover the maintenance of a property or indeed any damage that has occurred gradually over a period of time.
- Policy exclusions for GOC can be found under General Exclusions and/or peril specific exclusions.
- When handling any claim, it is important to establish when and how the damage was discovered and by whom. You should also consider the type of damage and whether it is likely to have occurred as a result of a single event or over a period of time.
- Insurers expect Policyholders to minimise damage to their property and this includes taking prompt action to prevent any further damage when a problem is identified.







# 9

UNDERINSURANCE





## 9. UNDERINSURANCE

### Contents

- 9.1 Penalties for Underinsurance
  - 9.1.1 Change of the Basis of Settlement
  - 9.1.2 Room Based and Bedroom Rated Policies
- 9.2 Commercial Policies
- 9.3 Pro rata Condition of Average
- 9.4 The Special Condition of Average
- 9.5 The Two Conditions of Average

### Introduction

The purpose of insurance is to provide protection against a loss. In essence, it is about creating a common pool of money by the many to meet the losses of the few. To ensure that the arrangement is equitable, it is necessary for everyone who pays into the common fund to pay their fair share. This section provides a basic understanding of what happens when underinsurance arises.

### 9.1 Penalties for Underinsurance

A range of penalties apply when underinsurance arises, including:

- Change of the basis of settlement
- Pro rata Average
- Reinstatement Average
- Day One Average.

#### 9.1.1 Change of the Basis of Settlement

This penalty is usually associated with domestic insurance. Since the late 1970s, it has become increasingly common to provide cover on a New for Old or Reinstatement basis. Settlement is based on the replacement cost of items of Contents or the rebuilding cost of buildings. However, it is usually a condition of the Policy that the sum insured is adequate to replace all items of Contents on a New for Old basis or to fully reinstate the building in the event of a total loss.

If the sum insured is not adequate, there will most likely be a penalty in the event of a claim. The nature of the penalty will be expressed in the policy and could include the following:

- Value of item at the time of loss instead of New for Old or Reinstatement
- Secondhand values paid in the event of underinsurance.



### Activity

Obtain the prospectus for a Household Policy. Look at how it highlights the basis of settlement and identify whether it points out that the sum insured must be adequate.

Now review a Domestic Policy wording. Find the section that deals with underinsurance and look at the penalties that are in place.

## 9.1.2 Room Based and Bedroom Rated Policies

The result of underinsurance is that the Insurer does not receive the full premium that they would otherwise receive and, in the event of a loss, the Policyholder receives less than they might expect. This is not good for either party and, over the years, Insurers have implemented many initiatives to combat this. For example, Bedroom Based and Room Rated policies make setting of the sum insured far simpler, encouraging the Policyholder to be adequately insured. These Policies may be set with either unlimited or banded sums insured depending on the number of rooms or bedrooms. It is important to check the definition of a room or bedroom and ensure that the Policyholder has followed the definition.

One definition of a Bedroom in a Policy is “Any room that was initially built as a bedroom, whether it is currently used as a bedroom or not”. This may be simple to establish in a modern house, but in a very old house the initial purpose of the room could be difficult to establish. Common sense governed by the *contra proferentem* rule should apply in such circumstances.

## 9.2 Commercial Policies

With regard to commercial policies, there are various penalties that exist and these mainly relate to different kinds of Average. The main principle of Average is that, in the event of underinsurance, the Policyholder bears the loss in direct proportion to the extent of underinsurance. In other words, if the sum insured is only 50% of the value at risk, the policy pays out 50% of the agreed loss, subject to all other terms and conditions.

There are a number of types of Average:

- Pro rata Condition of Average
- The Special Condition of Average
- The Two Conditions of Average.

The Policy will state which condition of Average, if any, will apply and the ABI recommend various wordings, as considered below.

## 9.3 Pro rata Condition of Average

The ABI recommended wording for Average is:

*“Whenever a sum insured is declared to be subject to Average, if such sum shall at the commencement of any damage be less than the value of the property covered within such sum insured, the amount payable by the Insurer in respect of such damage shall be proportionately reduced”.*

The calculation is simple and is as follows:

$$\frac{\text{Sum Insured}}{\text{Value at Risk}} \times \text{Loss}$$

For example:

$$\frac{\text{Sum Insured (£50,000)}}{\text{Value at Risk (£100,000)}} \times \text{Loss (£5,000)} = \text{£2,500}$$

## 9.4 The Special Condition of Average

The ABI recommended wording is:

*“Whenever a sum insured is declared to be subject to the Special Condition of Average, then, if such sum shall at the commencement of any damage be less than 75% of the value of the property covered within such sum insured, the amount payable by the Insurer shall not exceed that proportion of the amount of the damage which the said sum insured shall bear to the full value of the property insured”.*

Again this is a simple process. The calculation is identical to the one above except for one important difference. Average is only applied if the Sum Insured represents less than 75% of the value at risk. So if the Sum Insured is 80% of the value at risk, the full loss (up to the Sum Insured) will be paid. However, if the Sum Insured is only 74% of the value at risk, only 74% of the loss will be paid.

In effect, this version of Average recognises the difficulty in accurately assessing the value at risk and provides some leeway to the Policyholder.

## 9.5 The Two Conditions of Average

The ABI recommended wording is:

*“Whenever a sum insured is declared to be subject to the Two Conditions of Average*

- 1 if such sum shall at the commencement of any damage be less than the value of the property covered within such sum insured, the amount payable by the Insurer in respect of such damage shall be proportionately reduced, but*
- 2 if any of the property covered within such sum insured shall at the commencement of any damage be also covered by any more specific insurance, then this policy shall only insure the same for any value in excess of the amount of such more specific insurance(s) which excess value shall be deemed to be the value of the property covered hereby and subject to 1 above.*

*For the purpose of 2 only a more specific insurance is one which at the time of damage applies only*

- (a) to property as described herein, and*
- (b) at any but not all of the locations to which this insurance applies.*

**Note:** *The Two Conditions of Average are intended for use on Contents and/or Stock insurances arranged on a floating basis where specific insurance also applies”.*

The first condition is simply an Average clause and the calculation remains the same. The second condition relates to contribution. The full extent of the calculation for the Two Conditions of Average is beyond the scope of this course.



### Activity

Review some commercial Policy wordings and identify the penalties for underinsurance.





REPUDIATIONS

10







# 10. REPUDIATIONS

## Contents

- 10.1 The Rationale for a Repudiation
- 10.2 When and How to Repudiate
- 10.3 What to Tell the Policyholder
- 10.4 Signposting a Repudiation

## Introduction

This small section deals with repudiations. It concentrates on the message that should be given to the Policyholder and considers when repudiations should be made. When a claim is turned down or repudiated. The Policyholder will almost always be disappointed and the repudiation may well result in a complaint if it is not handled carefully and sensitively. The principles here can be applied equally to partial repudiations as well as the repudiation of a claim in full.

## 10.1 The Rationale for a Repudiation

It is of utmost importance to understand the Policy and appreciate why the loss is not covered by the Policy. Advising someone erroneously that there is no cover for a loss and subsequently being corrected by the Policyholder or perhaps another professional will be highly embarrassing and potentially damaging to both your personal reputation and that of the company you are working for.

Further, should the claim be repudiated incorrectly and the repudiation not be challenged, the Policyholder has not been treated fairly (TCF). Although unbeknown to the Policyholder, the principle must be that this is in breach of the FCA requirement of TCF. Competence in this must surely extend to ensuring that claims are not incorrectly repudiated.

To ascertain whether or not a loss is covered, it is necessary to review the Policy and consider the relevant insurance principles. You should already be familiar with the layout of a Policy and therefore will appreciate the following examples of when a claim might not be covered:

- The item claimed for falls outside of the definition of property covered by the Policy
- The cause of the loss is not an insured Peril
- The cause of the loss is excluded by a Peril, eg frost damage is frequently excluded under the Storm peril
- The loss is excluded by one of the General Exclusions
- There has been a breach of a General Condition
- There has been a breach of a Warranty
- The Policy was not in force at the time of the loss
- There has been an element of fraud
- There is a breach of the Claims condition
- The Policyholder does not comply with a condition subsequent to liability.



### Activity

Select a Household Policy wording and locate within the Policy a rationale for repudiating claims in the following circumstances. Be careful as the loss described may be partially or entirely covered by the Policy you have selected.

- a. Victoria has a specified engagement ring on her Policy. She participates in a triathlon and after the event she takes a shower at a public swimming pool. Victoria takes off the ring and leaves it on the bench in the changing room while she is showering. The ring, valued at £3,000, is missing on her return.
- b. Mick has a specialist amplifier that he uses for his band. Mick's sole income is from playing in the band. His home is broken into and the amplifier is stolen and he claims for this.
- c. The Policyholder has a Contents Policy. His claim is for his Koi carp which have been killed in a storm.
- d. Donald can hear running water in his ground floor bathroom but cannot see any dampness. He claims the cost of tracing the leak and the cost of accessing and fixing the water pipe which is known to be in excess of 80 years old.
- e. Theo has a claim for impact damage to his garden wall caused by a motor vehicle. It is believed that the vehicle was being driven by a friend of Theo and for this reason Theo refuses to provide the details of the motorist. Theo simply restates that as his Policy covers damage by impact by a motor vehicle his claim should be paid.

## 10.2 When and How to Repudiate

The decision as to when to repudiate will depend on some or all of the following:

- Your role
- Your authority to repudiate
- What other parties are involved
- Your personal safety
- The availability of all relevant information
- The likely reaction and whether steps can be taken to produce a more acceptable outcome.

If you are involved in the handling of claims then most likely you will be required to repudiate claims from time to time. However, the decision to repudiate will be based on your authority to do so. For instance, Insurers often delegate authority to Loss Adjusters but this may not always include the authority to repudiate. The particular agreement should be verified to ensure that it is not breached.

There may well be other parties involved who should be party to the repudiation. For instance, if you are acting as a Claims Handler for an Insurer or in an outsourced unit for the Insurer, you should consider what involvement the broker might like. The broker will be interested particularly if the claim:

- is for a new client
- is a major loss
- is for a major or important client.

Gaining the support of the broker can be highly valuable. If you discuss the repudiation with the broker they may be able to identify other policies that do in fact cover the loss, or they may identify extensions to the policy that provide the necessary cover. Sometimes the broker may wish to inform the policyholder themselves, or alternatively they may have already informed the Policyholder that they believed this would be the most likely outcome, or the broker will agree that the loss is not covered. At worst the broker will disagree with the decision, but their opinion can be taken into account and if the decision is reversed due to the argument put forward by the broker you have ensured that the Policyholder has been treated fairly and most likely avoided a complaint.

With regard to personal safety, this really applies to situations where meetings are face to face. On very rare occasions there could be such a strong reaction to the repudiation that your personal safety is threatened. It is vital in such situations to use tact and diplomacy.

A claim should not be repudiated until you have exhausted the possibility that cover does exist. Therefore, if some material evidence is unavailable, it is better to explain the position to the Policyholder. In this way the Policyholder will be likely to accept he has been given every opportunity to have the claim considered and therefore that he has been treated fairly.

### 10.3 What to Tell the Policyholder

The information concerning the repudiation that should be given to the Policyholder should be as complete as possible. This will ensure that the Policyholder has understood that you have considered the matter in detail and that the repudiation is not a rash decision.

The information should include:

- Your understanding of the loss and circumstances of the loss
- The limitation of cover in respect of the loss and why the claim is not covered
- Supporting evidence such as a quotation from the Policy
- A polite softener to close the matter off.



#### Activity

*Consider a claim for storm damage to a flat felt roof. List the evidence you would require to ascertain whether this constitutes a storm claim.*

Ideally the Policyholder will be advised verbally, giving them the opportunity to put forward other arguments or to clarify what you might have misunderstood. This should then be followed up in writing.

### 10.4 Signposting a Repudiation

A common complaint concerning a repudiation is that the policyholder was led to believe that the loss was covered and that the repudiation came out of the blue.

If there are any doubts about Policy coverage, these should be explained at the outset to allow the Policyholder the opportunity to put forward other rationale that may affect the decision. It is far better to gain the confidence of the Policyholder by explaining that the loss may not be covered but that you wish to make enquiries to establish that the loss is covered. You can also use this as an opportunity to explain their duty to mitigate the loss. So in effect the message is passed on step by step so that there are no surprises.



### **Putting this into practice**

*Discuss your repudiation process with a senior colleague. Find out what evidence your colleague usually obtains to support the repudiation of a claim. Ask the colleague about a claim that has been repudiated but the decision was subsequently overturned and the claim paid. Discuss the reasons why the original decision was overturned.*



FRAUD, DETECTION AND  
PREVENTION

11





# 11. FRAUD, DETECTION AND PREVENTION

## Contents

- 11.1 The Definition of Fraud
- 11.2 Offences Under the Act
  - 11.2.1 False Representation
  - 11.2.2 Dishonest
- 11.3 Intent
- 11.4 Identification of Fraud
- 11.5 Fraud Indicators

## Introduction

This section provides an understanding of what constitutes fraud, the indicators of possible fraud, how fraud may be prevented and how fraud can be identified.

Fraud costs the insurance industry millions of pounds per year and as a result costs the insuring public additional money in premium. Attitudes towards fraud vary and have changed over a period of time. Research indicates that on occasions Insurers are seen as a soft target. Even when a criminal is convicted of fraud against an Insurer, the courts sometimes give the impression that punishments should be restricted.



### Activity

*Locate your company policy towards fraud. Note that the company will be interested in fraud by Policyholders but should also have protections in place to prevent internal fraud. Consider for example who may authorise payments and what happens when larger sums are involved.*

## 11.1 The Definition of Fraud

Fraud is defined in the Fraud Act 2006. Section 1 of the Act creates a general offence of fraud and details three ways in which fraud is committed:

1. False representation - Section 2
2. Failure to disclose information when there is a legal obligation to do so - Section 3
3. Abuse of position - Section 4.

To be guilty of fraud, the Defendant must have been dishonest and there must be intent to make a gain or to cause or to intend another to suffer a loss. No gain has to be made nor a loss suffered for the offence of fraud to have been committed.

## 11.2 Offences Under the Act

The first offence under the Act is **false representation**. To understand this offence, the following three principles must be appreciated:

- What amounts to a **false representation**
- The legal definition of **dishonest**
- What amounts to **intent**.

### 11.2.1 False Representation

Representation has a very wide meaning in terms of the Act and can range from presenting a credit card, wearing identification or clothing such as a uniform implying status, sending a letter or e-mail or even simply by body language such as a nod of the head. Representation can also be by a failure to disclose information. For instance, if a Policyholder fails to advise Insurers of previous convictions in order to represent that he is of good character, the Policyholder may be guilty of fraud, providing the failure to disclose the convictions was done dishonestly and with intent to gain or to cause or expose the Insurer to the risk of loss.

It would also be the case that should someone falsely provide evidence to support someone else's claim this false representation may amount to fraud. So the Policyholder's friend who writes or confirms verbally to the Loss Adjuster that the Policyholder lost goods knowing that he did not may also be committing fraud. The recording of representations made is therefore highly valuable as the record can be used as evidence.

### 11.2.2 Dishonest

To be guilty of fraud, the representation must be dishonest. *R v Ghosh (1982)* defined dishonest as "dishonest by ordinary standards of reasonable and honest people and that the defendant must have known the act was dishonest by those standards".



#### Activity

*In the following circumstances consider applicability of "dishonest by ordinary standards of reasonable and honest people and that the defendant must have known the act was dishonest by those standards".*

- *Matt works for a firm of accountants. His friend Brian is seeking to obtain a mortgage and asks Matt to provide evidence in support of his earnings. Brian needs to show that he earns in excess of £50,000 whereas in fact last year he earned only £45,000. He is entitled to a bonus of £15,000 if he meets his sales targets, but he knows that he will be unable to achieve these targets. He explains this to Matt. Matt provides supporting evidence explaining that Brian has the potential to earn £60,000 but is unlikely to achieve the full sum this year due to the constraints on his bonus provision. Have Brian or Matt been dishonest?*
- *Graham is waiting for a bus. He has a prepayment card which he has to register electronically on boarding the bus. As he gets onto the bus, his mobile rings. It is his father who tells him that Graham's mother has been taken seriously ill. Graham forgets to register his card, and due to the situation gets off the bus at the next stop. He hails a taxi and goes to the hospital. Several days later he realises he never paid the fare. Has he been dishonest?*
- *Sheena owes her flatmate Scud £5. Sheena leaves a £5 note on the kitchen table before going to bed to remind her to take it to work the next day to pay for lottery tickets. Scud sees the money and thinks that it might be for him so takes it. Has Scud been dishonest?*
- *Bill works in the meat department of a supermarket. Cheryl, his girlfriend, comes to his department asking for some beef. Bill weighs the beef and puts the ticket on the bag showing the cost. He winks at Cheryl and places more beef in the bag. Cheryl says "no that's not right". Bill says "no it'll be fine". Cheryl goes to the checkout and pays. Have Bill or Cheryl been dishonest?*



From the examples above, you will see that it is sometimes difficult to decide whether someone has been dishonest by the standards set in the case of *R v Ghosh*.



### Activity

Go to the Financial Ombudsman website and review some of the cases that have been considered by the FOS concerning dishonesty.

## 11.3 Intent

Intent can be difficult to prove. The definition of theft in the Theft Act 1968 requires that the offender had the *intention* to permanently deprive the owner of the property. So the principle of proving intent is well known and it is therefore essential the evidence concerning intent is obtained and recorded.

The second offence under the Fraud Act 2006 is the ***failure to disclose information when there is a legal requirement to do so***.

The legal duty to disclose information may come from a statute or from the principle of utmost good faith so it is of considerable interest to those handling claims.

The elements of the offence are that the Defendant:

1. failed to disclose information
2. had a legal duty to disclose that information
3. was dishonest
4. intended, by that failure, to make a gain or cause a loss.

No actual gain need be made by the defendant and no loss need be suffered for the offence to have been committed; it is the dishonesty and intent that have to be proved. It may be difficult to demonstrate that the failure to disclose a material fact at inception of a Policy was done with the intent of gain several months later.

When assessing such matters, it is worth considering the attitude of the Crown Prosecution Service (CPS) who will take account of any public interest and the relative standing of the parties. Any explanation for the failure to disclose the information will also be considered. It can be expected that the CPS will see Insurers in a relatively strong position and if Insurers do not question information that the Court may consider they ought to have done a prosecution is unlikely to be secured.

It is worth considering when there is a duty to disclose information. Comment on this was provided by the Law Commission in its report on fraud No 276 Cm 5560 (2002) which included the following comments about the circumstances in which a legal duty might arise:

7.28 . . . *Such a duty may derive from statute (such as the provisions governing company prospectuses), from the fact that the transaction in question is one of the utmost good faith (such as a contract of insurance), from the express or implied terms of a contract, from the custom of a particular trade or market, or from the existence of a fiduciary relationship between the parties (such as that of agent and principal).*

7.29 *For this purpose there is a legal duty to disclose information not only if the defendant's failure to disclose it gives the victim a cause of action for damages, but also if the law gives the victim a right to set aside any change in his or her legal position to which he or she may consent as a result of the non-disclosure. For example, a person in a fiduciary*

*position has a duty to disclose material information when entering into a contract with his or her beneficiary, in the sense that a failure to make such disclosure will entitle the beneficiary to rescind the contract and to reclaim any property transferred under it.*

With regard to the measure of dishonesty and the meaning of intent, the same meanings apply as for Section 2 as detailed above.

The final offence relates to **abuse of position**. The elements of this offence are that the Defendant:

- occupies a position in which he is expected to safeguard, or not to act against, the financial interests of another person
- dishonestly abuses that position, and
- intends, by that abuse of that position
  - to make a gain for himself or another, or
  - to cause a loss to another or to expose another to a risk of loss.
- the abuse may consist of an omission rather than an act.

The offence is complete once the Defendant carries out the act that is an abuse of his position. Again it is immaterial whether or not there is any actual gain or loss.

## 11.4 Identification of Fraud

Fraud can result from:

1. A completely fictitious event, such as a staged accidental loss
2. A deliberate real event, such as arson by the Policyholder
3. A genuine event but exaggerated in terms of magnitude, such as a burglary where the Policyholder adds claims to the list of missing items that either never existed in the first place or were not stolen.

Identifying each of these situations varies. For instance, in example 1 above, it will be necessary to demonstrate that the incident simply did not occur.



### Activity

*Take a look at a Policy wording and try to locate parts of the policy that may protect insurers against a claim from a completely fictitious event. Consider claims for accidental loss, robbery and burglary where there is no forced entry. In each of these cases, there are no physical signs of the event.*

From the previous activity, you may well have found that for each of these situations there is a requirement to report the incident to the police. While this does not prevent the submission of fictitious claims, it is certainly a deterrent.

Insurers may also seek to protect themselves from the second example, a deliberate real event.



### Activity

*Take a look at a Policy wording and try to locate parts of the policy that may protect insurers against a claim for a deliberate real event. Consider a staged burglary where there is evidence of a forced entry, arson by the Policyholder, paint spillage or deliberate water damage.*

From the Policy, you will note that usually Insurers state their right to involve others in the validation of the claim. A Loss Adjuster may well spot inconsistencies with the Policyholder's version of events and could locate evidence that the event was caused deliberately. Of course it is important to ensure that it can be proved that either the Policyholder or someone on their behalf has caused the damage. Forensic evidence obtained by forensic scientists may well be a way of dealing with this.

Example 3 above mentions the exaggerated claim. Remember that a claim exaggerated purely for negotiation purposes will not be considered to be fraud. Requesting evidence of the loss will assist in this respect.



### Activity

*Review a Policy wording and locate the clause(s) that give Insurers the right to require evidence to substantiate the loss.*

## 11.5 Fraud Indicators

There are many indicators of fraud and they are often broken down into categories such as:

**Attitude** - This could include being rude, insulting, aggressive, over familiar, offering to compromise at an early stage or being over helpful

**Work habits** - Taking on lots of overtime, taking on several jobs

**Lifestyle** - Involvement with illegal drugs, association with known criminals, gambling, vices etc

**Economic stress** - Living beyond means, redundancy, unserviceable debts etc

**Opportunity** - The opportunity to commit fraud may present itself in many ways. It could be as a result of the nature of the person's position at work, or their knowledge of how the system usually operates, or the fact that they are so well known that they could be considered to be beyond reproach.

All of the above are possible indicators of fraud. However, it is of utmost importance that you never jump to conclusions. Remember too that different cultures and upbringings may cause people to act in different ways. Many people simply believe that it is immoral to claim a benefit to which they are entitled. This may result in behaviour that might not have been expected.



### Putting this into practice

*Talk to persons within your organisation who are responsible for the detection and prevention of fraud. Ascertain what your firm's policies are in relation to fraud.*





FINANCIAL CRIME

12





## 12. FINANCIAL CRIME

### Contents

- 12.1 Definition of Financial Crime
- 12.2 Definition of Fraud
- 12.3 Money Laundering Regulations
- 12.4 Key Points to Remember

### Introduction

Any role within the insurance industry requires you to be alert to the possibility of financial crime. This section outlines what is meant by financial crime and fraud. It also provides an overview of the Money Laundering Regulations 2007. This aspect partly overlaps with the Data Protection Act 1998, which is considered in detail in Book 1.

### 12.1 Definition of Financial Crime

The definition of financial crime is provided in Section 1(H)3 of the Financial Services Act 2012 as any offence involving:

- (a) *fraud or dishonesty;*
- (b) *misconduct in, or misuse of information relating to, a financial market;*
- (c) *handling the proceeds of crime; or*
- (d) *the financing of terrorism.*

*“Offence” includes an act or omission which would be an offence if it had taken place in the United Kingdom.*

Examples of financial crime are often in the news, particularly “identity theft” and “money laundering”.

Identity theft occurs when the details of an individual are put together and used by another individual to open bank accounts and obtain loans and credit cards etc. The honest individual can then find themselves being asked to repay loans or debts that they did not incur. This in turn can affect their credit rating and ability to borrow money in the future. Once an individual’s identity has been stolen, it can be costly and difficult to recover it and prevent further misuse. There can also be long-term issues with monies owed to various parties.



#### Activity

*Consider the type of information that is captured about Policyholders when dealing with a claim. Find out what controls your company has in place to prevent this information falling into the wrong hands and being used for identity theft.*

Money laundering is an attempt to turn illegitimate money into legitimate money. For example, Miss X sells drugs and pays £3,000 from drug dealing into a bank account. Later Miss X uses a debit card for that bank account to buy jewellery which she then sells for cash. When following the chain of money, the proceeds from the sale of the jewellery appear legitimate as the money has been “cleaned” or “laundered”.

There are several methods by which money laundering can occur in the insurance sector. One example is when an insurance policy is purchased using illegitimate funds but is then cancelled within the “cooling off” period. The insurance company reimburses the premium and so the money appears “clean”.

## 12.2 Definition of Fraud

Fraud is defined under the Fraud Act 2006 and can arise by four methods:

- a) By misrepresentation
- b) By failing to disclose information
- c) By abuse of position
- d) By making or supplying items for use in frauds.



### Activity

*Consider a claim for flood damage and the points noted above. What opportunities for fraud exist, who could commit fraud and what steps could be put into place to prevent fraud?*

## 12.3 Money Laundering Regulations

The purpose of the Money Laundering Regulations 2007 is to ensure that certain businesses operate adequate anti-money laundering controls.

The Regulations cover a wide range of businesses including:

- Financial and credit businesses
- Independent legal professionals
- Casinos
- Estate agents
- Accountants, tax advisers and auditors.

Businesses covered by the Regulations must have systems and processes in place to:

- Assess the risk of the business being used by criminals to launder money
- Check the identity of customers
- Monitor customer activities and report suspicious activities
- Retain all documents that relate to financial transactions, the identity of customers, risk assessment and management procedures
- Ensure staff are aware of the Regulations and receive necessary training.



### Activity

*You are dealing with an insurance claim following a fire with an element of Alternative Accommodation. An Estate Agent asks the Policyholder to prove his identity in order to secure a rental property. Unfortunately the Policyholder's documents were destroyed in the fire.*

*How would you explain to the Policyholder that it will be necessary to provide proof of his identity to the Estate Agent? Discuss with your colleagues how you might assist the Policyholder in a practical way.*



## 12.4 Key Points to Remember

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- In the claims handling environment, we tend to think of financial crime in terms of fraudulent insurance claims. However, there are many more ways that financial crime can occur in the insurance industry and it can be committed by any party.
- One of the statutory objectives of the FCA is to reduce the extent to which it is possible for a financial business to be used for a purpose connected with financial crime. Irrespective of the role you perform or the type of company you work for in the insurance industry, you should be aware of the regulations of the FCA and understand your responsibilities in relation to financial crime.

