

# Handling of insurance claims for Small and Medium-sized Enterprises (SMEs)

May 2015





# Contents

<b>1.</b>	Executive summary	2
<b>2.</b>	Our findings:	6
<b>3.</b>	Implications of our findings and next steps	16

## Annexes

<b>1.</b>	Findings of customer research	18
<b>2.</b>	Findings of case studies	19

# 1. Executive Summary

- 1.1** In our previous thematic review<sup>1</sup> of retail claims we stated that the point of claim was generally considered to be the moment of truth for the policyholder. It is at this point that the customer finds out whether the policy they have purchased has met their expectations. We found reasonably high levels of claimant satisfaction and a drive by firms to ensure that claimants' expectations were met and consumers were treated fairly during the claims process. A number of household insurers articulated a vision to deliver a claims experience that worked more effectively in the interests of consumers with the prompt and efficient settlement of claims.
- 1.2** In our 2014/15 Business Plan<sup>2</sup> we set out our intention to build on the findings from the retail claims review to understand if this claims philosophy was evident in the commercial segment of the general insurance market. We also wanted to understand the role that different firms played in the handling of claims for small and medium-sized enterprises (SMEs)<sup>3</sup> particularly given the prevalence of outsourcing of claims handling by insurers.
- 1.3** We focused our review on the handling of claims for SMEs primarily because they play a vital role in the health of the UK economy. According to the Department for Business, Innovation and Skills (BIS) 99.3% of private sector businesses are SMEs.<sup>4</sup> Moreover, SMEs are less likely to be sophisticated customers and many exhibit similar knowledge and experience to that of retail consumers when buying general insurance products.
- 1.4** How firms treat their customers is central to our expectations of their conduct. We expect customers to be at the heart of how firms run their businesses and in the case of this review how they handle claims. The prompt and fair settlement of a claim<sup>5</sup> may be of particular importance to SMEs as it could be critical to their business in the event of a major disruption.
- 1.5** In addition SME claims of a certain size tend to be more complex, for example than household claims and often involve several parties in the assessment and settlement of the claim. These typically include regulated firms such as insurers, insurance intermediaries including managing general agents<sup>6</sup> (MGAs) and loss assessors. Unregulated firms such as loss adjusters and third party administrators (TPAs) acting on behalf of regulated firms are also often involved in the claims process. Loss adjusters and TPAs are usually appointed by an authorised firm to act on their behalf. Our requirements in relation to outsourcing are set out in the FCA Handbook. The Senior Management Arrangements, Systems and Controls sourcebook (SYSC) is particularly relevant to this relationship.

1 TR14/8 Insurers' management of claims – household and retail travel: Report on the thematic project, May 2014

2 [www.fca.org.uk/news/business-plan-2014-15](http://www.fca.org.uk/news/business-plan-2014-15)

3 In this review we used the same definition of SME as in our thematic review TR14/9 Commercial Insurance intermediaries – Conflicts of interest and intermediary remuneration (May 2014). This is that BIS categorises businesses with 0-49 employees as small businesses and those with 50-249 employees as medium sized. The Federation of Small Businesses further segments the small category into micro (0-9 employees) and small (10-49 employees categories).

4 Department for Business, Innovation & Skills "Business population estimates for the UK and regions 2014"

5 ICOBS 8.1.1R

6 The Managing General Agents' Association defines an MGA as an intermediary whose primary fiduciary responsibility is to the insurer(s) which provide its capacity.

## Our approach

- 1.6** We selected the firms to be involved in the review according to a number of criteria including business model and size. We included: 5 insurers, 10 insurance intermediaries (including 5 MGAs) and 10 loss assessing firms. We interviewed the senior management and individuals responsible for handling claims, and reviewed claims files, at each of these firms. We also visited loss adjusters and TPAs who had delegated authority for handling claims.
- 1.7** This review was limited to first party non-motor claims such as those arising from fire, flood, escape of water, theft and business interruption. We did not consider third party claims such as employers' liability, public liability or professional indemnity claims. Throughout the review we concentrated on claims in excess of £5,000.
- 1.8** We also commissioned an independent research agency to carry out qualitative research with 100 SMEs that had made a claim. The claims were drawn from a sample provided by firms in the project. We did not carry out a systematic assessment of sales practices as part of this review however our customer research captured SMEs experiences of buying general insurance.
- 1.9** As larger claims tend to involve multiple parties we wanted to understand what role they had played in the claims process. We therefore commissioned a specialist firm of loss adjusters to look in-depth at 20 claims, on a case study basis, drawn largely from the 100 SMEs included in our customer research. The loss adjuster typically reviewed the files of the different parties involved in the assessment and settlement of the claim. The findings of both of these pieces of work can be found in Annex 1 and 2 of this report.
- 1.10** Towards the end of our firm-facing work the Insurance Act 2015 (the Act), which comes into force in August 2016, received Royal Assent. The Act changes certain existing laws which were identified as potentially causing unfair outcomes for insureds if relied upon by insurers. A number of the provisions of the Act will be relevant to claims similar to those considered in our review:
- The abolition of 'basis of contract clauses', which convert representations made by insureds in connection with a proposal for a non-consumer insurance contract or a variation of the same into warranties.
  - Where a term of an insurance contract has been breached, insurers will not be able to escape liability if the insured can show that non-compliance with the term could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred.
  - The insurer's liability will be suspended, rather than discharged, in the event of a breach of warranty.
  - The Act introduces a duty for the insured to make a 'fair presentation of the risk'. This replaces the previous duty of disclosure. Under the Act there are fairer and more proportionate remedies where the duty of fair presentation is not complied with.
- 1.11** Firms should note that the recast Insurance Mediation Directive<sup>7</sup>, which is currently under negotiation, could include measures relating to product oversight and governance. This has the potential to strengthen the requirements placed on insurers and intermediaries that manufacture insurance products to ensure that their products are consistent with the needs of the target market.

<sup>7</sup> DIRECTIVE 2002/92/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 9 December 2002 on insurance mediation and Distribution of insurance products and after-sale activities - European Commission

### What we found

---

- 1.12** In this review we found that there was a gap between the claims service received and SMEs' expectations. There was an **overall poor perception by SMEs of the claims experience** and some SMEs stating that they had **not been treated fairly**. This was **in contrast to what we found in the retail claims review**.
- 1.13** We did find evidence that claims were not always being managed effectively in the interests of SME customers. The most common cause of **dissatisfaction was a lack of clarity over who was responsible for driving the claims outcome**. This was often exacerbated by **poor channels of communication between the different parties** handling the claim. In a significant number of cases **poor communication with the claimant** about progress often led to delays in reaching a settlement.
- 1.14** We found a significant **number of instances where the sums insured were inadequate to cover the loss** incurred. The underlying reason for this was not always apparent but our review did highlight the material impact this could have on the claim.
- 1.15** We **did not find evidence of firms seeking to unduly delay the admission of liability**.
- 1.16** This report sets out our findings and how they relate to our requirements set out in our Handbook, in particular, Principles for Businesses (PRIN) 6, 7 and 9, Senior Management Arrangements, Systems and Controls (SYSC) and the Insurance Conduct of Business sourcebook (ICOBS).

### Implications of our findings and next steps

---

- 1.17** We expect customers to be at the heart of how firms run their businesses and in the context of this review how they handle claims. We expect claims to be handled promptly and fairly for all customers with systems and controls in place to ensure that this occurs and that customers are treated fairly.
- 1.18** We expect firms to consider carefully the findings of this review and analyse what changes they need to make to ensure that SME claimants are treated fairly. We intend to engage with firms and senior figures in the industry both individually and through a dialogue with relevant industry trade bodies to discuss the findings of this review, our expectations, and the changes that may be required to improve outcomes for SME customers.

### Who should read this report

---

- 1.19** This report is aimed at general insurers, intermediaries including MGAs, TPAs, loss adjusters, loss assessors and relevant industry trade associations and organisations representing small and medium-sized enterprises.

### Our rules as they relate to claims – an overview

Insurers, insurance intermediaries, MGAs and loss assessors<sup>8</sup> are authorised and regulated by the FCA.

SYSC 3.2.4 G sets out that a *firm cannot contract out its regulatory obligations. So, for example, under Principle 3 a firm should take reasonable care to supervise the discharge of outsourced functions by its contractor.*

The FCA's rules on insurance claims handling, which are set out in ICOBS<sup>9</sup> require amongst other things that insurers must:

1. Handle claims promptly and fairly;
2. Provide reasonable guidance to help a policyholder make a claim and appropriate information on its progress;
3. Not unreasonably reject a claim (including by terminating or avoiding a policy); and
4. Settle claims promptly once settlement terms are agreed.

More generally, FCA regulated firms are subject to certain High Level Standards, which are included in PRIN. For example firms must:

- Conduct their business with integrity, due skill, care and diligence;
- Take reasonable care to organise and control their affairs responsibly and effectively, with adequate risk management systems;
- Pay due regard to the interests of their customers and treat them fairly; and
- Pay due regard to the information needs of their clients and communicate information to them in a way which is clear, fair and not misleading.<sup>10</sup>

Firms also need to take reasonable care to establish and maintain such systems and controls as are appropriate to their businesses.<sup>11</sup> The nature and extent of the systems and controls which a firm will need to maintain will depend on a variety of factors and further guidance on some of the main issues which a firm is expected to consider in establishing and maintaining the systems and controls appropriate to its business is in the FCA Handbook<sup>12</sup> including, for example (as mentioned above) on external delegation or outsourcing. A firm must also take reasonable steps to establish and maintain adequate internal controls.<sup>13</sup> Guidance on internal controls is also in the FCA handbook.<sup>14</sup>

This thematic review did not set out to consider to what extent rules and guidance such as those highlighted above are being met but rather we wanted to understand the claims philosophy in the commercial segment of the general insurance market. The rules and guidance referred to here are not intended to be an exhaustive list of firms' regulatory obligations and other regulatory provisions may also be relevant depending on the circumstances.

8 The Perimeter Guidance Manual (PERG) 5.7.1 G states: the regulated activity of assisting in the administration and performance of a contract of insurance (article 39A) relates, in broad terms, to activities carried on by intermediaries after the conclusion of a contract of insurance and for or on behalf of policyholders, in particular in the event of a claim. Loss assessors acting on behalf of policyholders in the event of a claim are, therefore, likely in many cases to be carrying on this regulated activity.

9 ICOBS 8

10 PRIN 2.1.1 R

11 SYSC 3.1.1 R

12 SYSC 3.1 (Systems and controls and SYSC 3.2 (Areas covered by Systems and Controls)

13 SYSC 14.1.27 R

14 SYSC 14 (Risk management and associated systems and controls for insurers)

## 2. Our findings

### How claims by SMEs are handled

---

- 2.1** We wanted to understand how the handling of SME claims differed from what we found in our previous retail claims review. Our Principles for Businesses set out our expectations in relation to fair treatment of customers and exercising due skill, care and diligence and SYSC sets out how outsourced functions should be managed. Also ICOBS 8.1 states an insurer's obligations to its customers with regard to handling claims. As a result, even where the handling of claims is delegated (outsourced) to a third party, the insurer holds regulatory responsibility for any failings arising in the claims process or outcomes.
- 2.2** In this review we found that the way that SME claims are handled is determined by the size of the claim rather than the characteristics of the SME. Typically simple or lower valued SME claims are handled on a desktop basis by the insurer, or by a TPA, if outsourced. Often where claims were above £5,000 a loss adjuster was appointed. The loss adjuster acted as the "intermediary" between the SME and the insurer or MGA. The loss adjuster is primarily responsible for ascertaining the nature of the claim and is the SME's usual point of contact during the claim process.
- 2.3** Our research indicated that there was a gap between the claims service received and SME's expectations. In a number of cases SMEs responses suggested that the claims process did not appear to be working effectively in their interests. Our research concluded that a number of claims were going very wrong for claimants. The consequence was that in some of the more complex claims there was evidence of claimants being subject to financial and emotional stress. All of the elements surrounding the claims can take up considerable time and energy, and this can be damaging both to the business and the responsible individuals.

### Handling the initial stages of a claim

---

- 2.4** The first notification of the loss by the SME is often to their insurance intermediary. If the SME buys a policy direct from an insurer then initial contact could be with the insurer's own claims staff or a TPA acting on behalf of the insurer. If the loss occurs out of office hours the SME may also use a claims helpline.
- 2.5** How quickly firms make contact with a claimant following the first notification of loss is key as undue delays could have a significant impact on the speed of settlement of the claim. Whilst firms generally had service level agreements in place to arrange initial on-site visits performance varied significantly in the cases we reviewed.
- 2.6** We identified numerous examples of delays in carrying out visits to make an initial assessment of the loss, which can be exacerbated when there are several parties involved in handling the



claim. In some cases delays of up to ten days occurred and in two examples it was three weeks before the loss was assessed. We expect firms to handle claims promptly taking into account the circumstances of the claim and to have regard to whether customers are being treated fairly.

#### Example 1 – case study

A shop fire occurred on a Saturday morning. This could not be reported by the policyholder to their local insurance intermediary until Monday. This was then passed in turn to the intermediary's London office, the MGA which underwrote the risk, their TPA claims handler and finally to the loss adjuster who contacted the policyholder. This resulted in the on site visit to the premises ten days after a major fire.

- 2.8** A loss adjuster plays an important role in the management of claims and in some cases can make decisions by delegated authority on behalf of the insurer. One of the responsibilities of a loss adjuster is to establish the cause of the loss and if it is covered under the terms of the policy. We found that there was often a lack of consideration of the SME's circumstances during that period – in contrast to what we found in the retail claims review. SME respondents to our research stated that they were not always being treated fairly, which is highlighted by the example below.

*"To be honest from the beginning they gave me a false sense of security and then they made me feel like a criminal from then on in. They were totally untrusting of what I had to say (Micro-business, £100,000+ claim)"*

- 2.10** We also saw examples where delays in carrying out on site visits to assess the loss left SMEs unclear about what action they should take in the interim. For example, disposing of fire or water damaged items, and about business continuity arrangements to minimise disruption.

*"I wasn't given any advice or support on the phone – I wasn't sure whether I could start to clear up or whether I had to leave things as they were. (Micro-business, £20,000 to £99,000 claim)"*

- 2.12** In another example this led to a lower settlement amount.

#### Example 2 – file review

A bar was seriously damaged by fire and had to close while repairs were undertaken. A business interruption claim was submitted with the help of a loss assessor.

However, the loss adjuster stated that the bar should only have been closed for six weeks at most rather than the ten weeks it was actually closed, given the nature of the repairs required.

The SME pointed out that the loss adjuster did not visit the premises for three weeks after the loss. The SME did not take steps to get repairs under way during this period because he did not want to prejudice the position.

A settlement was reached however the SME thought that they should have received an additional sum to cover the losses incurred during this disputed period.

- 2.14** In our research we also found that SMEs were often unclear about the roles of different parties involved in the claims process. This was heightened by the fact that many of the SMEs had limited experience of making a large insurance claim. Many SMEs were unaware of the role of loss assessors and how to access their services. For SMEs the greatest value a loss assessor could provide appeared to be on claims which had stalled, by helping them to progress towards settlement. Also in many cases SMEs did not fully understand the role of the loss adjuster and whether or not they were there to provide advice on the claims process.
- 2.15** In our research a number of claimants stated that following the initial point of contact they were left with no clear sense of next steps. Many claimants felt that they were not given a clear plan highlighting the key stages of the claim process and timescales involved, which can have considerable impact on their finances and business continuity.
- 2.16** We expect firms to have due regard to the information needs of their customers during the claims handling process.<sup>15</sup> In our research a number of SMEs stated how valuable a forward plan would have been, to set out what the next steps would be following the initial meeting with the loss adjuster.

### **Determination of liability under the policy**

---

- 2.17** As part of the review we wanted to assess whether insurers unreasonably delayed admission of liability or sought to avoid liability under policies. We did not see evidence of admission of liability being unreasonably delayed or instances where insurers or MGAs sought unfairly to avoid liability under a policy, in a way that was inconsistent with the spirit of the Act.
- 2.18** In a number of cases there was potential for the claim to be denied, or the whole policy made void, because of non-disclosure of material information or a breach of warranty. The most common area of non-disclosure was the failure of the proprietors/directors of the business to disclose their involvement in a past business that had failed or matters such as previous county court judgements.
- 2.19** In these cases there was a careful assessment – usually involving the underwriting department – of i) the extent to which the undisclosed information or warranty breach was material to the acceptance of the risk or ii) was causally linked to the claim. We did not see instances where the claim was avoided unless the non-disclosure or warranty breach was material. In some cases, rather than seek total avoidance of the claim, a settlement that was acceptable to the policyholder and the insurer was agreed.

### **Ongoing management of the claim**

---

- 2.20** We found a limited number of cases where SMEs felt that their claim had been handled effectively with the parties involved working together to settle the claim promptly.

---

<sup>15</sup> Principle 7 (Communications with clients)

*"I was kept very well informed [by the firm of loss adjusters.] The intermediary was good. They were chasing me for information rather than me going to them and really I left it to the professionals to get on with it. (Micro business, £20,000 to £99,000 claim)"*

*"I think the claim was dealt with in a way that I could get hold of people very quickly. If I needed advice [the firm of loss adjusters] were extremely good. I just felt I'd been dealt with quite fairly. (Micro business, £20,000 to £99,000 claim)"*

- 2.21** However, in the majority of cases we found that SMEs had to chase for updates on the progress of the claim. In some instances there were periods of weeks where requests for updates on the progress of the claim remained unanswered. The reason for the lack of response was not always apparent from the claims file. However it was in contrast to what we found in the retail claims review where some insurers sought to proactively communicate with policyholders about the progress of their claim. We expect firms to take steps to ensure that SMEs are provided with appropriate information on progress of the claim.<sup>16</sup>
- 2.22** In some cases SMEs were seeking more than a mere update on progress and wanted advice and guidance. In one of the case studies the files included at least eight explicit requests for advice, guidance, assistance, clarification of procedure and timelines. In each of these cases little or no response was received.
- 2.23** With some cases there did not appear to be a drive to settle the claim promptly and fairly. For example, our research found that the length of time in settling the claim led a small number of SMEs to form the view that the claim was being drawn out in the hope that the firm would cease trading or withdraw the claim.

*"The first 2 months, nothing happened after the initial flurry of activity...they were just waiting for a reason to pay out as little as possible (Small business, £100,000+ claim)"*

*"I think we felt we'd been played...[or that they] hoped we'd go under before the claim paid out. When you're in that situation you can't commit to leases, cars, advertising, things like that – it's a long period of uncertainty (Micro business, £100,000+ claim)"*

- 2.25** In the case studies and file reviews we did not find evidence of firms unduly delaying progress of the claim so that the claimant would withdraw the claims or accept a lower settlement. However, it was often not clear from files how proactively they were being managed to conclusion and who was responsible for taking this forward.
- 2.26** For larger claims the number of parties involved in settling the claim and carrying out the remediation work can be numerous. In some instances we saw the loss adjuster co-ordinating the activities of the different parties, but this did not occur in all cases. In some instances the co-ordination was carried out by the SME. Our research found that a small number of claimants had spent up to 50% of their time managing the claim at certain points in its life cycle.

<sup>16</sup> ICOBS 8.1.1 (2) R

*"I found the whole process very difficult and time consuming – I was trying hard to keep an already struggling business afloat and I felt like I was project managing an insurance claim that revolved around three parties. It took a lot of time to keep on pushing for information and to know what was happening with the claim (Micro-business, £20,000 to £100,000 claim)"*

### Interim payments

- 2.28** Maintaining cash flow during a period of disruption to trading can be important to the continuation of the business. In line with treating customers fairly, good practice would suggest that firms carry out an assessment of the needs of the SMEs once liability under the policy has been admitted and, where appropriate, consider the need for continuing cash flow to be met. In our file reviews we found examples where this was actively considered by the loss adjuster and regularly reviewed to assess the need for further interim payments. These were made promptly without subsequent requests by the claimant. In contrast we found numerous examples where requests for interim payments had to be made, sometimes repeatedly, by the SME or the loss assessor or intermediary acting on their behalf.

#### Example 3 – case study

It took the SME and their accountant some time to provide the historic data to calculate the business interruption loss. However once that was available the loss adjuster and the SME reached a clear understanding as to how the business interruption loss would be calculated and how future payments would be made. At the end of every month the SME provided details of the turnover achieved for the previous month, which the loss adjuster compared to that expected and then made further interim payments to cover the shortfall in gross profit less any savings.

### Settlement of the claim

- 2.30** We looked at three aspects of the claims settlement process:
- SMEs' understanding of what they were entitled to under the policy and the assistance loss adjusters and loss assessors provide in determining this;
  - The quantification of the claim; and
  - The form of settlement, whether by repair, replacement or cash settlement.
- 2.31** Our research indicated that it can be difficult for SMEs to understand what they are entitled to under the terms and conditions of their policy. The basis on which the amount of settlement is determined can often be complex and can vary across different aspects of cover within a policy. For example, on plant and stock the basis of settlement is typically indemnity with deductions being made for wear and tear. On buildings the basis of settlement can be to rebuild or repair to the equivalent of new.

- 2.32** Loss adjusting firms are not typically remunerated by insurers and MGAs in a manner which provides financial incentives for them to reduce the cost of individual claims. However despite this the perception of some SMEs was that the loss adjuster was trying to reduce the amount of the claim.

*“Getting them to replace everything was a real penny-pinching process, in terms of the material they were using. They were always looking to cut corners. (Micro-business, £100,000+ claim)*

*“It felt like they were here to save the insurance company money. That’s what it felt like to me. We were claiming X amount, and it was like his job to get it for a discount. That’s what it was like. (Micro-business £5,000 to £20,000 claim)”*

- 2.34** In contrast where a loss assessor was appointed we found examples where they were able to point out other aspects of the claim which would be covered under the policy. This was expressed by one SME as:

*“He got my insurance policy, he was able to literally tell me what every single term meant and how it affected me and what I could and couldn’t claim for (Small business, £100,000+ claim)”*

- 2.36** With regard to the form of settlement, loss adjusters generally appeared flexible in accommodating claimants’ wishes. The settlement might be a cash payment to use as they wished, or in refurbishment of the premises to an improved standard with the customer making a financial contribution to this to reflect betterment. One example of this was where repairs to the premises of a joinery business would have cost £120,000 but as the SME wanted a cash settlement this was agreed at £100,000.

#### **Payment of claims**

- 2.37** ICOBS requires insurers to take responsibility for settling claims promptly once settlement terms are agreed.<sup>17</sup> However, we saw a number of examples where despite the amount of the settlement being agreed the mechanisms for carrying this out were often problematic. We found issues in relation to final settlement being chased by various parties, payment being sent to the incorrect address or account and insufficient funds being held by the TPA to settle the claim.

- 2.38** In our retail claims review we found that most of the insurers made payments to claimants by transfer direct to their bank accounts. This was in contrast to what we found in this review where payment, in many cases, was by cheque. One insurer in the review has instructed its loss adjuster not to request BACS payments for amounts less than £35,000. Payment by cheque not only presents the risk of the cheque being lost, but requires the SME to bank the cheque and wait for it to clear before the funds are in their account.

#### **What is important to SME claimants**

- 2.39** Our research showed that there are a number of things which are important to SMEs in the handling of their claim. In some cases these are provided, but in other cases they are not. Based on our research what is important for SMEs is:

<sup>17</sup> ICOBS 8.1.1 R

- An easy process to notify the claim and attendance of the loss adjuster at their premise with a speed appropriate to the circumstances of the loss;
- Understanding of the SME's circumstances on initial contact and guidance on what action to take/not to take to mitigate the loss;
- An action plan setting out what will happen, who is responsible, when and what information will be required to substantiate the claim;
- Co-ordination of the activities of the contractors, where appropriate, involved in the claim and for their work to be of good quality;
- A settlement that includes all the elements to which the SME is entitled under the policy;
- The claim to progress to settlement in a timely manner and there to be proactive communication about progress; and
- Payments to be made on a timely basis, whether they are to settle the claim or aid cash flow of the SME during the claim.

### The importance of adequate sums insured

- 2.40** Our research highlighted the importance of SMEs having appropriate sums insured for their needs and the negative impact on the amount of the claims settlement if they did not have the appropriate level of cover in place. In most cases sums insured should be sufficient to cover both physical assets – buildings, contents, stock etc. - and business interruption (BI). If sums insured are inadequate (i.e. the SME is under insured) this can result in a misalignment of the expectations of the performance of the policy at the point of claim.
- 2.41** There are particular complexities around BI, because this insurance has to be adequate in terms of the financial limits chosen and the period that the insurance covers. BI insurance can typically cover 12, 24 or 36 months (this is also known as the maximum indemnity period). The period of indemnity needs to be sufficient to allow the business to return to a similar financial position as it was in before the insured event (e.g. a fire) took place. The SME also needs to ensure that the financial limits in the policy are sufficient to cover the loss of profits for the whole of this period.
- 2.42** Making an appropriate assessment of sums insured can be difficult and was highlighted as an area of concern in 2011 report by The Insurance Institute of London *Business Interruption Policy Wordings – Challenges Highlighted by Claims Experience*.<sup>18</sup> The preface to the report stated that:
- *Our concern is that there has been a lack of clarity for a long time now – for insurers, adjusters and customers – over certain aspects of BI policies. For example, there is often a big difference between the technical meanings for words in a policy and the way words are used in everyday business.*
- 2.43** For example the definition of “gross profit” in a BI policy is likely to be different to that commonly used by accountants. This means that setting the correct sums insured to cover potential loss of profits can be challenging for SMEs.

<sup>18</sup> [www.cila.co.uk/files/265BIsinglePdf.pdf](http://www.cila.co.uk/files/265BIsinglePdf.pdf)

- 2.44** For an SME the impact of not having adequate sums insured could result in “average” being applied to its claim. This means that the claim settlement will be reduced in proportion to the degree of under-insurance. The insurer typically does this because the policyholder may not be entitled to full settlement of the claim if less than the full premium has been paid to insure the actual risk exposures presented to the insurer.
- 2.45** Commercial insurance policies usually set out how and in what circumstances average may be applied to a claim and some policies allow for some degree of underinsurance before average is applied (for example average might only be applied in a buildings insurance policy where the sum insured is below 85% of the reinstatement costs). The way in which average can be applied can therefore vary according to the policy, but the general principle is that, where underinsurance has occurred, there may be a proportionate reduction in the settlement of the claim.
- 2.46** We reviewed 97 files for claims in excess of £5,000 during our firm visits. In 21 of these claims files the sums insured on some aspect of the cover proved to be inadequate to cover the actual loss suffered by the policyholder.
- 2.47** The majority of the claims we reviewed were on policies sold on an advised basis by insurance intermediaries. However, we also looked at some claims on policies sold directly on a non-advised basis by insurers and some non-advised policies sold through insurance intermediaries. In some cases the sums insured were below 50% of the amount required to cover the loss. Some examples that we encountered during our file reviews are below.

### Example 3 – file review

The following are short summaries of some of the claims the thematic team reviewed, which featured inadequate sums insured:

- An SME experienced a serious fire. The insurance claim, for contents, stock and BI was over £1m. However, the Sum Insured for Business Interruption was only around a quarter of what was needed to fully cover their losses.
- A leak from a water tank caused extensive damage to the building where an SME was based. Around £80k of damage was caused. The Sum Insured on the building was less than half what it should have been in order to fully cover the building and the claims settlement was reduced accordingly.
- A catering firm suffered a major fire. The business contents were hugely underinsured: damage to the contents was estimated to be half a million pounds, but the claim was settled for less than half of that. Similarly the BI cover was only for twelve months and this proved inadequate for the business to get back to its former level of profitability. This business therefore suffered huge financial losses as a result of being underinsured.

- 2.49** In addition, in 12 out of the 20 case studies there were issues relating to sums insured. In 8 cases the material damage sums insured for buildings, trade contents and/or stock were inadequate. In 4 cases the loss exceeded the 12 month maximum indemnity period.

- 2.50** In a small number of the case studies the intermediary's file was reviewed. These files provided little evidence as to the nature of the discussions between the intermediary and the SME, their client, about sums insured. In one of the case studies the SME did not buy any business interruption insurance but the reason for this was not recorded on the file.
- 2.51** We did not carry out a systematic review of the selling practices of insurance intermediaries and insurers therefore it was not possible to determine what proportion of SMEs chose to set sums insured below the level necessary to be fully covered. However our research did capture SMEs' experiences of buying insurance and for the majority having the right cover was equally important as the price of the policy.
- 2.52** SMEs purchase insurance through a variety of channels, either direct from insurers or from insurance intermediaries, or from other intermediaries such as banks. Sales can be on either an advised or on a non-advised basis.
- 2.53** For both advised and non-advised sales FCA rules require insurance intermediaries to specify the demands and needs of the customer.<sup>19</sup> For advised sales the firm must take reasonable care to ensure the suitability of its advice for any customer who is entitled to rely on its judgement.<sup>20</sup> Insurance intermediaries may also have other, common law, duties. We also expect firms to provide customers with appropriate information in a comprehensible form about the policy so that the customer can make an informed decision.<sup>21</sup>

### Quality assurance and assessing claimant outcomes

---

#### Quality assurance

- 2.54** Where firms delegate authority for claims handling to a third party we expect them to have the appropriate governance arrangements and systems and controls in place to provide proper oversight of those activities, in order to ensure that their regulatory obligations are being met.
- 2.55** We found that there is widespread auditing by insurers and MGAs of the TPAs and loss adjusters who have authority to handle claims. Indeed we found that loss adjusters and TPAs have their own internal quality assurance processes. We also understand that firms are starting to refine the scope of their audits and to include more conduct focused metrics. This is a welcome step.
- 2.56** However, we found that audit and quality assurance processes did not always appear to be working effectively in a number of instances. For example firms did not always have processes in place to identify claims that had stalled because of unresolved issues. Furthermore, firms did not appear to have identified and put in place effective systems and controls to deal with policyholders or their representatives requesting, sometimes repeatedly, an update on the progress of the claim.

### Assessing claimant outcomes

---

- 2.57** In our retail claims review we commented that a number of the insurers stressed the importance of collecting information about the policyholder's experience. This was both formal information,

<sup>19</sup> ICOBS 5.2.2R and 5.2.3R (Identifying client needs and advising)

<sup>20</sup> ICOBS 5.3.1R (Identifying client needs and advising)

<sup>21</sup> ICOBS 6.1.5R



such as the findings of consumer research or complaints, or informal such as policyholders' views expressed during calls to claims handlers. Firms were able to cite examples of the feedback loops that existed to use this suite of information to improve products and services.

**2.58** In contrast firms in this review had less developed frameworks in place to capture customer experiences. What firms did in this area varied considerably. For example:

- An intermediary with a network of offices recorded claims enquiries and what resulted from them under 14 different headings ranging from "fell below excess" to "fraud/misrepresentation".
- Management information of an intermediary that placed business for SMEs over the internet shows that 50% of claims enquiries did not result in claim. This information was segmented and used to improve its products and services to customers.
- An insurer did not identify "repudiations" (e.g. where the whole policy is avoided) although it did have processes in place to handle instances where this was the case.
- In two cases –an intermediary and a loss assessor – all claimants were automatically sent a questionnaire at the conclusion of the claim.
- In the case of the intermediary where the policyholder had provided poor feedback they were contacted by a Claims Manager to understand the reasons for their comments.

**2.59** We also asked insurers to what extent they carried out any research to assess claimant satisfaction. We found that a number of firms had just – or were in the process of – introducing methods of systematically gathering feedback from policyholders about the handling of the claim. In the case of a loss adjuster it was proactively carrying this out rather than it being as a result of poor customer feedback.

**2.60** The monitoring of claimants' satisfaction was relatively new in a number of firms included in the review. As such firms generally were not able to cite examples of changes that had resulted from customer feedback. We expect firms to put in place processes and procedures to determine whether or not they are treating customers fairly.

## 3.

# Implications of the findings and next steps

- 3.1** We expect customers to be at the heart of how firms run their businesses and in the context of this review how they handle claims. Claims should be handled promptly and fairly for all customers and systems and controls should be in place to ensure that this occurs and that customers are treated fairly. In this review we found that there was a gap between the claims service they received and SMEs expectations. .

### Putting SMEs at the heart of the claims process

---

- 3.2** While considerable effort is devoted to quality assurance, current processes do not appear to be working effectively in the interests of customers. Our review highlighted that processes are not:
- Detecting and addressing inconsistencies in the handling of claims;
  - Identifying and taking steps to manage claims that have stalled because of unresolved issues; and
  - Identifying and addressing issues that appeared widespread, particularly the failure to communicate with policyholders about the progress of their claim.
- 3.3** There also needs to be greater clarity about who is responsible to ensure consistency of the overall claims outcome delivered.
- 3.4** We expect firms to consider carefully the findings of this review and to analyse what changes they need to make to ensure that SME claimants are treated fairly. We intend to engage with firms and senior figures in the industry both individually and through a dialogue with the relevant industry trade bodies to discuss the findings of this review, our expectations, and the changes that may be required to improve outcomes for SME customers.
- 3.5** We also intend to publish a discussion paper on the Handbook approach to SMEs as users' of financial services in due course and we would encourage firms to respond.

### Addressing issues with sums insured

---

- 3.6** It is our understanding that BIBA will shortly publish technical guidance for its members about how to ensure customers do not have inadequate sums insured. This is a welcome step. We will also consider what further action, if any, may be required in this area. We will also work with the organisations representing smaller businesses to develop a programme of communication about the importance of having adequate sums insured.

**Feedback to individual firms and action required by them**

---

- 3.7** We will provide feedback to the firms included in the review. Where appropriate, we may ask firms to carry out an internal review to determine whether individual instance of poor claims handling reflects more widespread issues.

# Annex 1

## Findings of customer research

Quadrangle was commissioned by the FCA to undertake qualitative research with 100 SMEs that had made a claim. This research informed the thematic review.

[www.fca.org.uk/your-fca/documents/research/commercial-insurance-claims-findings-from-research-with-sme-customers](http://www.fca.org.uk/your-fca/documents/research/commercial-insurance-claims-findings-from-research-with-sme-customers)

## Annex 2

# Findings of case studies

Camford Sutton was commissioned by the FCA to look in-depth at 20 claims, on a case study basis, drawn largely from 100 SMEs included in our customer research undertaken by Quadrangle. This work informed the thematic review.

[www.fca.org.uk/your-fca/documents/research/commercial-insurance-claims-by-smes-report](http://www.fca.org.uk/your-fca/documents/research/commercial-insurance-claims-by-smes-report)

Financial Conduct Authority



**PUB REF: 005056**

© Financial Conduct Authority 2015  
25 The North Colonnade Canary Wharf  
London E14 5HS  
Telephone: +44 (0)20 7066 1000  
Website: [www.fca.org.uk](http://www.fca.org.uk)  
All right reserved