Financial Services Authority

FSA®

Notice of undertaking

Introduction

As a qualifying body, we, the Financial Services Authority (the FSA), can challenge firms using terms that we view as unfair under the Unfair Terms in Consumer Contracts Regulations 1999 (the Regulations). We review contract terms that are referred to us by consumers, enforcement bodies and consumer organisations. This has led to Legal & General Insurance Limited undertaking not to use the terms identified in its Home Insurance policy that we consider may be unfair.

We have a duty under the Regulations to notify the Office of Fair Trading (OFT) of the undertakings we receive. The OFT has a duty to publish details of these undertakings, which it puts on its Consumer Regulation website. We also publish the undertakings on our website. Both publications will name the firm and identify the specific term and the part of the Regulations that relate to the term's fairness.

Even if firms have not given an undertaking or been subject to a court decision under the Regulations, they should remain alert to undertakings or court decisions concerning other firms as part of their risk management. These will be of potential value in showing the likely attitude of the courts, the FSA, the OFT or other qualifying bodies to similar terms or terms with a similar effect. Ultimately, only a court can determine the fairness of a term and, therefore, we do not recommend terms that have been revised by a firm to address our concerns as being definitely fair.

We cannot approve terms for the purposes of the Regulations; it is for firms to make an assessment of the fairness of their terms and conditions under the Regulations and in the context of the product or service in question.

It is important to bear in mind that wording that is fair in one particular agreement is not necessarily fair in another. When we accept an undertaking given to us from a firm to revise a term, this means that, on the evidence available at the time, we consider the term to be improved enough so that further regulatory action is not required.

Legal & General Insurance Limited undertaking in relation to its Home Insurance Essentials policy terms and conditions and for its other policies with the same or similar terms

<table>
<tr><td>Name of business</td><td>Legal & General Insurance Limited</td><td>Lead organisation</td><td>FSA</td></tr>
<tr><td>Trading sector</td><td>Insurance</td><td>Contract identifier</td><td>Home Insurance Essentials - policy booklet</td></tr>
<tr><td colspan="4">Original term

The buildings are insured against loss or damage caused by

5. subsidence or heave of the site on which the buildings stand or landslip

We will not pay for loss or damage

…………………………..

iv) Caused by settlement, shrinkage or expansion

N.B. The terms ‘subsidence’ ‘heave’ ‘ landslip’ ‘ settlement’ were not defined in the policy</td></tr>
<tr><td colspan="4">Application of the Regulations (Schedule 2 paragraph or as indicated)

Under the Regulations, all terms in standard consumer contracts may be assessed for fairness other than in relation to the definition of the main subject matter of the contract or to the adequacy of the price or remuneration as against the goods or services supplied. However, this exception is only partial, as it is subject to the proviso that such terms are expressed in plain and intelligible language: where they are not, they may be assessed as to their fairness. It follows that an unintelligible term that attempts to define the subject matter of the contract may be assessed for fairness under Regulation 5.

The above clause 5 (iv) (the ‘Original Term’) is an exclusion clause in an insurance policy. Exclusion clauses limit the risks that the insurer is prepared to insure, and therefore may ‘relate to the definition of the main subject matter of the contract’. The Council Directive 93/13/EEC</td></tr>
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(which was implemented in the UK by the Regulations) has a preamble that has been used by the courts in the UK to interpret the purpose and meaning of the law and, in this regard, Recital 19 provides useful guidance on this point. It provides that terms describing the insured risk and the insurer's liability should be regarded as the "main subject matter of the contract" and therefore not subject to assessment **provided** they clearly define or describe the risk or liability.

For ease of reference we set out the preamble in the Council Directive 93/13/EEC, which states: *'assessment of unfair character shall not be made of terms which describe the main subject matter of the contract...whereas it follows inter alia, that in insurance contracts, the terms which clearly define or describe the insured risk and the insurer's liability shall not be subject to such an assessment since these restrictions are taken into account in calculating the premium paid by the consumer.' (emphasis added)*

And we also set out Regulation 6(2)(a), which states: *'In so far as it is in plain and intelligible language, the assessment of fairness of a term shall not relate… to the definition of the main subject matter of the contract.' (emphasis added).*

In our opinion, the Original Term does not 'clearly define the insurer's liability' and is not drafted in plain and intelligible language because: the terms *'settlement, shrinkage or expansion'* are very broad and there is considerable uncertainty when considering how these exclusions might be interpreted and applied. For example, the average consumer may consider that subsidence will necessarily involve some kind of *settlement*/downward movement of the land/soil on which the building stands. The average consumer might also think that subsidence/heave would involve some kind of *shrinkage or expansion* of the soil in adverse climatic conditions and *shrinkage/ expansion* of building materials as a consequence. In summary, in our view, the wording of the Original Term makes it very difficult for the policyholder to determine what he/she is or is not covered for under the subsidence clause.

Recital 19 also indicates that clearly defined restrictions to cover are not subject to assessment for fairness because they will have been 'taken into account in calculating the premium' to be paid. However, in this case, given the lack of a clear definition, we do not consider that this particular risk could have been properly quantified and taken into account in the calculation of the premium. This supports our view that the term is not in *plain intelligible language* and therefore can be subject to an assessment for fairness under Regulation 5. On this basis, we set out the requirements of Regulation 5(1):

A term is unfair under the Regulations if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract, to the detriment of the consumer.

i) Significant imbalance to the detriment of the consumer

Under the Regulations a term will be judged according to how it is drafted in the contract, namely its *potential for* unfairness (not its application in practice). The unclear wording of the Original Term means that the firm could potentially interpret the term's meaning to its own advantage. In our view the lack of clarity in the term creates a significant imbalance as it gives the insurer considerable scope to refute a claim because any damage involving subsidence may potentially be said to be caused to some extent by 'settlement, shrinkage or expansion' and therefore not covered. The vagueness of the wording also makes it difficult for the consumer to determine whether he/she is or is not covered by the term and to challenge the insurer's decisions. It follows that such a broad exclusion could be applied to consumers' detriment by limiting the cover they receive.

ii) Good faith

The requirement of 'good faith,' according to case law, means that the supplier should deal openly and fairly with the consumer. In our view the lack of clarity about the meaning and scope of subsidence and the fact that the term does not reflect what the firm does in practice demonstrates a lack of openness that is contrary to the requirement of good faith.

How the term has changed

The Original Term will be deleted in Legal & General Insurance Limited's Home Insurance Essentials policies and all its other policies with the same or similar wording and replaced with the revised clause and new definitions for 'subsidence', 'heave', 'landslip', and 'settlement', set out below. The insurer no longer has wide scope to decide what constitutes "damage caused by settlement, shrinkage or expansion" and thus which claims to exclude; and, the consumer has clearer information as to what is or is not covered by the policy from the outset of the contractual arrangement.

New customers will receive a policy with the new wording from 1 January 2012 and existing customers will be notified of the changes at their annual renewal falling due after 1 January 2012**.**

In the interim, the firm has confirmed that it will treat all policyholders making claims under the Original Term as if the New Terms already applied.

In any event, the firm has explained to us that, in practice, the intention was to exclude from cover only settlement occurring in the first ten years of a building being built. We were also informed that the Original Term was intended to exclude only normal shrinkage or expansion of building materials that is unconnected to any subsidence, heave of site or landslip. The New Terms are intended by the firm to make these existing practices clearer to policyholders.

New Terms

The **buildings** are insured against loss or damage caused by:
5) **Subsidence** or **heave** of the site on which the **buildings** stand or **landslip**

We will not pay for:

Loss or damage:

i) To swimming pools, hot tubs, tennis courts, service tanks, central heating oil tanks, ground source heating pumps, terraces, paths, drives, walls, fences, gates and hedges unless **your home** is damaged by the same cause and at the same time.

ii) Caused by the compaction of infill.

iii) Occurring while the **buildings** are undergoing demolition, structural alterations or structural repairs.

iv) Caused by **settlement**.

v) Caused by river or coastal erosion.

vi) Arising from defective design, defective materials, or faulty workmanship.

vii) Arising from movement of solid floors, unless the foundations beneath the exterior walls of **your home** are damaged by the same cause and at the same time.
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To be added to the 'Definitions' section of the booklet:

Heave
Upward movement of the ground beneath the **buildings** as a result of the soil expanding.
Landslip
Downward movement of sloping ground.
Settlement
Downward movement as a result of the soil being compressed by the weight of the **buildings** within ten years of construction.
Subsidence
Downward movement of the ground beneath the **buildings** other than by **settlement.**

Other information

- We remind firms of the Insurance Conduct of Business Rule 6.1.5 which states that:

  A firm must take reasonable steps to ensure a customer is given appropriate information about a policy in good time and in a comprehensible form so that the customer can make an informed decision about the arrangements proposed

- Legal & General Insurance Limited was fully co-operative in providing this undertaking to us.

Undertaking published on 14 December 2011