On banks and insurers… Pray never the twain shall meet!

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Thousands of South Africans enter into mortgage loan agreements with one or other of the country's 'big four' banks each year. The banks 'front' the full purchase price (minus deposit) of the asset – usually a residential home – in return for a healthy whack of interest income over the term of the loan. As a condition of the loan, ownership of the home vests with the bank until such time as the homeowner makes the final mortgage payment and arranges to cancel the bond. In the event the homeowner misses his monthly bond repayment the bank can initiate steps to recover the property and sell it to recover costs.

But default risk isn't the only threat to ongoing bank profitability... Banks also need assurance that their investment is 'safe' in the event the underlying asset goes up in smoke, or is destroyed as a result of flooding, earthquake or hurricane! To mitigate this risk banks insist on proof of homeowners insurance as part of the mortgage agreement. Although the banks cannot stipulate which short-term insurer the homeowner approaches for this cover, the trend is toward using the banks' own insurer for this purpose. Many homeowners opt for bank insurance because of the apparent administrative ease at mortgage stage. But few consider the implications of bank and insurers having shared profit objectives. Can banks and their insurers keep transactions at arms length when the situation demands it? Not always – as you are about to discover...

An insurance horror story from Glennwood, Durban

We were paging through a copy of the Ombudsman's Briefcase Issue 1 of 2011 when we chanced upon an insurance complaint 'case study' worthy of a slot in South Africa's financial scandal rag, Noseweek. It involves an insured (let's call him Joe), his bank (un-named in the report) and the bank's in-house short-term insurance company. The insured purchased his home with assistance from the bank's home loans division, which – obviously – arranged the required homeowners insurance with the in-house insurer… Disaster struck, and Joe's home was destroyed by fire around October 2007.

Joe wasn't too concerned at this stage. After all, he had the necessary insurances in place. So he contacted the home loans division, who advised him that a claim would be lodged with the in-house insurance company. What followed is an indictment on several stakeholders in the domestic financial services industry. "A few days after the loss was reported the insurer sent out an assessor to inspect the property – thereafter the insured heard nothing – although enquiries made with the bank and insurance company suggested that the matter was being investigated further," notes the Ombudsman.

Joe's property was occupied by tenants at the time of the fire. He therefore informed the bank that due to the loss of this income he would be unable to service the monthly bond repayment. The bank seemed understanding, informing Joe (in his words) that "the insurance would pay us or reimburse us for any loss in income to the property, in order to allow us to

pay for the bond until the house is rebuilt.” Towards the end of December 2007 – six weeks after the incident – Joe received a call from the bank’s legal department asking about ‘missed’ bond instalments. By February 2008 Joe had heard nothing further from the bank. But things quickly got out of hand from there...

Bank-insurer stutters on claims payment, but repossesses in record time

With the help of a legal adviser Joe then discovered that the insurer had rejected liability for the claim… The insurer ‘blocked’ repeated requests for information on the refusal with the result Joe eventually turned to the Ombudsman for Short-term Insurance for assistance. With the Ombudsman’s intervention the insurer admitted that it had “made an incorrect decision to reject the claim” and that “the claim should have been entertained as soon as it was reported!” They undertook to instruct “the claims administrators on this claim to ensure that the assessor that was appointed obtain the correct quotations for us after which we will pay into the client’s bond account the amount less the excess of R500.00”.

Great… All settled then? Problem is things don’t always go smoothly in the real world. Joe’s nightmare was just beginning. It took almost six months for the insurer to determine a settlement figure for the fire damage. At this point Joe indicated dissatisfaction with the settlement offer and requested the Ombudsman to negotiate further… Meanwhile, unknown to Joe or the Ombudsman, the insurer settled the claim directly with the bank. Joe notes: “the bank collected the money and kept quiet about it!” And the bank wasn’t sitting around while its in-house insurer fiddled… The Ombudsman notes that without the insured’s knowledge “A summons had been served at the unoccupied residence, and after a default judgment had been obtained, the house was sold in execution!”

From bad to worse – the bank demands another slice of pie!

Let’s recap. Joe’s house burned down. He defaulted on payments while the bank’s in-house insurer twiddled its thumbs. The bank obtained judgment on the property despite its in-house insurer delaying the insurance payout and then went ahead with a sale in execution without the insured’s knowledge. It subsequently emerged (in November 2008) that the insurance company had made two payments into Joe’s bond account before it “discovered that the property was attached and sold in execution by the bank.” To make matters even worse the loss adjustor in this case applied “averages” to the claim, leaving a short-fall on the bond account, which the bank set out to recover by instituting legal proceedings. What a David versus Goliath battle! All Joe could do was request that the Ombudsman take the complaint further.

A second complaint to the Banking Ombudsman fell upon deaf ears. “The Insured argued that it had been premature for the bank to institute legal proceedings against him when there was a pending dispute before the office of the Short-term Insurance Ombudsman, and especially after the bank had known that the Insurer had accepted that it had incorrectly rejected liability!” **After the Banking Ombudsman failed to intervene the Ombudsman for Short-term Insurance was forced to pull out the big guns... He reminded the insurer of the provisions of the General Code of Conduct for Authorised Financial Services Providers and their Representatives – specifically the requirement for FSPs to provide their services “honestly, fairly, with due skill, care and diligence and in the interest of clients and the integrity of the financial services industry”.**

The Ombudsman observes: “The conduct of both the bank and the insurer fell well short of these requirements in virtually every respect!” He said the insurer was negligent in dealing with the claim, while the bank ignored the reasons for mortgage default… (Remember, the bank was aware of the dispute between their in-house insurer and the Ombudsman). “The Insurer was in effect trying to hide behind an artificial distinction between itself and the bank notwithstanding the fact that they were both members of the same Financial Services Group!” Why else would the insurer pay over the proceeds of the insurance claim to the bank as if it were a creditor? The insurer eventually agreed to review the matter and ensure that Joe was properly indemnified in terms of the policy and furthermore, compensated for the loss of the property.