WILHELM
RECHTSANWÄLTE

Lars Winkler Versicherungsmonitor.de, 14 September 2015

Column

Fidelity insurance: "gross negligence" as a pitfall

Fidelity insurance ought to protect companies against financial losses resulting from illegal conduct committed by own employees. This includes losses resulting from fraud, breach of trust and theft. For some years now, German insurers increasingly deny coverage or only compensate for part of the loss. They claim that the policy holder made the insured event possible due to gross negligence. The insurance often proves worthless as a result.

A main principle of German insurance law determines that an insurer is not liable if its policy holder caused the insured event with intent.

At first glance, fidelity insurance violates this principle. A company buys insurance coverage for the case that a company employee – a person of trust – causes a loss of the company by illegal conduct. A typical case in fidelity insurance is the misappropriation of money by members of the company. The members of the company often do not "simply" transfer money from the company's account to their own account, since such criminal conduct would immediately be detected. They e.g. rather hand in fake invoices of advisory companies which never executed the invoiced services. The person behind such fake company is the criminally acting company employee, who will either order the payment of the fake invoice himself or instructs an accomplice within the company.

Insurers promote fidelity insurance as useful and necessary to close insurance gaps which might otherwise arise: no company will be able to control every employee in every individual action. In case of respective criminal energy and especially in case of a collaboration of several employees, it is always possible to harm even a duly organized company through criminal deeds. No company will function properly and make profits if it puts all employees under general suspicion of criminal deeds.

For several years now, insurers though argue in case of an insured event under a fidelity policy, that the aggrieved company caused the insured event recklessly (with so called "gross negligence") by insufficient compliance measures. The insurer is consequently only liable for part of the loss. The company will have to bear the other part of the loss. The argument is always the same: the company had not implemented sufficient supervisory measures to avoid the criminal deed.

Hence, insurers often argue in the insured event that it is already reckless to allow a single person to sign bank transfers resp. to order payments. Here, a dual control principle should have been observed. According to the insurers, any violation of the principle of dual control already represents gross negligence.

This argumentation often surprises the aggrieved companies. They expected to have bought insurance coverage for the case that their own employees harm the company intentionally. Now they get to hear that insurance coverage would only be granted if it was not possible to prevent the criminal deed.

The aggrieved companies perceive this – rightly – as contradictory. On the one hand, a criminal deed of a company employee, a person of trust, caused the insured event. On the other hand, grave conduct – an allegedly reckless violation of organizational duties – leads to a (partial) release of the insurer from payment.

Moreover, it can be seen that especially in major insured events, the insurers subsequently request unrealistic compliance and organizational duties. If those duties had not been met, this shall be regarded as a reckless breach of organizational duties. Such argumentation ex post is always very simple: if an insured event occurred, it is in retrospect easy to show which organizational measure would have prevented this event.

If a company thus concludes a fidelity insurance policy or wants to renew an existing policy which is worth its name, the persons in charge should insist on a special term which does not allow the insurer to refer to gross negligent causation of the insured event by the policy holder in order to reduce or reject cover. The applicability of section 81 para. 2 Insurance Contract Act on fidelity insurance should therefore be excluded by a term in the insurance contract. If an insurer is not willing to include such term, the company should doubt whether a conclusion of such policy makes any sense at all.

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