

The complaint

W, a limited company, complains Allianz Insurance Plc turned down claims it made on its professional indemnity insurance policy.

W is represented by its director, Mr D who is in turn represented in bringing this complaint to our service by professional representatives who I'll refer to as H. All references to Allianz include its agents and claims handlers.

What happened

W's professional indemnity insurance with Allianz includes cover for a claim against it resulting from loss caused by the fraud or dishonesty of any employee. In July 2020 it contacted Allianz (through its broker) and said an employee had stolen significant sums of money from an account containing client money (which I'll refer to as the 'client account'). Allianz appointed a loss adjuster who reviewed information provided by W.

After considering their reports Allianz noted no claims had yet been made against W. However, it said it wouldn't provide cover if (as seemed likely) that did happen. It said Mr D had been using funds in W's client account to pay his and his family's personal liabilities. And the policy didn't cover claims "*arising out of, based upon or attributable to any actual or alleged dishonest, fraudulent or criminal conduct of an Insured*". It thought that applied here.

Allianz was also concerned that, after the theft had been uncovered, W used funds from new clients to meet the shortfall suffered by existing clients. It thought that was a further instance of dishonesty and, as that had taken place after the theft had been discovered, cover wouldn't apply to claims relating to this in any case. And it said the policy wouldn't cover a claims relating to theft from W as that didn't expose it to any third party liability. W provided further information on the reasons why Mr D operated the client account as he did but in June 2021 Allianz said that didn't change its position on policy coverage.

In August 2022 H contacted Allianz and said a claim had now been made from a client in respect of loss they had suffered. It sought confirmation cover would be provided for this. After considering further information from H, which was reviewed by loss adjusters, Allianz confirmed the decline of that claim in August 2023 for the reasons set out in previous correspondence.

Our investigator thought the policy was clear that if W had contributed in any way to a claim being made due to actual or alleged dishonest, fraudulent or criminal conduct then Allianz was entitled to decline it.

And in this case she thought it was reasonable of Allianz to conclude Mr D had withdrawn funds from the client account and used them for his personal benefit. As that had contributed to the deficit it was reasonable of Allianz to say the exclusion applied and it didn't need to take any further action.

H on behalf of W didn't agree. It made very detailed submissions and in summary said:

- It wasn't disputed there had been significant theft from W's accounts by an employee of W (who wasn't Mr D). It accepted Mr D had used the client account for non-client monies but this was because it paid a higher rate of interest than other accounts and so it made financial sense to do so. And while he'd made numerous withdrawals from that account (totalling around £560,000) he believed those were monies he was entitled to.
- It was inherently improbable Mr D acted dishonestly. Police investigation had led to criminal charges being brought against W's employee but no charges had been brought against Mr D. And he was the proprietor of a successful business and would have no reason to jeopardise that reputation. There had been no issues with making payments until the fraud by W's ex-employee took place. Mr D had been upfront about his use of the client account and there was no need for him to steal from his clients.
- The monies in the relevant account were a mixture of client and Mr D's own funds and so in making withdrawals he hadn't misappropriated client funds. It didn't think it was for Mr D to demonstrate there was a surplus in the account (so it contained money over and above what was owed to clients) because it was for Allianz to demonstrate a policy exclusion applied. It wasn't for Mr D to prove his innocence.
- In any case it had provided a detailed explanation of W's record keeping which it thought enabled Mr D to establish what amounts were owed to clients and so any outstanding account balance was at his disposal. And while there wasn't documentary evidence of every payment made by Mr D into the client account it had evidenced, for example, a significant payment he'd made in 2015.
- In addition W received fees of £1.2 million from December 2016 until March 2023 which significantly exceeded the amount Mr D had withdrawn from the client account. So there was more than enough money in that account to cover the withdrawals he made from it. And as a proprietor of the business he was entitled to use those amounts for his personal expenses. It thought, but for the theft by W's employee, there would have been more than enough money in the client account to pay all of the relevant beneficiaries.
- Allianz had suggested W may have owed its clients more than the amount it believed was due but that wasn't based on any comprehensive or forensic analysis of W's accounting systems but relied on assertion and isolated examples of the accuracy of individual amounts. It thought this was an attempt to reverse the 'burden of proof' test.
- It didn't think any more recent issues with payments into the account were relevant because they took place after the theft had been discovered. And in any case Mr D disputed there had been any wrongdoing here and it questioned why he would have embarked on a course of action that meant client monies were handled dishonestly having already notified the police and Allianz of the theft which had taken place.
- It didn't think that Allianz had properly considered the representations it made and didn't think it had acted fairly or reasonably in concluding Mr D had committed fraud which was an extremely serious allegation which wasn't justified by the available evidence.

I issued a provisional decision on the complaint last month. In summary I said:

The relevant rules and industry guidelines say Allianz has a responsibility to handle claims promptly and fairly. It shouldn't reject a claim unreasonably.

I've looked first at the terms and conditions of W's policy. That says:

"The Insurer will pay on behalf of any Insured, who is not the actual perpetrator, all Loss resulting from any Claim for Fraud/Dishonesty of any Employee(s) of the Company provided that the relevant fraudulent or dishonest conduct occurred before the date of discovery by any principal, partner, director or Member of a Company of reasonable cause of suspicion of Fraud/Dishonesty on the part of the Employee(s), whether or not it is possible at that date to identify the Employee(s) involved in the Fraud/Dishonesty".

In this case I don't think it's disputed an employee of W stole a significant amount of money from it over a sustained period. And while at the point W first notified Allianz of this no claim had been made that did subsequently take place. So at that point there were circumstances which the policy could respond to. And it was the claim made in June 2022 which led to H contacting Allianz and its subsequent decision the policy wouldn't provide cover. I think it's appropriate for me to focus in this decision on whether Allianz acted fairly in saying that.

Allianz has relied on the 'Conduct' exclusion the policy contains to say it wouldn't be providing cover. That says "This policy shall not cover Loss in connection with any Claim...arising out of, based upon or attributable to any actual or alleged dishonest, fraudulent or criminal conduct of an Insured". The relevant definition of 'Claim' is "any written demand for compensation in respect of a Wrongful Act of an Insured". And the definition of Insured includes both W and its directors (when acting in that capacity).

As Allianz is seeking to rely on an exclusion in the policy the onus is on it to show, on balance, it applies. If it's done that the onus would then shift to W demonstrate it doesn't. And I think the key questions here are whether Allianz has shown, on balance, that there has been actual or alleged dishonest, fraudulent or criminal conduct by Mr D. And if that is the case whether the loss W is seeking cover for under the policy (in relation to the claim made against it in June 2022) arises out of, is based on or is attributable to that conduct.

Allianz told us it believed Mr D's use of the client account had contributed to the deficit it contained. He hadn't disclosed to his bank or clients that he was using that account for his personal funds and his record keeping didn't enable him to properly distinguish any personal funds he held in that account. And he hadn't evidenced a claimed deposit of around £274,000 of personal funds into the account. He also said earnings by W (of £1.2 million) had been deposited in that account but that was inconsistent with statements he'd made saying these had been placed in a separate office account. And as these were business funds they shouldn't in any case have been withdrawn by Mr D for his personal use.

There were many inconsistencies in the accounting records including a discrepancy of around £320,000 in the amount showing as owed to a client compared to the amount actually received from them. And after the theft had been discovered Mr D continued to make personal withdrawals from the client account which further depleted the funds available for clients and increased the potential loss for which he was seeking cover under his policy.

I've carefully considered what Allianz and W's representatives have said (both in their submissions to our service and more generally). I don't think there's any evidence to suggest criminal conduct on the part of Mr D and from my reading of Allianz's submissions they aren't alleging that. So the question is whether his usage of the client money account could reasonably be classed as dishonest or fraudulent.

I've thought first about the question of dishonesty. If Allianz has shown that applies there's no need to consider whether the behaviour of Mr D was also fraudulent which I agree is a serious allegation and potentially a criminal offence. The exclusion doesn't capitalise that term so I don't think any definitions the policy contains of it would apply in the context of the exclusion clause. So I've considered what a reasonable approach to this would be.

I think it's appropriate to take into account relevant case law when considering a fair application of that term. I'm aware that the Supreme Court has set out a legal test for dishonesty in the case of 'Ivey v Genting Casinos (UK) Ltd (trading as Crockfords) [2017] UKSC 67'. In summary it established a two-step process; first ascertain the actual knowledge or belief of the individual or defendant as to the facts and then ascertain whether the individual or defendant acted dishonestly according to the objective standards of ordinary decent people.

In this case H says it's significant the police haven't taken action against Mr D. But any action the police took would be based on whether they were satisfied the criminal standard for prosecution had been met. H also says it's unlikely Mr D would knowingly have acted dishonestly. And he thought he was entitled to act as he did in relation to client account withdrawals (because there was a mix of client and personal funds in that account). So he was simply taking out money that he believed represented his own funds.

However, taking into account the case law I've cited, the question isn't whether Mr D believed he was acting dishonestly but if, taking into account his reasons for acting as he did, his actions would be considered dishonest by the standards of ordinary decent people. In considering that I've taken into account that the Solicitors Regulation Authority rules are clear that a firm must "keep client money separate from money belonging to the authorised body". They go on to explain that money must only be withdrawn from a client account "for the purposes for which it is being held, following receipt of instructions from the client or the third party for whom the money is held; or on the SRA's prior written authorisation or in prescribed circumstances".

I appreciate W isn't regulated by the SRA but it does carry out legal work and appears on the SRA register (because I understand it employs a solicitor who carries out some reserved legal activities for it). And I think it's fair to say those rules exist because of the importance of maintaining a clear separation between client and firm money and providing confidence to a client that their funds are adequately protected. I think that's something which would apply regardless of the fact the SRA's rules don't cover W.

Mr D has suggested he operated the client account as he did because it attracted a higher rate of interest which benefited his personal and office funds. But it's not clear to me he couldn't have obtained a similar rate of interest on an alternative account. In any case I think most people would likely consider the inherent risks of mixing funds in this way would outweigh any potential benefit from a higher interest rate.

And I don't think it is clear from the evidence that the only funds Mr D had withdrawn from the client account were ones that he was entitled to. I've reviewed the analysis by Allianz's loss adjusters which I think does pose legitimate questions as to what deposits were made into the client account by Mr D and whether all of the funds he withdrew from it related to monies he was entitled to. And I don't think those issues are fully addressed by the information H has provided on behalf of W.

So I think it was reasonable of Allianz to conclude the records of what had been paid into the client account were unclear and there were discrepancies in respect of the amounts W thought was owed to its clients compared to the sums that had actually been paid in.

And the evidence didn't show Mr D had taken reasonable steps to satisfy himself there was a surplus on the account prior to making withdrawals from it. In doing so there was therefore a material risk he had taken money from the account to which he wasn't entitled. Taking into account the relevant case law and the test it sets I don't think it was unreasonable of Allianz to consider the dishonesty part of the 'Conduct' exclusion was applicable here.

However, it's not enough simply to show dishonesty. In order to turn down the claim on that basis Allianz also needs to show the loss W is seeking cover for under the policy (in relation to the claim made) arises out of, is based on or is attributable to that conduct. Allianz said in its submissions to our service the conduct exclusion doesn't cover "any loss" arising out actual or alleged dishonest conduct of an Insured. But that isn't what the policy says. It excludes "Loss in connection with any Claim...arising out of, based upon or attributable to any actual or alleged dishonest, fraudulent or criminal conduct of an Insured". So for the exclusion to apply the loss relating to the claim that's been made needs to arise out of, be based upon or attributable to the identified dishonest conduct on the part of Mr D.

If the loss associated with the claim made in June 2022 was clearly associated with a loss to the client account as a result of Mr D withdrawing money from it then Allianz might be able to fairly apply that term. But while, as I've said, it's not clear whether all of the amounts Mr D withdrew from the client account were ones he was entitled to it's also not disputed that there was theft of significant funds from that account by W's employee.

If it was unclear what the amount of that loss was meaning it was simply impossible to distinguish between the contribution that had made to the deficit on the client account and that which might result from Mr D's actions I think the exclusion could also apply. However, that isn't the case here. The loss adjuster has verified that fraudulent transactions on the part of W's employee from the client account amount to around £959,000. So there is a clear loss to that account which would exist regardless of Mr D's conduct in relation to it

It may be Allianz could fairly decline sums in excess of the evidenced fraudulent transactions by W's employee. In addition it might be able to decline cover for any claims relating to losses arising after the date of discovery of the theft because those amounts wouldn't then be linked to the actions of W's employee. But I don't think Allianz can fairly decline cover for the claim made in June 2022 which does relate to the period during which the fraudulent conduct by W's employee was taking place, where the value of the claim is less than the loss caused by that conduct and where there's no clear evidence to show that loss arises out of, is based upon or attributable to the dishonest conduct I've concluded Mr D was responsible for.

Putting things right

Allianz isn't entitled to apply the conduct exclusion to the claim made in June 2022 and will need to reconsider that against the remaining terms and conditions of the policy. If that claim meets the terms of the policy Allianz will need to settle the claim in line with those terms.

I appreciate that the definition of Loss in the policy also includes Defence Costs which are defined as "reasonable fees, costs and expenses incurred by or on behalf of an Insured, with the prior written consent of the Insurer". But I don't think Allianz can fairly decline to pay any Defence Costs in this case because it didn't consent to those. The reason that consent wasn't obtained was because of its incorrect decision to turn down this claim. So if the claim is one that meets the policy terms Allianz will need to reimburse Defence Costs W incurred which otherwise meet the above definition.

From the information I've seen there may also be a dispute over the value of the estate that forms the subject of this claim. However, if that is the case the issue is to what extent Allianz would be liable for losses associated with it. So that's something which can be taken into account as part of the reconsideration of the claim.

Where I uphold a complaint, I can award fair compensation to be paid by a financial business up to the limit that was in place at the point the act or omission giving rise to the complaint took place. I think that date in this case would be August 2023 because that's when Allianz confirmed its decision to decline the claim following a review of the further information that had been provided to it. So the limit I can direct Allianz to pay up to is £415,000. If (as seems possible) the amount of fair compensation exceeds that limit I recommend Allianz pays the balance.

I appreciate there may be other claims made on the policy relating to the theft by W's employee. However, in this decision I'm only dealing with the claim made to Allianz in June 2022. Any other claims will need to be considered on their own merits against the full policy terms. If W is unhappy with the outcomes Allianz reaches on those that's something which could potentially be considered as part of a separate complaint.

Responses to my provisional decision

H didn't have any further comments. Allianz did make further submissions. In summary:

- It accepted for the conduct exclusion to apply there must be a causative link between the identified dishonesty and the claim made on the policy. But it didn't think that dishonesty needed to be the sole cause of the claim. If the dishonesty was a material contributing factor that would be sufficient to trigger the exclusion. It then said it agreed with our investigator that if Mr D had contributed in any way to a claim being made due to actual or alleged dishonest, fraudulent or criminal conduct it was entitled to decline the claim.
- It didn't agree that, but for the theft by W's employee, there would have been sufficient funds in the client account to repay all relevant clients on demand the amounts they were due. Mr D hadn't shown he'd paid sufficient funds into the client account to cover the withdrawals that were made for his own personal benefit. It drew attention to the findings of its loss adjuster who established there would have been (prima facie) a shortfall on the account regardless of the theft by W's employee. And it said Mr D's behaviour in continuing to make withdrawals from the client account after the theft had been discovered must have increased the potential loss and contributed to the claims against W that were subsequently made.
- So it thought Mr D's actions had at least contributed to the losses clients were now seeking to recover from W in the claims that had been made. And it had done enough to show the exclusion applied. W therefore needed to show it didn't which it hadn't done. It would be impossible of Allianz to do so without a full examination of W's financial records which it didn't have access to and which Mr D had accepted were incomplete anyway.
- It also questioned whether the claim was one that was appropriate for us to consider given it raised serious issues of dishonesty and the amounts at stake were substantial. It said there was a significant conflict of evidence regarding the adequacy of the funds held in the client account by W. This should be resolved through the courts where cross-examination of witnesses could take place if necessary.

So I need to reach a final decision.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

First, I don't agree Allianz can rely on the 'Conduct' exclusion where the actual or alleged dishonest conduct has contributed in any way to a claim being made. That's because that isn't what the term says. It excludes "*Loss in connection with any Claim...arising out of, based upon or attributable to any actual or alleged dishonest, fraudulent or criminal conduct of an insured*". It doesn't say (as it could have done) that it applies where the dishonest conduct in any way contributes to the loss connected to the claim.

However, if the dishonesty was a material contributing factor to the 'Loss' (as defined in the policy) it might well have arisen out of, be based upon or be attributable to that conduct. And I acknowledged in my provisional decision that it wasn't clear from the evidence that the only funds Mr D had withdrawn from the client account were ones he was entitled to. Allianz may also be correct in saying there would have been a shortfall on the account regardless of the theft by W's employee (and that could have been exacerbated by Mr D continuing to make withdrawals from the account after the loss was discovered).

But I don't think that means Allianz is entitled to apply the 'Conduct' exclusion in this case. I accept Mr D's actions may have contributed to an overall loss to the client account. But the exclusion doesn't apply to that. It applies to '*Loss in connection with any Claim*'. And as I explained in my provisional decision it's the loss associated with the claim made against W in June 2022 that is the subject of this complaint. So for the conduct exclusion to apply Allianz would need to show the dishonesty by Mr D had been a material contributing factor to the loss in that case.

If that clearly arose out of, was based upon, or attributable to a loss to the client account resulting from Mr D withdrawing money from it Allianz might be able to fairly apply the exclusion. But (as I said in my provisional decision) that isn't the case here. Regardless of whether the withdrawals Mr D made from the client account were ones he was entitled to it's not disputed there was a theft of funds from that account which the loss adjusters have quantified at around £959,000. And the value of the claim made against W in June 2022 was less than the loss to the client account which resulted from that theft. So if the theft had still taken place but there had been no dishonest conduct by Mr D that loss would still have existed in its entirety and the claim would still have been made.

I made clear in my provisional decision that Allianz might well be able to decline other claims if the total losses claimed exceeded the amount stolen. And it might also be able to decline cover for any claims relating to losses arising after the date of discovery of the theft because those amounts wouldn't then be linked to the actions of W's employee. But it remains my view that Allianz can't fairly decline cover for the claim made in June 2022 which does relate to the period during which the fraudulent conduct by W's employee was taking place, where the value of that particular claim is less than the loss caused by that conduct and where there's no clear evidence to show that specific loss arises out of, is based upon or attributable to the dishonest conduct I've concluded Mr D was responsible for.

Finally, Allianz has suggested this is a complaint that would be more suitable for the courts to determine. If a complaint could only be resolved using powers available to a court (such as giving evidence under oath or the ability to cross examine witnesses) we might decline to consider it on that basis. But that's not the case here. The core issue in this case is whether Allianz has correctly and fairly declined this claim on the basis of the 'Conduct' exclusion. In my view that's something which I'm able to determine. And for the reasons I've explained in this decision I don't think Allianz is able to rely on that exclusion in relation to this claim.

Putting things right

Allianz isn't entitled to apply the conduct exclusion to the claim made in June 2022 and will need to reconsider that against the remaining terms and conditions of the policy. If that claim meets the terms of the policy Allianz will need to settle the claim in line with those terms.

I appreciate the definition of 'Loss' in the policy also includes 'Defence Costs' which are defined as "*reasonable fees, costs and expenses incurred by or on behalf of an Insured, with the prior written consent of the Insurer*". But I don't think Allianz can fairly decline to pay any Defence Costs in this case because it didn't consent to those. The reason that consent wasn't obtained was because of its incorrect decision to turn down this claim. So if the claim is one that meets the policy terms Allianz will need to reimburse 'Defence Costs' W incurred which otherwise meet the above definition.

From the information I've seen there may also be a dispute over the value of the estate that forms the subject of this claim. However, if that's the case the issue is to what extent Allianz would be liable for losses associated with it. So that's something which can be taken into account as part of the reconsideration of the claim.

Where I uphold a complaint, I can award fair compensation to be paid by a financial business up to the limit that was in place at the point the act or omission giving rise to the complaint took place. I think that date in this case would be August 2023 because that's when Allianz confirmed its decision to decline the claim following a review of the further information that had been provided to it. So the limit I can direct Allianz to pay up to is £415,000. If (as seems possible) the amount of fair compensation exceeds that limit I recommend Allianz pays the balance. This recommendation is not part of my determination. Allianz doesn't have to do what I recommend. It's unlikely that W can accept my decision and go to court to ask for the balance. So W may want to get independent legal advice before deciding whether to accept this decision.

I appreciate there may be other claims made on the policy relating to the theft by W's employee. However, in this decision I'm only dealing with the claim made to Allianz in June 2022. Any other claims will need to be considered on their own merits against the full policy terms. If W is unhappy with the outcomes Allianz reaches on those, that's something which could potentially be considered as part of a separate complaint.

My final decision

I've decided to uphold this complaint. Allianz Insurance Plc will need to put things right by doing what I've directed in this decision.

Under the rules of the Financial Ombudsman Service, I'm required to ask W to accept or reject my decision before 21 March 2025.

James Park
Ombudsman