DRN-4323804

The complaint

A limited company, which I will refer to as S, has complained about the settlement provided in relation to a business interruption claim under its business insurance policy with certain underwriters at Society of Lloyd's.

Mr S, as a director S, has brought the complaint on its behalf. Mr S is also represented in this complaint but for ease, I'll refer to Mr S or S throughout.

What happened

S is a travel agent. It made a claim under the policy in 2020, after it was impacted by the Government's response to the Covid-19 pandemic.

The underwriters agreed to cover three periods of lockdown and travel restrictions (24 March to 4 July 2020, 5 November to 2 December 2020 and 20 December 2020 to 23 March 2021) which it calculated was a total of 223 days. The underwriters said the total loss of revenue over this period, having compared figures for previous years, was around £2.7million. It deducted costs of sales savings and other savings for wages and general operating costs. Having deducted these, it determined the total net loss of income was just over £340,000.

However, the underwriters also said that S was underinsured, as the revenue sum insured under the policy was significantly less than the true amount. Because of this, they applied the average clause in the policy which says that if the business interruption sum insured is less than the actual revenue in the 12 months prior to the loss, then the claim will be proportionately reduced.

The underwriters calculated that S should have been insured for £3.6million but only taken cover for £500,000, 13.91% of the appropriate figure. The underwriters made a proportionate deduction to reflect that underinsurance and paid around £55,000 in settlement of the claim.

S made a complaint against the underwriters that it had based the settlement on loss of gross revenue, when S says it should have been based on loss of gross profit. S said that, as a travel agent, it would only retain the commission element of any payments and around 80% of its revenue/turnover would be passed on to the tour operator. So loss of revenue cover was inappropriate for its business, as its income is only around 20% of its turnover and it would never be able to claim for anything near the suggested sum insured on a gross revenue basis. It accepts there'd still be some underinsurance even using gross profit as the basis of cover, but the underinsurance would have been a significantly lower percentage and therefore the settlement would still be considerably more (it says around £340,000).

I issued a final decision on that complaint in January 2023. I determined that the policy covers loss of income as a result of business interruption. The policy defines income as money received by S for services provided, which would be the same as revenue received. And the schedule was clear that the sum insured was revenue up to £500,000. I did not think that any misunderstanding about the basis of the sum insured was as a result of anything the underwriters did wrong. I also concluded that it would be for the brokers to ensure the appropriateness of the cover provided and whether it was suitable for S's needs.

My final decision on that complaint was therefore that it was fair for the underwriters to apply the average clause based on revenue in the way it did.

S has now raised a complaint that the average clause should not have been applied at all, as the underwriters would have been aware that the sum insured was less than its turnover, as turnover was increasing and was disclosed at the start of the policy. So S says the underwriters should not have provided this policy with this level of cover.

The underwriters say the broker asked for standard business interruption cover and the £500,000 sum insured is the standard cover offered. The underwriters issued a quotation based on this request which was accepted by the broker. The broker did not raise any issues with the insurance schedule they sent out – which set out the level of cover provided - or about the premium being lower than expected.

The underwriters say on occasion they might review an application further and increase it to a maximum of £1million cover, if they are made aware the standard cover is not sufficient to meet the applicant's needs. However, this would be for the broker to assess; and it was not for them to assess the suitability of the policy, even if they'd known that S's turnover was increasing. They also send out guidance about how to calculate the business interruption sum insured; and turnover would not automatically dictate the level of loss of revenue cover required.

The underwriters also said that if it had applied the Insurance Act 2015, they would have been entitled to void the policy, as it would not have provided a policy for the level of cover S says it should have had.

One of our Investigator's looked into the matter. He did not recommend that it be upheld, as he did not think the underwriters had acted unreasonably in providing the policy they did. The Investigator also said that policyholders sometimes decide to choose lower cover and effectively self-insure part of the risk.

S does not accept the Investigator's assessment. It has made a number of arguments in response to the Investigator and in support of its initial complaint. I have considered everything it has said and have summarised the main points below:

- The underwriters were provided with details of the risk to insure including S's turnover and the quotation provided was for standard cover that was inadequate.
- The underwriters proposed the policy themselves and "*the average small business owner may well believe that the insurer was recommending this policy for the business*".
- Given that the underwriters proposed the policy in full knowledge of the facts means it is unfair to apply the average clause and it should be set aside.
- If the underwriters had known of other issues at the outset they would have refused cover; it is wrong for them to only do so in the event of a claim when it comes to underinsurance. This means S had no opportunity to get appropriate cover elsewhere.
- S suggests the underwriters therefore profited from the premiums unfairly.
- Any decision to self-insure should only be by prior agreement and with full knowledge. S says it would only be suitable for specific policyholders with specific advice from brokers.
- There is no mention of self-insurance in the policy documentation or any correspondence, so this case is about underinsurance only. And the underwriters are dealing with it as underinsurance, so self-insurance should not play any part in how

the case is decided.

- The underwriters would not be entitled to void the policy because they were well aware of the underinsurance and yet proposed a policy with standard cover that was inadequate.
- The underwriters should never have accepted this policy and never have benefited from the premium. It seems that underwriters are deliberately turning a blind eye and if averaging is applied in this case, then the insurer is being allowed to financially benefit from underinsurance without paying the price when they get caught out.

As the Investigator has not been able to resolve the complaint, it has been passed to me.

In the meantime, S has said it also considers the claim needs to be reassessed as it was calculated incorrectly. S says that the indemnity period should have started from 5 March 2020, as that is when Covid-19 became a notifiable disease. S did raise this previously and I said in my previous decision that: "*S is also unhappy that the underwriters only paid for the time it was forced to close (i.e. 233 days) and not for the entire period that its business was affected by Covid-19, which was far longer than this up to 12 months cover. The policy covers disruption to the business and doesn't require it to have been closed. As far as I am aware, this has not been considered by the underwriters or Society of Lloyd's yet, so I can't address this in this decision. The Investigator can assist in progressing this aspect of complaint if necessary."* I do not think this point has yet been raised with the underwriters by S, and certainly not as part of this complaint, so again I cannot address it in this 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.

Level of cover and sale of policy

There are specific rules which apply to the sale of insurance products. These rules are set out, in part, in the Insurance: Conduct of Business sourcebook ("ICOBS"), part of the Financial Conduct Authority Handbook. The rules include that those selling insurance have a responsibility to provide clear information about the cover being provided, in order to put the customer in a position where they can make an informed choice about the insurance they are buying. This includes providing clear information about the main cover and any significant terms. If the seller is also making a recommendation or advising a customer to take a particular policy, then they also have to take steps to try and ensure the suitability of their advice.

The underwriters did not sell this policy to S and they did not provide any advice to S about its insurance needs or the suitability of the policy. The policy was sold by an independent broker. I do not therefore consider that the underwriters had any obligation to ensure the suitability of the policy or provide any advice about the level of cover.

However, S says that the underwriters proposed the policy themselves, rather than simply providing a policy applied for by the broker on its behalf. And that the underwriters should have known the policy would not be suitable, given the turnover figures provided to them in the proposal form. S also says that as the underwriters knew that they could not provide a policy with the required level of cover, it should have informed S of this, so it could have got adequate cover elsewhere.

I have therefore considered the way the policy was provided to S and the information provided.

S's broker completed a "*market presentation*" form, which is essentially a proposal form. It set out S's turnover in recent years and other details of the business and cover required.

The third page of the form, headed "*Client details and General Information*" gives S's name, address and trading details and also says:

> *"Business interruption -*
> *standard GBP500K SI*
> *adequate: yes"*

The broker had therefore stated on the proposal form that the standard cover provided by the underwriters of a sum insured of £500,000 was adequate. I can see that later in the form, the broker has provided details of "*business activity*" which included S's turnover in the previous year and expected turnover in the forthcoming year and this is shown as £6 million approximately. However, I do not think that this in itself is enough to mean that the underwriters had a duty to provide any advice about the suitability of the policy. I do not agree that the fact the turnover figures were also on the proposal form imposed any additional duties on the underwriters to ensure suitability of the level of cover which the broker had said was adequate in that form.

The underwriters provided a quotation for cover with the sum insured for business interruption stated as being adequate on the proposal form. It was then up to S, with the assistance of the broker, to assess if the policy offered by the underwriters was suitable for it and if not to go elsewhere or enquire about higher level of cover.

The underwriters did have an obligation under ICOBS to produce appropriate information about the policy in good time and in a comprehensible form so that the broker could comply with the rules that applied to them, and so that S could make an informed decision about the arrangement proposed.

The Financial Conduct Authority Handbook also sets out the Principles which apply to regulated businesses, including underwriters. Among other things, the Principles require a business to: conduct its business with integrity; pay due regard to the interests of its customers and treat them fairly; and communicate information to customers in a way which is clear, fair and not misleading.

I have therefore considered the documentation produced by the underwriters.

The underwriters provided a quotation to the brokers, which said on the first page:

> "*<u>Business Interruption</u>*
> *Loss of revenue* *£500,000*
> *Loss of gross profit* *NOT INSURED*
> *12 months indemnity period*
> *Additional Increased Cost of Working* *NOT INSURED"*

After the quotation was accepted, the underwriters produced the policy schedule for year September 2019- September 2020, which said there is cover for business interruption as follows:

> *"Loss of revenue £500,000*
> *Additional Increased cost of working £ not insured*
> *Indemnity period 12 months."*

The policy also says it will cover business interruption losses:

> *"in accordance with the Basis of Settlement detailed below and stated as an item against the sub section in the schedule being either loss of income or increased cost of working…*
>
> *LIMIT OF LIABILITY*
>
> *The Insurers' liability under this Sub Section in respect of any item for Loss of Income will not exceed the sum insured stated …in the Schedule but if such sum insured is less than the Annual Income* [in the 12 months immediately before the date of the event leading to the claim] *… the amount payable will be proportionately reduced".*

The policy defines income as:

> "*money paid or payable to the Insured for services provided in the course of the Business at the premises".*

In my opinion the above documentation was sufficiently clear about the basis of cover being quoted for and the level of business interruption cover that was being provided by the policy.

Having considered everything available to me, I do not therefore think that the underwriters did anything wrong in offering the policy and level of cover it did. And I do not think they needed to refuse to offer any cover at all based on the fact of the turnover figures being in the proposal submitted by the broker. So even if they were aware of the higher turnover figure than the sum insured, I do not think they were at fault for the correct level of cover not being taken.

Average clause

Having determined that the underwriters were entitled to provide the policy and the level of cover it did, I need to consider whether they were entitled to reduce the settlement paid based on the underinsurance. In doing so will take account of the relevant law as well as what is fair and reasonable in all the circumstances.

S's policy is a commercial one so the law that applies here is the Insurance Act 2015 ("the Act"). When considering a complaint where underinsurance is alleged, before considering the policy terms, I must first consider the Act. The Act sets out the duty of the commercial customer to make a fair presentation of the risk to the insurer. In order to fulfil this duty, the Act says a commercial customer must disclose everything they know, or ought to know, that would influence the judgment of an insurer in deciding whether to insure the risk and on what terms. If it is found that they didn't fulfil this duty then the insurer might have remedies available to it under the Act. The remedies it might have depend on the difference the qualifying breach of the duty to make far representation had.

I've first considered whether S made a fair presentation of the risk at renewal in September 2019 (as this is the policy which was in force at the time of the claim). S provided its turnover figures to the broker and the broker provided those to the underwriters in the proposal form. However, as set out above it said that the sum insured of £500,000 was adequate, which was not correct. There was not therefore, in my opinion, a fair representation of the risk when S applied for the policy.

S has confirmed that it did not intend to self-insure any part of the business interruption risk. It says this possibility shouldn't be a part of my decision making about the complaint and I agree. It seems to me the reference to self-insurance by the Investigator was in relation to this being a possible reason why some customers don't insure for the full amount of any risk

but that it would still amount to underinsurance. I do not think he was suggesting S had intended to self-insure.

As there was an underinsurance the underwriters were, in my opinion, entitled to take that into account when settling the claim. The underwriters have confirmed that this cover would not have been available at all if they had known of the true sum insured required. Given this, the remedy under the Act would mean that the underwriters could have avoided all cover.

However, instead they decided to apply the average clause set out in the business interruption section of cover. I have already set this clause out above but for ease of reference, I set it out below again. It states:

> *"LIMIT OF LIABILITY*
> *The Insurers' liability under this Sub Section in respect of any item for Loss of Income will not exceed the sum insured stated …in the Schedule but if such sum insured is less than the Annual Income* [in the 12 months immediately before the date of the event leading to the claim] *… the amount payable will be proportionately reduced."*

I do not think the average clause relied on is inherently unfair. Similar clauses are common to most commercial policies of this type of which I'm aware and the Act does not prohibit such terms, if they do not put the customer in a worse position than if the remedies under the Act were applied. I do not think that anything in the proposal form or that the underwriters knew about S's turnover means it should be required to disregard the underinsurance and this policy term.

Having considered everything, I think the underwriters acted fairly and reasonably and in line with the policy terms when it applied the average clause to the claim settlement. I do not therefore agree that it needs to make any further payment in response to this complaint.

My final decision

I do not uphold this complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask S to accept or reject my decision before 20 October 2023.

Harriet McCarthy
Ombudsman