

The complaint

T, a limited company, is unhappy with the amount Zurich Insurance PLC paid following a claim it made on its business protection insurance policy.

What happened

Following a fire at its premises in July 2019, T made a claim on its business protection insurance policy. Zurich said T was under insured and so it would reduce the amount payable in line with the 'average' condition which the policy contained.

T disputed Zurich was able to do that. It said guidance produced by Zurich said where an insured hadn't made a fair presentation of risk (and that wasn't deliberate or reckless) it wouldn't reduce the value of the claim but would charge the additional premium that would have applied if it had known all the material facts. And the policy summary contained the same information. It thought any inconsistency with the policy document should be read in favour of the customer.

Our investigator thought the policy terms were clear in relation to the 'average' clause and that formed the contract between the parties. And while Zurich's guidance set out its general approach it also explained that where a policy contained an 'average' clause that's what

would apply. So he thought Zurich had acted reasonably in applying 'average' in this case. T didn't agree. It said its director was a layperson who wasn't experienced in insurance and wouldn't have had the understanding of these matters that Zurich did. It shouldn't require a lawyer to interpret what a policy meant and T made the decision to take out the policy based on the information it was provided with at that time and relied on the policy summary. It wasn't provided with the policy wording until after the sale had completed.

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

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

I've looked first at T's policy which does contain clauses that allows Zurich to settle a claim on a proportionate basis where underinsurance has taken place. Under the business protection section it says:

"If at the time of the damage the sum insured for Item 1 – Loss of income and extra expenses is less than the income which would have been received during the maximum term allowed by the indemnity period but for the damage, the amount we pay will be reduced in proportion to the amount of the under insurance."

However, as this dispute has arisen due to the information that was provided when the policy was first taken out and at subsequent renewals, I think it's fair to first consider the relevant law. And as T's policy is a commercial one the law that applies here is the Insurance Act 2015 which sets out remedies open to a business when it's found a policyholder didn't provide the information they ought to have done when the policy was taken out.

Under the Act a commercial customer has a duty to make a fair presentation of the risk to the insurer. In order to fulfil a fair presentation of risk, the Act says a commercial policyholder 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 they didn't fulfil this duty then in order to say there has been a qualifying breach, the insurer needs to show that it would have either not offered the policy at all, or offered it on different terms.

In this case T hasn't questioned Zurich's conclusion that it was under-insured or raised any issues in relation to that either in its complaint to it or subsequently with us. And I can see that when taking out the policy it declared an annual income of around £614,450. Under the policy terms the insured amount was the greater of twice that amount or £1.5 million. But the claim it made for the subsequent two years period amounted to around £2 million (Zurich's calculation of the figure was around £1.83 million).

The renewal documentation T was sent said "Please check the details in the enclosed documents are correct and the cover meets your needs. Remember it is important your sums insured are adequate or you may find in the event of a claim you may not receive full settlement." I think if T thought its income was going to increase as significantly as the claim it subsequently made indicated, it should have told Zurich so the insured amount under the policy could be amended, and a premium charged to reflect that. As it didn't do that, I don't think it made a fair presentation of risk to Zurich.

Zurich has said it would have charged a higher premium to reflect that increased risk of around £3,890 (compared to the amount T did pay which was around £2,000). And it's provided underwriting evidence in support of that. I'm therefore satisfied that, under the terms of the Insurance Act, there has been a qualifying breach. And where an insurer has shown it would have charged a higher premium if the correct information had been provided, it allows the insurer to settle the claim based on the proportion of premiums that were paid, compared to those that should have been.

In this case Zurich has applied the 'average' clause in the policy which takes into account the proportion of the sum insured rather than the proportion of premium paid. Where a term in the policy puts a policyholder in a worse position than they would have been under the Act, I would usually go on to consider whether the insurer made that sufficiently clear at the time it sold the policy.

However, I don't think T has been put in a worse position by Zurich applying the 'average' clause. T paid 51 % of the premium it should have done for cover under the policy. But applying 'average' means it's received a settlement of around £366,600 against what Zurich says was a loss of around £447,600. So it's been paid around 82% of the value of its claim. As that's resulted in a better outcome for T, I don't think Zurich acted unfairly in applying 'average' in this particular case.

T argues Zurich should apply a different approach entirely from either the policy or the Insurance Act. It says it should request an additional premium from it and then pay the claim in full. In support of this it's relied on the wording of the policy summary and a guide Zurich produced for customers and brokers on the Insurance Act.

I appreciate the guide Zurich produced does say where there hasn't been a fair presentation of risk "rather than reducing a claim proportionally we have decided instead to charge the additional premium that we would have charged if we had known the relevant material facts and pay any claim(s) in full". However, I think it's reasonable to say the guide should be read as a whole and it goes on to explain "where our policies contain average or underinsurance clauses, these will apply independently of our remedies for breach of the duty of fair

presentation of risk.”

In any case while I understand this guide was available on Zurich’s website I haven’t seen anything to show it was provided to T when taking out or renewing this policy. The information on the broker’s website includes the policy summary and policy wording but doesn’t include this guide. So I don’t see it can have played a part in its decision to do so.

I appreciate the policy summary which was provided as part of this process says “The policy embraces the principles of the Insurance Act 2015 law reforms. It also incorporates a modification which has the aim to promote good customer outcomes, whereby in cases of non-deliberate or non-reckless non-disclosure or misrepresentation we will request any additional premium which may be required and pay subsequent claims in full rather than proportionately reducing subsequent claims payments”.

I agree that doesn’t set out the full position as contained in the policy which says that won’t apply in relation to average clauses and under insurance. And I understand why T thinks that should have been made clear. Its representatives have also referenced the Supreme Court judgement in FCA vs Arch Insurance which said the person to whom a policy document should be taken to be addressed is “not a pedantic lawyer who will subject the entire policy wording to a minute textual analysis”.

But that judgement also said for a policy of the type in question (sold principally to SME’s) a policyholder on entering into a contract “is taken to have read through the policy conscientiously in order to understand what cover they were getting.” So the expectation of the courts is that a policyholder will have read the policy. It’s that wording which forms the basis of the contract between Zurich and T. And I can see that wording was available on the broker’s website.

In any event, even if the policy summary had been clearer, I’ve not seen evidence which persuades me that would have led T to do anything different. In particular it hasn’t shown this was an important factor in its decision to take out this policy. Or that if given clearer information it would have sourced (and been able to obtain) a policy that operated in the way it wanted in relation to the payment of additional premium. So I don’t think that even if Zurich had made the position clearer T would have the cover it wanted in place for the claim it subsequently made. As a result I don’t think there are grounds on which I could fairly ask Zurich to pay the claim on that basis.

Responses to my provisional decision

Zurich didn’t respond to my provisional decision. T did respond. In summary it said:

- Zurich hadn’t asked about the projected income for the business and T’s declared annual income was as accurate as possible at the time it was made and in line with the amount recorded in its accounts. And that was within the limits set out in the policy.
- Following the fire T (and associated claim) Zurich offered a renewal quote for around £3,538 with a significantly increased business interruption limit. So T questioned whether the figure Zurich had quoted for what it would have charged at the earlier renewal was correct given that was for a lower sum insured and without any claim having been made.

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.

I appreciate the information T provided to Zurich was in relation to its declared annual income and may have reflected the correct position at that time. I'm not aware Zurich did specifically ask about projected income. But as this was a commercial policy the duty on T wasn't just to answer the question asked but to make a fair presentation of risk. And, as I said in my provisional decision, that means a commercial policyholder 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.

I continue to feel that if T thought its income was going to increase as significantly as the claim it subsequently made indicated, it should have told Zurich so the insured amount under the policy could be amended, and a premium charged to reflect that. I think that's supported by the renewal documentation T was sent which said *"remember it is important your sums insured are adequate or you may find in the event of a claim you may not receive full settlement."*

T has questioned Zurich's position on what it would have done if given the correct information. And it's provided renewal documentation which does show increased cover for business interruption and was after it had claimed on its policy. The premium on that quote is for around £3,538.

But Zurich previously provided underwriting information which showed the amount it would have charged if a fair presentation had been made (around £3,890). I agree that's higher than the renewal quote offered to T but that quote was based on a declared annual income of around £622,000. So it was without an assessment of the actual risk to Zurich of the projected increase in that amount. I think that's likely to explain the discrepancy here.

I remain satisfied that Zurich would have charged more if a fair presentation had been made. And for the reasons I explained in my provisional decision I don't think Zurich acted unfairly in applying average in this case given that put T in a better position than it would have been if the remedy set out in the Insurance Act had been used.

My final decision

For the reasons set out above and in my provisional decision I've decided not to uphold this complaint. Under the rules of the Financial Ombudsman Service, I'm required to ask T to accept or reject my decision before 18 September 2023.

James Park
Ombudsman