DRN-3651835

The complaint

Mr J is unhappy that Royal & Sun Alliance Insurance Limited ("RSA") intends to reduce the amount it will pay for a claim he made on his landlord insurance policy.

What happened

The circumstances of this complaint aren't in dispute, so I'll summarise the key points:

- Mr J is a landlord who owns a number of properties and insured them with RSA.
- The policy renewed in April 2021. Shortly after, there was a fire at one of the properties. Mr J got in touch with RSA, who appointed loss adjusters to look into the claim. Some initial queries arose, and all were resolved apart from one.
- RSA said the damaged property was underinsured. It valued the cost of rebuilding it at £173,863 but Mr J had insured it for £116,818. That meant it was insured for around 67% of the value RSA thought it should have been.
- RSA accepted the claim was covered by the policy. But because RSA thought the property was underinsured, it said the claim would be settled proportionately. I understand that meant it intended to pay Mr J 67% of the claim value.
- Accepting there had been avoidable delays and communication problems during the claim, RSA offered Mr J £150 compensation.
- Mr J didn't think this was fair, for a number of reasons. He questioned how RSA had calculated the higher figure and whether it had been based on local rates.
- Our investigator thought it was fair for RSA to settle the claim proportionately. And as RSA's was the only valuation completed by an expert, she was persuaded it was reasonable to rely on it to determine the rebuild cost and degree of underinsurance.
- Mr J disagreed. Much of his focus was on RSA's calculation of the rebuild cost. He also provided information to suggest the proportionate settlement should be calculated differently.
- An agreement couldn't be reached, so the complaint has been passed to me.

I recently issued a provisional decision in which I said:

> I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.
>
> When considering what's fair and reasonable in the circumstances I've taken into account relevant law and regulations, regulators' rules, guidance and standards,

codes of practice and, where appropriate, what I consider to have been good industry practice at the time.

Whilst I've read and taken into account everything said by both parties, I'll only comment on the points I think are relevant when reaching a fair outcome to this dispute. That's a reflection of the informal nature of this Service.

To recap, RSA has accepted the claim for fire damage is covered. This complaint has arisen because it intends to reduce the value of the claim settlement to 67%. RSA is relying on a policy term to do this. The wording and meaning of the term aren't in dispute, so I don't see a need to repeat it all here.

In brief, if the cost of reinstating the property is significantly greater than the sum insured, the claim will be settled proportionately, based on the sum insured compared to the cost of reinstatement. This has been referred to by RSA as the 'average clause'.

Most of the dispute has been about establishing the rebuild cost. And more recently, the method of calculating the proportionate settlement. In both cases to question RSA's proposed settlement proportion of 67%. However, I don't think that's the key point when deciding what a reasonable resolution to this complaint is. I'll explain why.

RSA has proposed to reduce the claim settlement because it doesn't think Mr J insured the damaged property for its full rebuild cost. Whilst I recognise RSA is seeking to rely on the average clause to reduce the settlement, it's doing so because it doesn't think Mr J provided the right information at the 2021 renewal.

Mr J's is a commercial policy. So the relevant law relating to the information he had to give RSA at the renewal – is the Insurance Act 2015. Amongst other things, it requires Mr J to 'make a fair presentation of the risk' to RSA. Relevant to this complaint, that meant providing a reasonable estimate of the cost of rebuilding the property.

Insurance Act 2015

The Act sets out the remedies available to RSA if Mr J breached that duty. For deliberate or reckless breaches, the Act entitles RSA to void the policy and decline all claims. It's accepted the claim, so it doesn't think Mr J's made a deliberate or reckless breach. For all other breaches, the remedy available to RSA depends on what it would have done had a fair presentation been made.

Relevant here is that if RSA would have offered the policy for a higher premium, it may reduce the claim proportionately – based on the amount of premium paid compared to the higher premium it would have charged.

RSA seemed to consider this point in July 2021. In reference to the damaged property possibly being underinsured, it said "*the premium would remain unchanged as a result of this one property in question*".

More recently it said it would have charged a higher premium, but it hasn't said by how much or provided any underwriting evidence to support that. So based on the evidence available to me, I'm not satisfied RSA would have charged a higher premium if Mr J had insured the damaged property for a greater amount.

As RSA wouldn't have charged a higher premium, *even if* Mr J didn't make a fair presentation of risk, it has no remedy under the Act. That means RSA is unable to reduce the claim settlement.

RSA has argued that the Act doesn't prevent an insurer from relying on an average clause.

The Act includes a 'contracting out' section. In summary it says that a term of a policy that would put the commercial customer in a worse position in relation to sections 2, 3, or 4 would have no effect unless certain 'transparency requirements' are met. The sections mentioned include the duty of fair presentation.

I'm satisfied the average clause puts Mr J in a worse position than the Act. As noted above, under the Act RSA is unable to reduce the claim settlement, but under the average clause it intends to reduce the claim to 67%.

In my view, unless RSA met the transparency requirements, the Act makes clear that the average clause is of no effect in this situation. RSA hasn't sought to argue that it met the transparency requirements or otherwise 'contract out' of the Act. Accordingly, I'm satisfied the average clause is of no effect and therefore can't be applied in this case.

I note in its final response to Mr J's complaint, RSA said "*in view of … the fact that the presentation of risk was not correct, the proportionate settlement clause will stand*". That's consistent with the language of the Act and shows RSA thought Mr J breached his duty under the Act.

Other policy terms

If I were to accept what RSA has said about the Act – that it doesn't prevent RSA from applying the average clause – I would also need to consider the other policy terms.

RSA has pointed out that the policy contains a 'fair presentation of risk' clause. In summary, this sets out the steps RSA can take if Mr J failed to make a fair presentation of the risk at renewal. It doesn't reference the Act but uses the same language of it and the steps are all in line with it. This clause says it operates in addition to any other terms of the policy relating to underinsurance.

RSA maintains it is only seeking to rely on the average clause. And it says its entitled to because the average clause is the primary underinsurance term – with the fair presentation of risk term acting in addition to it, not instead of it.

RSA's policy also contains a section entitled "*How we will deal with claims to comply with … The Insurance Act 2015*". Within this section it sets out a number of steps it may take if claims are made and the policyholder hasn't provided accurate information. These steps are in line with the Act and the 'fair presentation of risk' policy term. Including a point which says:

"*where a higher premium would have been charged we will reduce the amount of the claim settlement proportionate to the premium we would have actually charged had the circumstances been disclosed*"

It doesn't mention how it may interact with other policy terms.

In summary, that means RSA's policy contains three separate terms that deal with a situation where Mr J may have breached his duty to make a fair presentation in relation to the sum insured:

1. The average clause, which puts Mr J in a worse position than the Act
2. A term which mentions and follows the Act
3. Another term which follows but doesn't mention the Act – and operates in addition to the average clause

I'm not satisfied this provides for a clear and consistent set of policy terms. RSA has chosen to rely on the first term. It says it's the primary term for dealing with underinsurance.

Even if that were the case, it's difficult to understand and reconcile how the third term can operate 'in addition to' the first, provide a different outcome to the first, yet have no impact according to RSA. And the second term appears to standalone – without reference to other terms – yet also have no impact according to RSA.

One of the terms explicitly references and relies on the Act – and another is consistent with it, mirroring its language. So RSA's policy relies on the Act in places. Despite that, its chosen to rely on a term which puts Mr J in a worse position that the Act.

In these circumstances, I'm not persuaded it would be fair and reasonable for RSA to disregard the Act, the two policy terms consistent with the Act – and rely on a separate term to reduce Mr J's claim settlement.

Other considerations

RSA has argued the Act doesn't prevent it from applying the average clause – and neither does its other policy terms.

Even if I were to accept those arguments, which I don't, I'm required to look not only at the relevant law and the policy terms, but also at what I consider to be fair and reasonable in the circumstances.

At its simplest, the situation is as follows: had Mr J insured the damaged property for the amount RSA says he should have done, it wouldn't have charged a higher premium. It would have offered the same policy, with the same cover, for the same premium. And it would have covered this claim in full. Yet, because RSA considers the damaged property underinsured, it would like to be able to pay a reduced claim settlement.

I'm not satisfied this amounts to a fair and reasonable position. In essence insurance is an agreement between policyholder and insurer. In return for the policyholder agreeing to pay the premium in full, the insurer agrees to pay valid claims in full. Here RSA seems to accept Mr J paid as much premium as he needed to – but hasn't agreed to pay the claim in full. That doesn't seem equitable or fair to me.

So even if my understanding and interpretation of the Act and the policy terms is incorrect, I'm not satisfied RSA has treated Mr J fairly and reasonably. Because of that I intend to uphold this complaint and require RSA to put things right.

Putting things right

I think the appropriate remedy at this stage is to find that RSA can't rely on the average clause to reduce the claim value. The remaining terms and conditions of the policy will apply to the claim. Both parties will need to work together to determine how to settle the claim – and if that's by cash payment, to agree on a figure.

Mr J has a claim for loss of rent and associated expenses. He and RSA should also work together to progress that.

In its final response to Mr J's complaint in July 2021, RSA accepted there had been failures in the way the claim was handled up to that point. It offered £150 compensation. That was around a year ago and I understand the claim hasn't progressed since.

It's clear Mr J has found this claim and complaint distressing to deal with. A number of different parties were involved on RSA's behalf, which seems to have slowed down the process and made communication less straightforward. I understand Mr J has had health problems and the way things have been handled has had an impact. I haven't seen any evidence to suggest these problems were *caused* by the way RSA dealt with things, but I'm satisfied they would likely have been made worse during this period of stress.

I know Mr J feels very strongly that RSA treated him unfairly, particularly in relation to its calculation of the rebuild cost. He's suggested RSA tried to defraud him. Whilst I can understand his frustration at finding his claim settlement may be reduced and subsequent difficulties trying to find out why, I haven't seen any evidence to suggest RSA or its agents have acted dishonestly or inappropriately.

I think RSA genuinely considered a higher rebuild cost was more accurate. In principle, its entitled to reach that view, although for the reasons above I haven't made a finding about the rebuild cost – I've found that RSA shouldn't have proposed to apply the average clause.

Had RSA reached this position when it should have done, I'm satisfied Mr J's distress and inconvenience could have been lessened. Taking into account events up until now, I'm satisfied a greater compensation award is proportionate. I intend to require RSA to pay a total of £500 compensation. If it has already paid the £150 it offered earlier, it can deduct that from £500 and pay the remaining £350.

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.

RSA accepted the provisional decision.

Mr J said he was happy with my findings.

As neither party has challenged or questioned the provisional decision, I don't see any reason to change my findings or comment on them further. I'll focus on the other points that have been raised.

RSA has already been in touch with Mr J about the next steps, including the loss of rent aspect of the claim.

The policy cover is limited to 12 months of loss of rent, but Mr J says his loss exceeds that timeframe as a result of the dispute about underinsurance. He's concerned that RSA may not pay for all of those losses.

The complaint before me was about RSA's proposal to reduce the claim value as a result of alleged underinsurance. This decision resolves that complaint. The next steps are for RSA and Mr J to work together to settle the claim, without a deduction for underinsurance.

I won't be making any findings about those next steps as it's for both parties to engage with one another and reach an agreement. But generally I would expect RSA to take into account the reasons for the timescale and consider whether it would be fair to limit the loss of rent settlement in the circumstances. I understand RSA has made Mr J an offer beyond the limit, so it seems to be aware of this general position.

If an agreement can't be reached, Mr J will be entitled to bring a new complaint about the way RSA has settled the claim.

My final decision

I uphold this complaint and require Royal & Sun Alliance Insurance Limited to:

- Settle the claim without reliance on the average clause and subject to the remaining terms and conditions of the policy.
- Pay a total of £500 compensation.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr J to accept or reject my decision before 30 September 2022.

James Neville
Ombudsman