DRN-3843280

The complaint

Ms S complains about the way Liverpool Victoria Life Company Limited (LV) has settled a claim she made on a personal income protection insurance policy.

What happened

The background to this complaint is well-known to both parties. So I've set out a summary of what I consider to be the key events.

Ms S took out a personal income protection insurance policy in 2008 to protect her own occupation. She was self-employed until mid-2015 when her business became a limited company. Ms S was the sole director and paid herself a monthly salary, together with dividends.

Unfortunately, in 2016, Ms S was diagnosed with cancer and was unable to work. So she made an incapacity claim on her income protection insurance policy. LV accepted Ms S' claim and paid her full monthly benefit.

In February 2018, Ms S returned to work on a part-time basis. LV accordingly paid Ms S rehabilitation benefit. However, it calculated the benefit due on an 'hours' basis, rather than using the formula set out in the policy terms and conditions. That's because it considered the turnover and profit of the limited company and compared it with Ms S' salary. It concluded that Ms S was entitled to receive a higher salary than she was paid but had chosen to take a lower one and leave the profits in the business. It felt that if it calculated Ms S' benefit in line with the policy terms, it would effectively be allowing her to maximise her rehabilitation benefit whilst paying herself a minimal income. It said it had taken legal opinion and it had concluded that paying Ms S benefit in line with the policy formula wouldn't be in the spirit of the policy.

LV also concluded that given rehabilitation benefit had been in payment for some years, it required medical evidence to demonstrate that Ms S remained unfit to return to work on a full-time basis.

Ms S was unhappy with LV's position and she asked us to look into her complaint.

Our investigator didn't think Ms S' complaint should be upheld. He thought that as Ms S was the sole director of the limited company, she'd been free to choose how much to pay herself. He felt that if LV paid Ms S in line with the policy formula, it would be subsidising her income while allowing profits to remain invested in the business. And he thought the policy was aimed at corporate customers rather than individuals. So he felt that by calculating Ms S' benefit in line with an hours-based approach, LV was treating her in line with beneficiaries of corporate policies. He didn't think LV needed to do anything more.

I issued a provisional decision on 7 November 2022. In my provisional decision, I explained the reasons why I didn't think LV had treated Ms S fairly. I said:

'The relevant regulator's rules say that insurers must handle claims promptly and fairly. So

I've considered, amongst other things, the terms of Ms S' policy and the available evidence, to decide whether LV has treated her reasonably.

In 2016, LV accepted that Ms S had made a valid incapacity claim on her policy and so it commenced the payment of monthly benefit. In February 2018, it accepted that Ms S was entitled to receive rehabilitation benefit, as she remained incapacitated to the extent that she couldn't return to full-time work. The evidence indicates that LV continued to accept that Ms S was entitled to be paid rehabilitation benefit until at least 31 May 2021 (as it appears to have continued to pay benefit until that date).

Next then, I've turned to consider the applicable policy terms and conditions, as these form the basis of LV's contract with Ms S. These were the terms both parties agreed to when they entered into the personal contract of insurance. For clarity, this policy is not a corporate policy and I disagree with the investigator that it would be appropriate to interpret the contract as if it were. LV's contractual liabilities are directly with Ms S and it agreed to insure her income personally.

Section 10 sets out how LV calculates rehabilitation benefit if a policyholder returns to work after incapacity, but on a part-time basis. The policy states:

'We will work out the amount of rehabilitation benefit using the following formula:

(Income before incapacity – reduced income / Income before incapacity) x normal benefit.' LV has set out what it means by income. The policy defines income as:

The life assured's taxable earned income, This is the gross income the life assured earns less any expenses which are allowable against income tax.'

Section eight of the policy explains the maximum benefit LV will pay. It says:

'We will work out the maximum monthly benefit referred to in condition 7 in the following way.

First we take 50% of the life assured's Income before Incapacity and divide by 12 to obtain the monthly equivalent.

Then we deduct the monthly equivalent before tax of any of the following payments that the policyholder or the life assured receives or is entitled to receive, which relate to the period for which benefit is paid.' (My emphasis added.)

In brief, LV believes that as the sole director of the limited company, Ms S is entitled to draw a higher salary than she's chosen to. Instead, she's decided to retain profits within the company rather than pay herself more. Its view is that if it paid benefit in line with the policy formula I've set out above, Ms S would effectively be maximising rehabilitation benefit while paying herself a minimal salary. It considers that such an outcome wouldn't be in the spirit of the policy and therefore, it's decided to pay rehabilitation benefit using an hours-based approach. It's referred to legal opinion it's obtained which supports such a position. This legal opinion hasn't been provided to us as part of LV's evidence, although it's open to it to send this to me in response to this provisional decision should it wish to.

Currently, I don't think LV can contractually justify its position. There is simply no term which allows it to pay rehabilitation benefit using an hours-based approach in the contract it agreed to enter into with Ms S at the outset. I'm satisfied that the formula it's used to calculate rehabilitation benefit is clearly and unambiguously set out in the contract terms. There is simply no provision for LV to deviate from the contractual position after it has accepted that

rehabilitation benefit is payable. If it had wished to include an hours-based approach to benefit calculation in certain situations, it was open to it to include such a term within the contract. LV drafted the contract terms. I accept it may not have intended for rehabilitation benefit to be paid using the formula it drafted in situations such as these. But such an intention doesn't mean it can disregard its own contract terms at the point of claim. This means then that I'm currently satisfied that LV should reasonably have paid Ms S' rehabilitation benefit in line with the formula set out in the contract.

I've looked carefully at the tax returns which Ms S provided to HMRC and her company accounts for the relevant periods. These show that Ms S paid herself broadly £8040 per year, together with dividends. The remainder of the profits remained invested in the limited company. In my view, the company accounts and evidence of Ms S' tax returns to HMRC show what her taxable earned income was during the relevant period, in line with the definition of income given in the policy terms. So it seems then that the income Ms S has declared to LV is her taxable earned income. And as I've explained, while I understand that LV may wish to limit its liability in situations such as these, I can see no legal basis on which it can depart from the contract terms when calculating rehabilitation benefit. Nor do I find it would be fair and reasonable for it to do so.

This means that I currently plan to direct LV to recalculate Ms S' rehabilitation benefit payments in line with the formula set out in the policy terms and to compare this with the amount it paid using an hours-based approach. It should then pay Ms S the difference between each payment and add interest at a rate of 8% simple per annum from the date each benefit payment was paid until the date of settlement.

It's clear that LV has some concerns as to whether Ms S remained unable to work full-time hours as a result of incapacity after 31 May 2021. LV isn't bound to pay benefit indefinitely – it's reasonably entitled to periodically review a claim to ensure a policyholder remains incapacitated in line with the policy terms. The policy allows LV to request further evidence to support a claim which is in payment and it says:

'We also reserve the right to require the life assured to be examined by a doctor of our choice and to ask for any other reasonable evidence we need to consider your claim or to confirm that the life assured remains Incapacitated.'

In my view, given the claim was first made in 2016 and Ms S returned to work in 2018, it was reasonable for LV to request further medical evidence to demonstrate that the claim should remain in payment and that Ms S was still prevented from working full-time by her incapacity. So I don't think LV acted unfairly when it concluded that it required further evidence of Ms S' continued incapacity in order to continue paying rehabilitation benefit.'

I asked both parties to provide me with any further evidence they wanted me to consider.

Ms S had nothing to add.

LV disagreed with my provisional decision and I've summarised its response:

- There had been confusion around the way LV had calculated benefit. Originally, an hours-based approach had been used as LV was waiting for financial information. An hours-based approach had therefore been a mechanism by which rehabilitation benefit could be paid on an interim basis, with the intention that there'd be a 'true-up' when the financial information had been received;
- However, once the financial information had been received, the hours-based approach wasn't an appropriate means of assessing rehabilitation benefit. And at that

point, a further calculation should've been undertaken by reference to the policy formula to assess the actual level of benefit Ms S was entitled to receive;
- Accordingly, it intended to recalculate the benefit based on the formula set out in the policy and based on Ms S' accounts;
- One of the components of the formula is 'normal benefit'. It remains the case that maximum monthly benefit should be calculated in line with the payments Ms S is entitled to receive. It remains LV's view that as sole director of her business; Ms S was entitled to draw a higher salary from the company, but instead decided to retain her profits in it;
- As such, LV considers that by taking into account the income Ms S is entitled to receive; this will reduce her normal benefit down to zero. So on that basis, Ms S was entitled to zero Rehabilitation benefit and Ms S has been overpaid benefit during the relevant period. LV considers it would be entitled to recover those overpayments;
- It asked me to note that section 10 allows for LV to review the amount of rehabilitation benefit if maximum benefit changes; and that maximum benefit is not intended to be a static figure;
- It stated that income protection is indemnity insurance and is intended to compensate for losses suffered as a result of incapacity causing the inability to work. The profits in the company, which are entitled to be paid to Ms S, should be taken into account. If such potential income is not taken into account but is the result of her choosing to keep profits in the company, Ms S would benefit from the policy. Ms S can draw down these profits when she chooses;
- Individuals shouldn't profit from insurance and benefit is designed to motivate policyholders to return to work. If the company profits aren't taken into account, the likelihood is that Ms S will ultimately draw a greater income than she did pre-disability;
- Therefore, it asked that I confirm that the assessment of normal income should include the company's profits;
- It maintained its position with regard to cessation of payment after May 2021.

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.

Having done so, I still don't think LV has treated Ms S fairly and I'll explain why.

First, I note that LV has accepted my findings regarding the way in which the policy states that benefit will be calculated. As Ms S appears to have accepted this too, I see no reason to explore this point further. For clarity, Ms S' benefit must be recalculated in accordance with the formula set out in the policy terms.

However, it's clear that LV still considers that given Ms S' choice to retain profits in her own company rather than draw-down a higher salary; she is entitled to receive higher monthly income than she actually draws. And therefore, it's calculated that taking such profits into account, it's actually overpaid benefit.

I've considered this point very carefully. I can see why LV considers that if Ms S later chooses to draw down the profits which have accumulated in her company over time, she may well draw a higher income than she did before she became incapacitated. And I appreciate that LV considers this is contrary to the point of income protection insurance – which I agree is designed to indemnify policyholders who are unable to work due to incapacity.

But in weighing-up how benefit should be paid, it's critical that I return again to the terms of

the contract between Ms S and LV. So for ease of reading, I've restated the terms I consider to be relevant:

We will work out the amount of rehabilitation benefit using the following formula:

(Income before incapacity – reduced income / Income before incapacity) x normal benefit.' LV has set out what it means by income.

The policy defines income as:

The life assured's taxable earned income, This is the gross income the life assured earns less any expenses which are allowable against income tax.'

Section eight of the policy explains the maximum benefit LV will pay. It says:

'We will work out the maximum monthly benefit referred to in condition 7 in the following way.

First we take 50% of the life assured's Income before Incapacity and divide by 12 to obtain the monthly equivalent.

Then we deduct the monthly equivalent before tax of any of the following payments that the policyholder or the life assured receives or is entitled to receive, which relate to the period for which benefit is paid.'

This dispute now turns on the income Ms S is *entitled* to receive. LV has not defined what 'entitled to receive' means in the policy terms and conditions. It was open to it to do so if it wished to include potential profits in its calculations. This seems to be a wider interpretation of the clause than has actually been set out in the terms of the contract.

As I've set out above, the financial evidence Ms S sent LV, including her tax returns, explains exactly the income she drew down from the company. I'd reiterate that these show Ms S paid herself broadly £8040 per year, together with dividends. It remains my view that this evidence makes clear what her taxable earned income was during the relevant period, in line with the definition of income given in the policy terms.

So I still think that the income Ms S has declared to LV is her taxable earned income and was the actual income she received prior to her incapacity. I haven't seen any evidence that prior to her incapacity, Ms S was drawing down any profits from the company. As such then, by taking into account Ms S' actual, declared income when calculating benefit, rather than calculating future, potentially drawn profits, it appears to me that LV would be indemnifying Ms S' position, rather than bettering it.

I don't dispute that section 10 makes it clear that the calculation of rehabilitation benefit isn't static; nor that LV can't re-calculate benefit should one of range of factors change. But in this case, I don't think LV has evidenced such a change in the income Ms S did receive. And as LV hasn't defined what it means by 'entitled to receive' or highlighted that it may take company profits into account in any calculation, I don't think it's contractually or reasonably entitled to take Ms S' company's profits into account when recalculating the benefit due.

That being so, I don't agree that LV can factor any potential profits or future draw down into account when recalculating the rehabilitation benefit due to Ms S, using the policy formula.

LV has referred to its decision to maintain to stop benefit from May 2021, due to lack of medical evidence of Ms S' continuing inability to return to work full-time. I note Ms S hasn't

made any further submissions on this point and it remains the case that I don't think there's sufficient evidence to conclude that Ms S remained incapacitated from May 2021 onwards. So my findings on this point remain unchanged.

My final decision

For the reasons I've given above and in my provisional decision, my final decision is that I uphold Ms S' complaint.

I direct Liverpool Victoria Life Company Limited to:

- Recalculate each rehabilitation benefit payment it paid Ms S between 5 February 2018 and 31 May 2021 using the policy formula and compare this with each payment it made using an hours-based approach. It should then pay Ms S the difference (if any) between each payment.

- Add interest at an annual rate of 8% simple to any additional amount from the date each payment should've been made until the date of settlement.

If Liverpool Victoria considers that it's required by HM Revenue & Customs to take off income tax from that interest it should tell Ms S how much it has taken off. It should also give Ms S a certificate showing this if she asks for one, so she can reclaim the tax from HM Revenue & Customs if appropriate.

Under the rules of the Financial Ombudsman Service, I'm required to ask Ms S to accept or reject my decision before 8 February 2023.

Lisa Barham
Ombudsman