DRN-3881473

The complaint

A company, which I'll refer to as N, complains about the amount American International Group UK Limited ("AIG") has offered to pay for a claim made on its commercial insurance policy.

Mr and Mrs R bring the complaint on behalf of N. For simplicity, I'll refer to Mr R only, as he has primarily dealt with things.

Reference to AIG includes things said and done by its agents and representatives.

What happened

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

- N has a commercial property insurance policy underwritten by AIG. It was taken out through a broker, M.

- There was a fire at the property in July 2021, which caused substantial damage. Mr R got in touch with AIG to make a claim on the policy. AIG accepted the claim and made arrangements to settle it.

- AIG said N's buildings were underinsured. At the renewal prior to the claim, N's sum insured was £112,216. AIG said it should have been £228,000. That meant N was only insured for around 50% of what it should have been – so AIG would only pay 50% of the buildings claim.

- AIG also carried out other estimates, ranging from £180,000 to £190,000. Mr R disputed these valuations. He provided one for £124,000.

- Separately, Mr R had replaced the roof at a cost of around £18,000 and asked AIG to reimburse it. AIG didn't agree the entire roof needed replacing and included the cost of localised repairs in its schedule of work.

- AIG agreed to pay for an independent valuation to be carried out to resolve this dispute. That valuation estimated the rebuild cost of the property at £156,000. Accordingly, AIG offered to pay for 71.93% of the cost of building repairs.

- Mr R complained about the offer. AIG thought it had acted fairly. It pointed to a policy term to explain why it had reduced the buildings claim settlement and reiterated that the roof didn't need replacing.

- Our investigator thought the complaint should be upheld. She said it was reasonable for AIG to rely on the rebuild estimate of £156,000. And that meant Mr R hadn't provided the right information at the renewal prior to the claim. She said the appropriate remedy for that was for AIG to follow the Insurance Act 2015. And doing so would mean AIG paying 97.31% of the claim. She thought AIG's position on the

roof repair was fair. And she recommended it pay £750 compensation for the distress and inconvenience caused to Mr and Mrs R during the claim.

- Mr R didn't think this amount of compensation reflected the experience he and Mrs R had been through since the fire. And AIG thought it was entitled to apply the policy term, rather than the remedy set out in the Insurance Act.

- As an agreement couldn't be reached, the complaint has been passed to me.

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.

N has a related dispute with AIG about its claim for business interruption. That's being considered separately. In this decision, I'll only be considering the buildings claim.

AIG accepted the buildings claim and has offered to settle it. This complaint is about the two deductions AIG made – for the roof and the proportionate settlement.

Roof damage

I understand Mr R was concerned about the condition of the roof following the fire and arranged for it to be replaced. AIG included the cost of localised repairs in its schedule of work but didn't think full replacement was necessary.

If Mr R was able to show that a repair wouldn't be successful and a full replacement was required to achieve a lasting and effective repair of the fire damage, then I may consider it fair to ask AIG to pay for it. But he hasn't provided any evidence to show this.

So, as it stands, I don't think it would be fair to ask AIG to pay more towards the roof damage. If Mr R provides evidence to support this point, I would expect AIG to consider it.

Proportionate settlement

AIG has relied on a policy term to proportionately settle the buildings claim. The policy term says, in summary, that AIG will pay the cost of restoring the damage, provided:

> *if at the time of the damage the Sum Insured is less than 85% of the full reinstatement value of the buildings, the amount payable by the insurer will be reduced in proportion to the amount of underinsurance.*

Based on the independent valuation of the rebuild cost at £156,000, AIG said the sum insured was around 70% of what it should have been and therefore this policy term applied.

I'm satisfied the term is in the policy and sufficiently clear. But I must also consider whether it would be fair and reasonable in the circumstances for AIG to apply it.

AIG has proposed to reduce the claim settlement because it doesn't think Mr R insured the property for its full rebuild cost. Whilst I recognise AIG is seeking to rely on the policy term to reduce the settlement, it's doing so because it doesn't think Mr R provided the right information at the 2020 renewal.

N's is a commercial policy. So the relevant law relating to the information Mr R had to give AIG at the renewal is the Insurance Act 2015. Amongst other things, it requires Mr R to

‘make a fair presentation of the risk’ to AIG. Relevant to this complaint, that meant providing a reasonable estimate of the cost of rebuilding the property.

As the broker selling the policy to N, it was M’s responsibility to provide appropriate guidance and support about what information to provide at the renewal – including about the sum insured and rebuild cost. So I won’t be able to consider those things in this complaint against AIG. I’ll focus on the things AIG is responsible for.

Insurance Act 2015

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

Relevant here is that if AIG 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. AIG seems to recognise this, because it sent an extract from the Act highlighting this remedy to our investigator.

AIG 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 policy term AIG has relied on puts N in a worse position than the Act. I’ll explain why.

There’s been a lot of dispute about the value N should have given for the sum insured at the 2020 renewal. Both parties provided estimates. To resolve that dispute AIG agreed to pay for an independent valuation. It’s unclear whether the valuation estimated the rebuild cost at the time of the renewal (November 2020), the time of the damage as the policy term requires (July 2021) or the time the valuation was carried out (March 2022).

However, I understand both parties agreed to settle this point by relying on the advice of the independent valuation. And even if they didn’t, given the range of other values suggested (£124,000, £180,000, £190,000 and £228,000), an estimate of £154,000 doesn’t seem unreasonable to me.

AIG has said that if Mr R had given a sum insured of £154,000 at the renewal, it would have charged an additional premium of £46.34. N actually paid £1,676.52, so that means it should have paid £1,722.86. Accordingly, the proportionate settlement set out in the Act is 97.31%. By relying on a policy term, AIG has offered 71.93%. So the policy term is clearly disadvantageous to N compared to the remedy set out in the Act.

So, unless AIG met the transparency requirements, the Act makes clear that the policy term is of no effect in this situation. AIG hasn’t sought to argue that it met the transparency requirements or otherwise ‘contract out’ of the Act. Accordingly, I’m satisfied the policy term is of no effect and therefore can’t be applied in this case.

Other considerations

AIG has argued the Act doesn't prevent it from applying the policy term. *Even if* I were to accept that argument, 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: Mr R has paid 97.31% of the premium it should have done to ensure the sum insured reflected the likely rebuild cost of the property. However, AIG would like to pay N only 71.93% of the claim value. That doesn't seem equitable, and I'm not persuaded it treats N fairly and reasonably in the circumstances.

So even if my understanding and interpretation of the Act is incorrect, I'm not satisfied AIG has treated N fairly and reasonably. Because of that I'm satisfied it would be fair to uphold this complaint and require AIG to put things right.

Putting things right

AIG has already established the cost of repair. It should settle the claim by applying a proportionate settlement of 97.31% to that cost. It can also take into account the remaining terms and conditions of the policy, such as the excess. If it has already made any interim payments towards the full settlement amount, they can be deducted.

The policyholders are Mr and Mrs R, trading as N. So whilst this is a commercial policy, the insured party is effectively two individuals. In these circumstances, I think it's fair to consider whether they should be paid compensation for any distress and inconvenience unnecessarily caused by AIG.

Mr and Mrs R have found things very difficult since the damage happened. It wouldn't be appropriate for me to go into too much detail here, but it's clear the impact of the damage has been significant on them both. Particularly Mr R.

However, I must keep in mind that AIG isn't responsible for the fire itself, or the damage and upset it inevitably caused. So it wouldn't be fair for me to ask it to compensate for those things. But if the way it has handled the claim has *avoidably added* to Mr and Mrs R's distress and inconvenience, I think it would be fair for it to pay compensation.

I think AIG should have reached this position much sooner. It's initial estimates of the rebuild value were significantly higher than the independent valuation, suggesting they were unreasonable and avoidably caused delays to the claim process. And its insistence on relying on the policy term has meant Mr and Mrs R going without a considerable amount of money for many months.

That's impacted their ability to have the building repairs carried out and get their lives back to normal. It's clear that's had a big impact on their day to day lives and wellbeing for a prolonged period of time.

Taking into account all the circumstances, I'm satisfied £750 compensation is reasonable and proportionate to the *avoidable* distress and inconvenience caused by AIG.

My final decision

I uphold this complaint.

I require American International Group UK Limited to:

- Settle the claim without reliance on the policy term and subject to the remaining terms and conditions of the policy.

- Pay £750 compensation.

Under the rules of the Financial Ombudsman Service, I'm required to ask N and N to accept or reject my decision before 10 February 2023.

James Neville
Ombudsman