

FLAXMANS

A Thought Leadership Proposition
For
A Joint Initiative between

UK Insurers at risk & Government

In the Matter of

Covid 19 Business Interruption Insurance
Recovery Scheme

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Flaxmans
7th floor, Bankside House,
Leadenhall St,
London EC3A 4AA
T 020 3972 6440
W flaxmanpartners.co.uk

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Roger Flaxman ACII MAE
Chartered Insurance Practitioner
Expert to the courts
Chairman and Principal Consultant

Urgent Need for Action

The government's reassurance to the public in early March that "Coronavirus will now be recognised by insurers and so "trigger a claim"" proved not to be as straightforward as it was intended. It has in fact failed most businesses that were encouraged to rely upon it. That failure is the unintended consequence of a misconception, but not a fault, of government of the nature of the pandemic from the perspective of ordinary insurance law and practice.

The result has been insurance companies voting with their feet to deny indemnity even where the policy appears to the ordinary reader to provide cover for the event. That does not help anyone; and rampant litigation is a dangerous way forward; for the future economy.

There is a profound and urgent need for government and society, together, to keep businesses afloat for the sake of the nation's future. The insurance industry has an important part to play and must be given the opportunity to do so.

This paper proposes a way forward that can ease the burden for both the insurance industry and the government, it being an essential participant in any solution, so as to reduce the impact upon uninsured policyholders now and the economy going forward.

The Essential Issue

Insurance underwriters knew what they were doing when they agreed to issue insurance policies that extend to cover the risk of disease, especially those with regard to Business Interruption risks,

They expected to insure occasional localised incidents of disease; any one insurer perhaps being at risk for a couple of dozen businesses (their own policyholders) in any given town or city.

They did not expect to be at risk for a disease that invades every inch of the country at the same time; i.e. "a pandemic". However, some of the industry's policy wordings are not sufficiently explicit to make that limitation clear.

Had the pandemic risk been foreseen and had there been a demand for "pandemic insurance" the industry would have had to decline to offer the cover and seek help from government to address the risk and feasibility of indemnity for the nation; in a way similar to how it would deal with war and nuclear risks.

It is now too late to turn the clock back but it is not too late to address the outcome in a way that would:

- Reduce the burden of loss on the relevant businesses
- Keep to a minimum the future costs to the taxpayer
- Create a fair system of loss mitigation and indemnity
- Utilise the expert resources of the insurance industry in tandem with the financial resources of government to achieve the best outcome as soon as practicable.

Litigation will achieve nothing but a legacy of disdain for the insurance industry. Neither the Industry nor the economy can afford the consequences of that outcome.

Even now it would be far less expensive for both government and the industry to retrospectively arrange a jointly funded and executed programme which honours, in good faith, the insurance policies intended to extend to disease risks rather than allow litigation to make the matter so much worse for so much longer.

Doing nothing is an option for government. The industry can sit on its hands and ride out the litigation- but at a cost to it and to taxpayers, eventually.

Doing something requires **extraordinary thinking outside the ordinary parameters** of the way insurance typically works in practice.

This is a thought-leadership proposal for developing a potential solution to the crisis facing, in particular, UK plc's nation of shopkeepers and SMEs.

At the same time it would enhance the profile of the **insurance industry** in close co-operation with government at a time of national and international crisis. It will demonstrate a **government** that works closely with valued expertise, skills and resources. It will also protect the insurance industry and the government for their respective necessary interest.

The principal concern in the UK is for the consequences for **Business Interruption** suffered by policyholders and the value of their insurances. There is of course also concern for consumer related policies, for example, **travel, health and medical as well as event cancellation/curtailment policies such as weddings and entertainments.**

The focus of this paper is on Business Interruption because it would have the most value to the UK if it can be successfully addressed.

COVID 19 Government / Insurer BI Recovery Initiative

Implications of Further Risk of Loss and Damage

Implications for UK Govt

Revenue loss resulting from failed businesses

Corporation tax

VAT

Insurance premium tax

Stamp duty

Operational business taxation such as road tax, fuel duty, energy duty, airport tax, etc.

Increased costs of social support

Unemployment benefits

Housing benefits

Housing market stagnation

Mental health support

Business grants to stimulate regeneration

Collapse of Commercial and Private vehicle sales (new and used)

Clogging of Courts / Judicial systems for years

Loss of revenues to Insurance markets

Loss of premium income from collapsed businesses

Loss of trust from buying public both private and commercial

Costs of defence (third parties) i.e. lawyers adjusters etc.))

Costs of defence (internal) i.e. claims staff, reserving actuaries, senior management etc.))

Pressure on share price through negative publicity

Pressure on solvency

Pressure from shareholders to respond ethically as directed by FCA.

Pressure from shareholders to maintain dividend

Costs of marketing to rebuild trust in supply chain of brokers, MGAs and policyholders

Executive Summary

This paper makes a case for a **Joint Initiative between (primarily) the UK Government and the British insurance industry** to deliver and manage a co-insured Business Interruption recovery scheme for the mutual benefits of

- The UK's business entities (as defined)
- The UK Government and Parliament for and on behalf of the interests of the subjects of the United Kingdom
- The UK insurance industry and the underwriters at risk

Present Government Initiative

The government reacted quickly to offer a cash-flow resource to aid the nation's retention of employees (as defined). It has not yet addressed the risks to business from the inability to pay its standing overheads. It should reconsider that need. Doing so would support the additional risks of extending lockdown.

Business interruption insurance typically requires mitigation of the losses by the Insured. The losses can be reduced substantially by comparatively small sums of money being regularly fed to keep the business alive whilst the recovery process is under way.

The cost to government of furloughing staff would be part of the business interruption loss equation - it would not be an additional cost to government.

Businesses are obliged to pay their monthly overheads and contractual obligations. If default becomes "common or garden" because of lack of access to cash the consequences for government in monetary terms in supporting individuals that suffer as a consequence of bankrupted employers is inconceivable. This prospect has not yet surfaced in the media. It is, however, recognised by experts in insurance; and no doubt by government.

Method - A Localised Epidemic

If the Covid 19 virus had been confined to a small area of the country, e.g. within a 25 mile radius of an epicentre (the area often used in policy wordings that provide Disease etc. cover) the insurance industry would simply utilise its tried and tested BI loss-adjusting resources to measure the loss and control the payment of policy proceeds as the reinstatement (etc.) process proceeds. It would drip-feed the funds needed to promote recovery month by month and deliver the Insured an indemnity for its BI loss. This would usually take between six and twenty four months.

BI insurers adjusting a typical BI claim recovery would *not* just offer to pay 80% of the wage/salary bill and ignore the rest; because a full recovery of the business would be prejudiced; in fact the business would be unlikely to survive.

Method - A National Epidemic/ Pandemic

The insurance industry's method of dealing with all Business Interruption claims would apply broadly in the same way as a localised epidemic but in this case the aggregated cost of indemnity would exceed the means of all insurers to meet their obligations; hence the need for government cash support that would be so organised that the net burden is shared between government and insurers, with insurers being reimbursed by government, but only to the extent of an agreed scale that recognises the variations of cover contained in each policy

in force. This would relieve the insurers of having to bear the full cost but not deprive policyholders of a fair treatment outcome; likewise, government assistance would be limited and spread over an agreed period (See Proposition item 3 below)

A prospect of further Government cost, funding and bail out

Current press reports include suggestions that Treasury officials are considering future pandemics may be met by an insurance similar to Pool Re (terrorism risk) or Flood Re (flood risks). That does not deal with the immediate problem of getting the nation back on its feet, which with every passing week will become exponentially more costly and difficult.

Debt, credit ratings, litigation threats, receiverships and acute human health impediments and deaths would frustrate any revival of a business that could not pass the high street banks' qualification of "prospects of successful recovery".

The government has, in prospect over the next two or three years, the task of guiding and funding the recovery of the entire nation's interrupted businesses back to a Britain being a "going concern". It is foreseeable that Government will have to significantly increase its funding to business and possibly bail out airlines, financial institutions and others as well as provide further support to the NHS. Any measure that can **reduce the likelihood of thousands** of closed and bankrupt businesses should be seriously considered, now.

The Proposition

Broadly the concept is:

1. Government contracts with UK BI insurers (to be defined) for a period of up to five years) [initially] to administer *on behalf of* Government its tried and tested BI loss adjustment techniques to every entity that holds a BI insurance policy **whether or not it has any extension of coverage** that may or may not include “Covid-19 peril cover”
2. Insurers would be reimbursed by Government for the indemnity and costs of the outlay they make to each “Insured” which is beyond what the policy would otherwise cover.
3. Insurance policies would be “assigned” to government for the purpose of establishing its contribution / reimbursement, thus sharing the risk between insurers and government.
4. The precise method of loss adjustment and indemnity would be specifically designed (by BI experts) to spread the costs of recovery **over a period that would mitigate** the risk of the Insured’s collapse, according to the circumstances in each case. This would benefit government’s cash flow and also reduce opportunities for fraud by opportunist Insureds and crime syndicates. It is likely that many businesses’ actual loss would be less than currently anticipated if the business can be prevented from final collapse. Recovery after final collapse is likely to be impossible in the present litigation climate.
5. The indemnity and costs reimbursement to authorised insurers *may* (after careful examination) be reduced from 100% to require the industry to bear some part of the loss if there is a **commercial reason** to do so. There may well prove to be so because of the guaranteed funding by government and the benefit that would bestow on the operating costs of the insurance company under the special arrangement.
6. The proposition does not at this stage contemplate businesses that do not have any BI insurance and that is a feature that requires careful social / political consideration.
7. There is no reason why it should not be included but it would require a separate technique because there would be no base policy coverage from which to start. That, however, would not be a problem to overcome.
8. It is necessary to consider the fact that at present the UK insurance industry is likely to eliminate from the market any insurance for a **future pandemic**. Talk of replicating Pool Re and Flood Re are rife but Pandemic has a very different risk profile to terrorism or flood. It is unlikely that the entire nation will suffer at the same time from a terrorist attack (except germ warfare) or a flood that covers the entire country. Therefore, the risk profile of a pandemic is significantly different from a terrorism or flood risk and requires a different model; more closely aligned to nuclear or war risk model.
9. However, if a future pandemic is now foreseeable (and we believe it is) the government could usefully build a contingency resource with the insurance industry to deal with it; and that should start now.
10. The resources available from Loss Adjusters may require the recruitment of retired people but this is no different from the NHS initiative.

Related Matters

To assist non-insurance readers with the essentials of the Covid 19 insurance issue:

Business interruption (BI) cover is usually part of a more comprehensive insurance programme insuring the buildings and other property of the business entity. Most BI insurance only pays out if the Property, buildings or contents have been damaged by an insured peril such as fire, flood water damage, etc. In the absence of physical damage the BI policy does not ordinarily pay out. (That is not properly understood by over 50% of policyholders - until they have a claim)

By no means do all BI policies have cover extended to meet the risks associated with the presence of a disease or of enforced closure or cancellation. Probably less than 20% of all BI policyholders have insurance that would cover even an *epidemic* disease risk, with certainty.

Coverage

A brief summary of reasons for policies providing cover, or not, are set out in **Appendix 1**.

Litigation threats

Lawyers throughout the UK are actively seeking to attract business from commercial entities and consumers to fight the insurers in the courts. **This would be damaging and counter-productive** and should and could be discouraged if there is a better solution.

Furthermore, the cost involved in litigating against insurers will be unaffordable to the vast majority of entities and by the time the result is known a year or more could have passed, and the business would no longer be trading.

The widely reported litigation threats against Hiscox are simply a gamble on the prospects of success. A solution that allows the policyholders to be indemnified with joint government / insurer support as proposed, would allow the unpredictable risks and unintended consequences of litigation to be avoided in favour of creating a solution for now and a template for managing another pandemic in the future.

Recommendation

1. Use:
 - a. the, experience, knowledge, skills and resources of the strongest insurance market in the World
 - b. access to money and the powers of government and parliament

to create an unprecedented joint initiative to keep businesses going through the crisis and out the other side.

2. Set up a steering group of BI experts and insurance law specialists to flesh out the technical pros and cons of the proposition.
3. Identify strengths, weaknesses, threats and opportunities arising from the proposition.
4. Identify government representatives who may be attracted by the proposition and guide them in the merits of using the resources of the world's strongest insurance industry to help Britain to recover from the catastrophe.

Appendix 1

'There are, broadly, four kinds of BI cover extensions surfacing in this episode

- *Property Damage plus extension for Non- Damage (i.e. disease) peril with listed diseases*
- *Property Damage plus extension for Non- Damage (i.e. disease) peril with no restrictions*
- *Property damage plus extension for Non- Damage (Loss of Attraction) perils including disease*
- *Some policies also have denial of access.'*

Is there Cover in most policies?

Mostly, no there is not. It will be natural for businesses that find themselves in financial trouble to turn to their Business Interruption insurance (BI) policies and expect cover for their losses. In fact, only some 50% of all businesses buy BI cover, because they do not perceive the need for it - until a situation like this strikes. Even if you do have the policy the cover for Coronavirus will probably be absent.

Regrettably, our research to date indicates that very few commercial BI insurance policies extend to indemnify business policyholders for losses arising from the Coronavirus pandemic. Those that do will have limiting conditions that may require expert help to understand how they apply in practice.

This is not because the insurance industry is deliberately avoiding the issue. It is because the circumstances of a relatively unknown virus spreading so unexpectedly and rapidly across the world has never before been a foreseeable risk with such wide-reaching economic consequences that would create a demand for insurance protection of the ordinary business.

Why is there no insurance protection?

Until now it has been generally assumed by the “authorities”, the insuring public and the insurance industry, that risks arising from a disease or contamination which resulted in “lockdown” and its consequences, was a risk that would primarily affect only one entity or property at a time; for example a public building, hotel or cruise ship. Consequently, insurance for a pandemic on the scale we have now experienced was not generally thought to be necessary; the risk of a National or Global pandemic being thought improbable. Consequently, there was no demand to create a market for the cover.

Nevertheless, some businesses were far-sighted enough to foresee a possibility of BI losses arising from a need to shut down for a variety of reasons and some insurers were able and willing to offer some cover. A few years ago, a few insurers were far-sighted enough to foresee the need for this kind of BI protection and offered it to a greater or lesser extent in their ordinary policies. It generally costs more than the ordinary BI policy, and many businesses did not take it up on grounds of cost; or believing it unnecessary.

It is therefore fair to say that some cover exists in some policies for the losses now being sustained; but it is rare. It will be a matter of examining the facts in every circumstance and

perhaps some negotiation with the insurer to establish whether any given policy provides any protection in the current situation.

An Example of Cover

If cover exists at all, it would be written in a clause within the policy (or added as an endorsement to the policy – usually attached to the policy’s Schedule) which may resemble the following example.

The Company shall indemnify the Insured in respect of Damage (as defined) in this Section caused by:

- a) Murder, Suicide or Disease or
- b) any human infectious or human contagious disease (excluding Acquired Immune Deficiency Syndrome [AIDS] or any AIDS-related condition)

an outbreak of which the local authority has stipulated shall be notified to them and which is manifested by any person while in the (premises insured) or within a 25-mile radius thereof and resulting in interruption of or interference with the business during the Indemnity Period

Appendix 2

ROGER FLAXMAN ACII; MAE;



CHAIRMAN and PRINCIPAL CONSULTANT

FLAXMANS

Chartered Insurance Practitioner

Academy of Experts Accr. - Expert Witness

CEDR Solve Panel Accr. Mediator

CEDR Accr Negotiator - Dispute Resolution

Experienced Expert to the Courts in Matters of Insurance

"There is so much more to a contract of insurance than the policy wording explains. It is in that rich vein of insurance practice that so often lies the solution to a dispute."

Roger's insurance career started in September 1970 as a fire and accident insurance broker at Brokers at Lloyd's, Leslie & Godwin (long ago subsumed into what is now Aon) where he cut his teeth on a wide variety of international property insurances in USA, Northern Europe and Scandinavia.

In the mid-1970s he migrated to, the then relatively new class of liability insurance, professional indemnity, the demand for which was fuelled by the rapid development of case law in the 1980s which created a new source of remedy against the professions and service providers of sundry types and sizes.

In 1979 at Lloyd's broker C T Bowring (later integrated with Marsh) he became involved in the mandatory insurances of Lawyers, Accountants and Chartered Surveyors, and advisers to the professional bodies on the developing demands and needs of protection for both the practitioners and their clients. This was followed by the development of Directors and Officers insurances and other high-risk liability programmes both at home and overseas, which led Roger to be exposed to a rich vein of developing law and insurance needs for professionals and construction industries in particular.

A period of time in Australasia dealing with Mutuals and Defence Unions led to a new angle to tackling the development of insurance contracts to meet financial service industry needs and later, the evolving computer and Bio Science industries that were in need of insurance more flexible than the traditional lines.

In the mid-1990s Roger became involved with the PI insurance of insurance brokers at Lloyd's of London and soon thereafter with the British Insurance Brokers Association who engaged him to advise its members on broker duties, obligations and liabilities; and the management of the risks in an increasingly high-speed, high-tech sales environment.

In January 2000 after a thirty-year career as national and international broker Roger set up a business advising professional bodies and trade associations and this led to a claims advocacy service for policyholders and increasing demand for his services as an expert to the courts; mainly in matters of insurance industry practice and broker/ agent negligence claims.

Since 2000 Roger has served in circa 160 cases as expert to the courts. He is a member of the Academy of Experts.