

Business interruption insurance in the COVID-19 era

In an article for Risk & Compliance magazine, Romy Comiter and Najia Mukhtar from FTI Consulting's Global Insurance Services team discuss business interruption insurance in the COVID-19 era.

To what extent has the coronavirus (COVID-19) pandemic focused companies' attention on business interruption risk?

Mukhtar: While the pandemic is certainly a uniquely large-scale, global catastrophe event that has caused significant disruption to businesses and their supply chains, companies were alive to the risk of business interruption prior to COVID-19. This is due to operational resilience factors, including rising reliance on technology and data, heightened cybersecurity risks and the vulnerabilities associated with management of third parties and increasingly global supply chains in the context of global political and socioeconomic instability. Brexit, for instance, continues to cause significant disruption in supply chains for both UK and European businesses. Arguably, companies had not foreseen pandemics as a key factor that could lead to business interruption until COVID-19 occurred. Unsurprisingly however, by 2021 this had changed. For instance, according to the Allianz Risk Barometer survey, the pandemic featured as the main cause of business interruption risk in 2021, highlighted by 59 percent of respondents. It had only been identified by 3 percent of respondents the year before.

What scenarios does business interruption insurance typically cover? How far does a typical policy cover business interruption losses caused by COVID-19?

Mukhtar: Conceptually, business interruption insurance covers the policyholder for loss of revenue when a covered event disrupts normal business activities. The two most frequent examples of covered perils are fire and flood. The cover is often included in property policies and protects the insured for loss of revenue due to a direct physical loss, damage or destruction of the insured property. In the case of COVID-19, however, such business interruption cover in property policies would not be relevant in so far as the pandemic did not usually cause damage or destruction to property. In the UK, following the outcome of the Financial Conduct Authority's (FCA's) business interruption test case in January 2021, the FCA published a list of non-damage business interruption policies included in their test case, that are, in principle, capable of responding to losses arising from the COVID-19 pandemic. Broadly speaking, the FCA argued and won the case in the UK Supreme Court for 'disease' and 'prevention of access' clauses in non-damage business interruption policies to be applicable in the circumstances of the COVID-19 pandemic. The extent of

the payout will vary depending on policy details, including exclusions and limits such as the maximum period of interruption that is covered, such as indemnity period, and the maximum amount covered, namely the gross profit or income. Estimates of actual lost revenue will be based on previous years' trading performance and forecasts of expected revenues during the indemnity period. Policies may additionally cover the increased cost of working caused by the insured peril.

Comiter: The legal landscape for COVID-19-related business interruption insurance coverage claims is continuing to evolve. In the UK, the judgement left some issues unresolved, particularly in relation to certain coverage clauses and how claims should be quantified. In relation to those issues that were decided, the judgment is likely to have wider implications for future claims. It is expected that cases will continue to be filed for the next few years. The legal situation varies across countries, so a global company must be mindful of its coverage, and where and how best to present its case.

What are the key challenges for insurance companies in responding to the outcome of the FCA's COVID-19 business interruption insurance test case? To what extent do they apply in other global jurisdictions?

Mukhtar: Firstly, there is the obvious financial impact on UK insurers with the Association of Business Insurers (ABI) projecting that its members will pay up to £2bn for COVID-19 insurance claims in 2020. Another key challenge faced by UK insurers is reputational. There has been an erosion of public trust in the industry, particularly following the outcome of the FCA test case. In the public's eyes and under the regulator's scrutiny they are the corporate 'Goliaths' denying legitimate claims to small businesses – the proverbial 'Davids' – forced to shut down during the pandemic. Insurers will need to ensure that governance and decision making over the process of re-evaluation of claims and complaints is sufficiently robust and documented to withstand regulatory, other stakeholder and potentially media scrutiny. We expect insurers to seek assurance over their business interruption COVID-19 claims programmes, including assurance over third parties in the case where these have been outsourced to claims management agents.

Comiter: Insurers will have to manage the review of the COVID-19 claims and complaints alongside 'business as usual' activity. The claims volume and diversity, coupled with heightened scrutiny by the FCA and policyholders, will put significant pressure on resources. Technology can assist in triaging the claims and ensure they are

handled appropriately and consistently. Quantification is complicated and a 'one size fits all' approach is unlikely to be appropriate. Consideration must be given to all mitigation available to the claimant, alongside how a claimant could have adapted its business to avoid full closure. This is complicated due to multiple lockdowns, and the differing restrictions. Once the front-end claims are handled, insurers will be faced with recovering from their reinsurers. The situation is fraught with complexities and reinsurance recoveries may not be a simple case of follow the fortunes. Excess of loss reinsurers should not face the same issues as those covered in the FCA test case, but there will be additional complexities involving aggregation, hours clause, allocation over multiple policy periods, and ex-gratia payments.

How important is it for insurers to treat customers fairly when calculating payouts for business interruption? What assessments should be made?

Mukhtar: The FCA's test case and the ongoing actions it is taking to support policyholders in making claims and to monitor the adequacy and speed of insurers' response is underpinned by its mandate regarding the fair treatment of customers. To illustrate, the FCA has recently issued guidance on deductions by insurers in relation to government payouts received by some policyholders. Insurers also need to be cognisant of the FCA's requirements around vulnerable customers, formalised in the FCA's Final Guidance on Fair Treatment of Vulnerable Customers, issued in February 2021. This will be relevant in the way that claims and complaints are handled by claims handlers and complaints teams, how vulnerable customers are identified, how any outstanding information is obtained from them and the extent to which payments to customers that may be considered vulnerable are delayed.

Comiter: The FCA will look to insurers to provide evidence that the claims and complaints were handled appropriately, consistently and in a timely manner. All policy wordings must be assessed to document how the court findings apply to the wordings and establish criteria for evaluating both resolved and pending claims and complaints. Consideration of customers must be prominent in the coverage decisions, loss adjustment and communications. There are various techniques that allow for rapid segregation of claims into homogeneous groups and between low-risk, low-value records and high-value, high-risk records. Each group can then be analysed for timelines of responses and resolution and the application of legal principals by specific policy clauses. The results can be reported in detail and

at aggregate level to demonstrate consistency across similarly situated claims, as well as highlight why variances exist, supported by claim-specific evidence.

What are your expectations for business interruption coverage in the years ahead? What will be COVID-19's legacy in terms of shaping future insurance policies?

Comiter: There are many lessons to be learned from the FCA business interruption coverage test case, particularly that there is a divergence between what the insurers intended to cover and what a policyholder understood to be covered. As with all coverage cases, the pandemic has reinforced that the devil is in the detail of the policy wording – you cannot imply the terms and must rely on the specific words and phrases used in a policy. We expect that there will be a detailed review of business interruption policy wordings to enhance contractual clarity and ensure that policies are priced to correctly reflect risks associated with, now more likely, pandemic type catastrophe perils. Policyholders will need to scrutinise their policy wording, update their business continuity plans, analyse how their business interruption claims are calculated, and then determine the relevance and changes required. Consequently, policyholders will become more in tune with their individualised requirements and may be willing to pay higher prices for explicit cover against this type of peril in their overall insurance coverage.

This article has been reprinted with kind permission from Risk & Compliance magazine.

The views expressed in this article are those of the author(s) and not necessarily the views of FTI Consulting, its management, its subsidiaries, its affiliates, or its other professionals.

ROMY COMITER

Managing Director
+44 (0)20 3319 5659
romy.comiter@fticonsulting.com

NAJIA MUKHTAR

Director
+44 (0)20 7269 7235
najia.mukhtar@fticonsulting.com