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Insurers vs Small Businesses: A High-Stakes Battle Over Lockdowns

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Oliver Ralph and Robert Armstrong
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UK court case will be scrutinised as companies try to claim on interruption policies

The UK's financial regulator will take insurance companies to the High Court next month in an effort to answer an increasingly vexed question: how much of the bill for the coronavirus pandemic should the industry pick up?

The answer will help define a global legal battle that is arguably the biggest to emerge from a crisis that has claimed more than 400,000 lives and plunged the global economy into recession.

While insurers have paid out on everything from event cancellation to travel claims, the case brought by the Financial Conduct Authority centres on whether business interruption policies cover the losses inflicted on businesses by the lockdowns imposed to stop the spread of Covid-19.

It is a battle already being waged in Europe, the US and the UK — sometimes in courts and tribunals, but more often directly between big insurers and small businesses fighting for survival.

"They are using a blanket refusal to pay and not looking at each case on its merits," said KC Suri, owner of the Reel Cinemas chain in the UK whose £4m claim has been rejected by French insurance group Axa. "It is a very high-handed decision from Axa and other insurers . . . it is the principle we are fighting for."

The small businesses, ranging from restaurants to dentists to hairdressers, say that business interruption insurance policies should cover the economic damage wrought by coronavirus, and that they have often been wrongly denied payouts that could prove a financial lifeline.

The industry says that, in all but a few cases, the costs of a pandemic are simply not covered by policies designed to pay out if businesses have to close temporarily because of an event such as a fire.

"Business interruption policies are property-based policies," said Huw Evans, director-general of the Association of British Insurers. "The vast majority of them provide cover against flood and fire and other physical damage to a building."

Mr Evans said a minority of policies had extensions that covered infectious diseases, but that business interruption insurance would have been five times more expensive if it had been designed for pandemics.

If the industry is adamant that the small print is clear, it is also aware of the reputational risk of a fight pitting well-resourced multinationals against small businesses.

In the UK about a dozen action groups have embarked on campaigns to put pressure on insurers to stump up. One, for example, the Hiscox Action Group, has assembled hundreds of business policyholders and launched a £40m claim against the FTSE 250 insurer.

“In a normal year, this money disappears down a black hole,” Rupert Younger, director of the University of Oxford’s Centre for Corporate Reputation, said of the cost of insurance. “But when you do actually want something, the insurers turn around and go, ‘Ah, that was an exception that was not covered’.”

It helps explain why some insurers are writing cheques to avoid ending up in court.

Switzerland’s Helvetia Insurance, for example, has offered to pay companies in the food industry even though it says that coverage for pandemics is excluded in its epidemic insurance policies. Thomas Buberl, the chief executive of Axa, has called on dissatisfied customers to negotiate rather than litigate.

In the US, however, plenty of disputes are already heading to court.

“There are over 100 Federal cases now that have been filed throughout the country,” said Robin Cohen, an insurance lawyer at McKool Smith in New York. “What is interesting is that the insurance industry has refused to pay any losses, irrespective of whether policies involved contain a [pandemic] exclusion — they have decided on blanket refusal.”

The logic for such an approach stems, in part, because many insurers use standardised wording in policies for small businesses — so a decision to payout on one case could have vast repercussions. One of the specific battle lines is over whether a policy’s wording allows a small-business owner to claim for losses if they were forced to shut by the government.

It is why the UK High Court case will have a global audience. The FCA has asked the court to rule on 17 disputed policy wordings from eight different insurers, including Zurich, RSA and Hiscox, in a bid to establish whether the interruption to business caused by the pandemic is covered.

Even if the ruling were to favour policyholders, claimants will still face hurdles and lengthy discussions over how much they are owed. That means any potential payments are likely to be months away.

“If the court says that the policies trigger and exclusions don’t apply, you’ve still got a long way to go to get paid,” said Bruce Hepburn, chief executive of advisory firm Mactavish. “The FCA is effectively resolving ambiguity over some wordings on some contracts.”

Should the industry lose, it could be staring at a total claims bill that is considerably more than the $100bn that Lloyd’s of London has forecast the industry faces from coronavirus. When the virus first erupted, executives offered apocalyptic predictions of bankruptcy if insurers were forced to retroactively change policies to include pandemic coverage.

That particular threat, which was proposed in several US state legislatures, has receded, but the costs could still be substantial. Insurance broker Willis Towers Watson predicts that business interruption coverage could cost insurers more than $40bn in the UK and US alone.

If courts begin to rule against the industry, the size of the financial hit will grow. Zurich, for example, expects to pay out $750m in claims related to coronavirus, but says that figure may rise by $200m if the High Court rules the wording of policy does provide cover.

It will not just be insurers feeling the heat. Spiralling costs for the industry could ultimately rebound on regulators, too.

One US-based industry lobbyist said: “If we did write [pandemic risk] then it is one of the biggest regulatory failures in history — because we were not required to hold any money against it.”

Since the lockdowns shut western economies earlier this year, the industry’s European regulator, Eiopa, has urged insurers to ensure they can absorb payouts as well as navigate any tumult in financial markets.

Beyond the financial bill, some insurers fear that customers’ anger over business interruption policies means they will not be coming back.

“We will be very careful about how we insure in the future,” said Mr Suri of Reel Cinemas, who spends about £250,000 a year on insurance. “We will make sure we get what we pay for with no grey areas.”

A recent survey from McKinsey, for example, found that a third of small companies in the UK may stop buying such insurance, partly because of the coronavirus controversy.

Mr Hepburn of Mactavish warns customers will take far more care when buying insurance. “Businesses will scrutinise their policies as they never have before,” he said. “I think the industry is heading towards a much bigger problem than they have now.”

The ABI disputes that the industry has treated customers poorly during the pandemic, pointing to flexibility on a range of policies and that significant sums have been paid out. “If you look across the piece, it has been a very significant response,” said Mr Evans.

For now, policyholders will be hoping for a repeat of the victory secured last month by French restaurant owner Stephane Manigold, who had taken Axa to a tribunal over its refusal to pay out on his business interruption policy. The tribunal ordered the insurer to make a payment of €45,000.

At the High Court next month, the stakes will be much higher.