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Business interruption insurance - are we out of the woods?

More than twenty-one months have elapsed since the WHO was informed of cases of pneumonia from unknown causes. A novel coronavirus was identified, and life as we had known it was thrust into a trajectory that no one could have predicted. The impacts have been devastating - with more than 4.5m deaths worldwide over this time. Globally, more than 6.7% of global GDP was lost in 2020 because of the pandemic.[1]

The COVID-19 crisis affected all business sectors and insurers were inundated with claims across multiple lines whether that be for health, life or non-life cover.[2]

These financial impacts had repercussions on capital maintenance too. Further strain related to how insurer operations had to be adapted to remote working and dealing with channel overload.

And despite these challenges on operations, the insurance sector – in particular short-term insurers – initially expected the impact on claims to be relatively manageable. Most insurers learned lessons from the SARS outbreak of 2003 and introduced exclusion clauses for communicable diseases and epidemics/pandemics into their non-life products such as business interruption (BI) and travel insurance[3]. As a result, most BI insurance available in South Africa only covers physical damage to an organization's assets which render it unable to operate - so insurers' positions were that coronavirus related claims were not covered by these policies. Then came the government-enforced nationwide lockdowns to curb the spread of the virus and the situation needed to be reassessed.

Government, pressure groups and the media voiced their concern over the position that most insurers had taken on BI insurance cover, along with the impact on potential pay-outs to customers. There were significant parallels to the recent issues in the UK banking sector on payment protection insurance and interest rate hedging[4] and against this backdrop, claims needed to be considered quickly and individually on their merits. The key was to get money paid out rapidly to those who needed it the most.

The rule of law and intervention of regulators

Given the extensive work done by underwriters after 2003 to scope out pandemics from BI cover, and in spite of initial views from various insurance associations that standard BI insurance would not respond to COVID-19 related claims (in most countries) both regulators and business association groups were challenging this stance[5].

What followed (and continues to develop) was that not all insurance policies are equal. There was significant divergence in practice regarding policy wording and it has become clear in most countries where the courts have intervened that each policy and case needed to be assessed on its own merit.

[1] Statista 2021 - GDP Loss COVID-19 economy

[2] KPMG – Do insurers have COVID-19 covered KPMG Insights

[3] KPMG – Do insurers have COVID-19 covered KPMG Insights

[4] Business interruption insurance: Next steps for insurers and brokers KPMG Insights

[5] BI claims arising from COVID-19 womblebonddickinson

In the UK, the FCA decided that the quickest route to resolving the issue and providing certainty for all parties was to go to the High Court to seek a declaration on what the wordings covered. In June 2020, the FCA began a test case in the High Court, where their counsel had reviewed over 500 policy wordings to arrive at the 21 representative policy 'types' issued by the eight insurers included in the test case. They then selected wordings that were representative of the key issues in dispute at the time between policyholders and insurers. These 21 policy types contained three types of cover wording:

(i) cover for BI caused by an outbreak of disease within a specified radius of the premises.
(ii) cover for BI caused by denial of access to premises, following public authority action, taken due to an emergency.
(iii) 'hybrid' wordings which combine a requirement for both outbreak of disease and public authority denial of access to premises.

Similar analyses have been performed in other countries, not all driven centrally through the regulators as was the case in the UK. In addition to the categories above, distinctions were made for those policies where there are no infectious disease clauses and where BI extends solely to damages to property.

In South Africa more legal certainty was provided in December 2020 following rulings by the Supreme Court of Appeal. In this market the "central question … was whether the government's imposition of a lockdown … was covered by the infectious diseases clause," the written judgment read. In this instance, and thereby setting legal precedent, the question was answered in favour of the policyholder. With insurers in South Africa having lost four times in the high court and one appeal at the Supreme Court [6], most have now moved onto settling BI claims. What continues to evolve however is the interpretation of "indemnity periods" covered in the contract and now, almost ten months after the ruling the burden is on policyholders to supply all the relevant information to support the purported losses.

Not all countries are as progressed as South Africa in its legal conclusions – with many cases still playing out in the various courts of law:

Legal judgements leaning towards policyholders	
United Kingdom	The Financial Conduct Authority (FCA), which had brought a closely-watched test case on behalf of policyholders against major insurers, indicated in September 2021 that 27,248 companies out of 42,308, which had had claims accepted, had received at least an interim payment. Small companies in Britain, which demanded that their insurers cover claims for losses accrued during the COVID-19 pandemic, have received more than one billion pounds in full and interim business interruption pay-outs to date[7].

More favourable judgements towards insurers	
USA	Policyholders continue to lose most COVID-19-related business interruption coverage disputes. However, a picture on the issue will likely not emerge before state supreme and federal appellate courts issue more rulings on the issue. Insurers so far have largely argued successfully that the coronavirus does not result in physical loss or damage to property — the critical issue in many COVID-19 cases — and therefore lost revenue is not covered under all-risks policies. Federal courts have mainly ruled in favour of insurers, but policyholder attorneys say it is too soon to draw any conclusions on the overall eventual outcome[8]. Refer to the graph sourced from Hunton Andrews Kurth LLP that highlights the trend in complaint activity (and lawsuits) in the USA.
Australia	More recent Federal Court rulings dismissed applications for declaratory relief, finding that the losses claimed were not resulting from physical loss, damage, or destruction of properties and that COVID-19 did not constitute a catastrophe within the meaning of the Civil Authority Extension. However, like the US, there are other test cases currently afoot throughout Australia which, over the next few years, will provide further clarification on interpretation issues for business interruption policies in the context of COVID-19[9].
Canada	The Supreme court found in favour of insurers – "Business interruption must be the result of the direct damage to an insured good." As such, it was of the opinion that the deterioration caused to a good due to contamination was not covered by the policy[10].

[6] Court rulings in SA - Daily Maverick

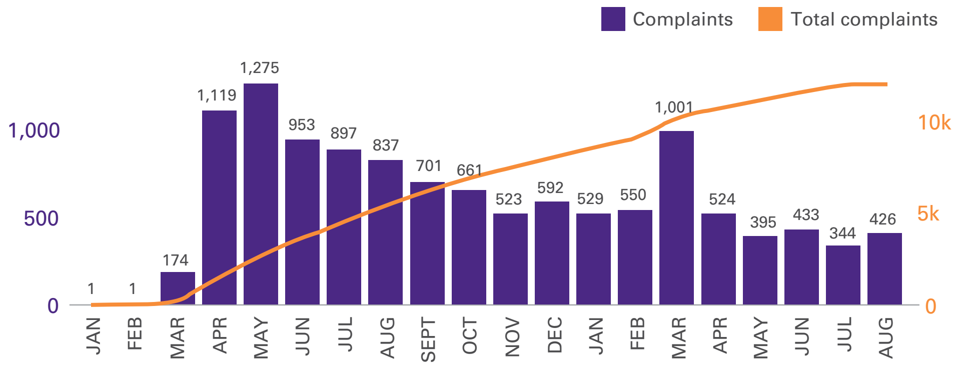
[7] UK COVID-19 business insurance payouts - Reuters

[8] Business Insurance - USA Early COVID-19 rulings tilt to insurers

[9] Collin Biggers & Paisley - Insights - A recent update on Covid-related business interruption coverage (cbp.com.au)

[10] The Lawyers Daily - COVID-19, class actions and business interruption: Quebec court renders trilogy of decisions - The Lawyer's Daily (thelawyersdaily.ca)

COVID-19 lawsuits wave



Source: Hunton Andrews Kurth LLP

Focus by the regulators

In the initial months, South African regulators intervened to ensure that policyholders were treated fairly, given differences in interpretation of the BI clauses. Their attention in the last six months has moved onto ensuring that insurers are not dragging their heels in making payments to policyholders which threaten to put policyholders out of business. Most regulators continue to adopt a customer first approach [11] to the resolution of issues identified, and there is an expectation that insurers must assess these issues in line with their obligations and act honestly, fairly, and professionally in the best interests of customers and with due skill, care and diligence.

In the UK, the tracking of case load and payments per insurer are being made available to the public. This "name and shame" approach has not been adopted in many other countries, with most regulators opting to follow up directly with insurers and put pressure on them in private discourse.

The response from reinsurers

In the initial months, the primary concerns where whether reinsurers would themselves cover losses submitted to them by insurers and whether there was sufficient capacity within the market to handle the quantum of losses emanating from the pandemic (including, but not limited to BI claims).

However, with more time having passed, there have been few instances where reinsurers have rejected claims made by insurers, and even fewer disputes which were escalated to courts of law.

The reinsurance market has proven to have had sufficient depth and was able to absorb losses without any notifications of reinsurers requiring intervention by central banks or regulators in their territories to remain solvent. While reinsurers have buffered the storm to date, many have cautioned that there remain numerous legal actions related to the COVID-19 pandemic (between primary insurers and policyholders) that are ongoing and emerging in different jurisdictions, which could also affect their results if court decisions are unfavourable[12].

What is concerning is insurers' and reinsurers' appetite for pandemic related risks in future years. Santam released their Insurance Barometer in September 2021, and John Melville, Santam's executive Head of Underwriting Services, Reinsurance and International indicated:

"The pandemic is proving to be more than a passing risk event. Instead, it has turned out to be a powerful catalyst of other systemic risks which combined make insurance less affordable. … [R]einsurers have increased the premiums they charge insurers for catastrophe cover. They also moved quickly to exclude pandemic risk from their cover." In global markets. Nicholas Scofield, Chief Corporate Affairs Officer for Allianz Australia indicated "When you've seen some of these new wordings, there's not a cigarette paper, or a crack of sunlight in some of these revised infectious diseases wordings through which someone could even dream that a claim would be possible … [E]verybody is tightening that up. There won't be much doubt when the next pandemic comes about whether there's cover or not. I don't think it will warrant a test case."[13]

If insurers cannot diversify these risks at a global level, then they cannot insure them; and if this is the case, businesses and consumers will have to bear the responsibility to protect themselves against "uninsurable" pandemic and other excluded catastrophic risks.

Several insurers, both global and local, when reflecting on this potential insurance gap have considered alternatives to the traditional BI cover. Most of these alternatives suggest partnerships between insurers, the public and government to build up a fund that everybody can draw from when a pandemic occurs. In South Africa, whether this is a potential expansion to the mandate of SASRIA will only be determined over a few years, and that means that a number of businesses may find themselves exposed.

[11] Reinsurance News - COVID-related BI & cat losses a challenge for reinsurers

[12] Reinsurance News - COVID-related BI & cat losses a challenge for reinsurers

[13] Insurance Business Mag - Should BI insurance cover pandemics? | Insurance Business Australia (insurancebusinessmag.com)

So how do insurers adapt?

KPMG has been talking to insurers and brokers in the market to advise on key learnings over the last eighteen months on what more can be done to limit the impact on the industry.

A few themes have arisen:

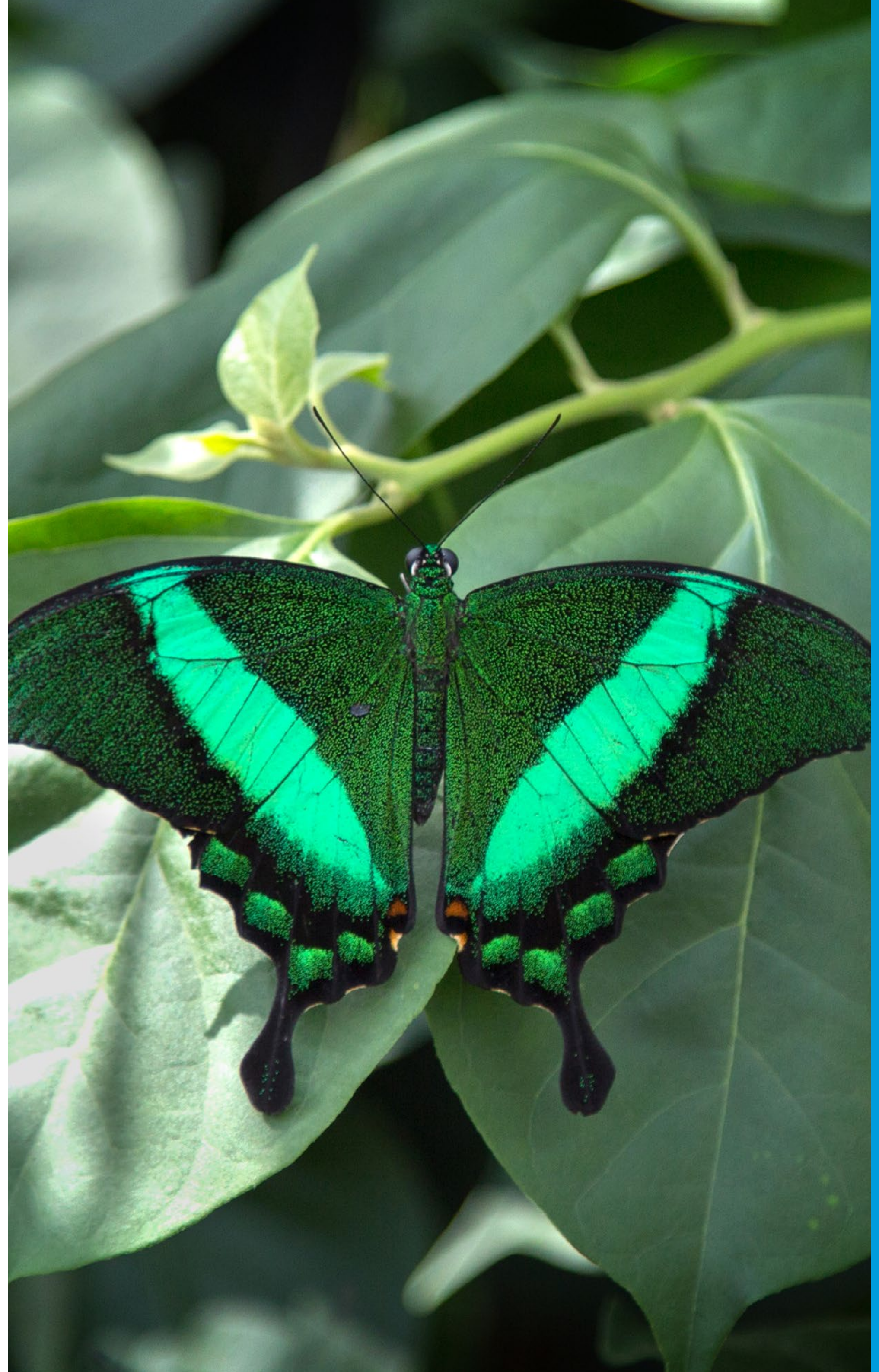
Dealing with channel overload – insurers have learnt valuable lessons on dealing with the huge spike in customer contacts when scenarios such as this have emerged. Identifying and planning for events such as these will help insurers to respond more quickly. Insurers may also need to consider how teams are cross skilled to ensure that more agile working is possible where 'volume shifting' is required based on sets of claim events.

Digitized is optimised – a number of insurers struggled initially to get to grips with their exposure and various manual processes needed to run to source and obtain information to help them understand gross exposure as well as gather information to assess the event scenarios for reinsurance recoveries. Those insurers with more advanced digital underwriting, claims, and administrative processes were in a much stronger position than others that did not have seamless and granular data available for analysis. More so now than ever, technological investments are key for insurers to keep pace with the emerging risks that have arisen.

Scenario planning – given the legal uncertainties associated with BI and infectious disease clauses, more insurers are now spending time carefully working with their legal and risk teams to stress test implications of different scenarios and what they would mean for policies in force. Where unintended consequences arise, contract wording is being tightened up to ensure that there is absolute clarity on risks covered.

Social responsibility is on the rise – while social media has been a blessing over lockdown – giving us Jeruselma and Elsa Majimbo, it has also enhanced the voices of activist policyholders. For a few years now, the damage that this can have on brands has been on insurers' radars, but the events over the last 550+ days of lockdown have refined the focus on how much more needs to be done to engage quickly and deliberately with policyholders to understand sentiment and prevent any fall out.

So are we out of the woods? Nearly – there is still some road to cover, but it is good to see that insurers are adapting to meet the challenges ahead.



KPMG Connected Enterprise

KPMG Connected Enterprise is a customer-centric, enterprise-wide approach to digital transformation. It is a **framework** designed to connect and align **front, middle and back office functions** to adapt to the dynamic changes and pressures on the insurance industry and organization and it focuses on every process, function, and relationship of a business on meeting **customer expectations**, creating business value and driving sustainable growth in a digital world.

Our solution can help organisations future proof themselves through ambitions that are more **adaptable** and **connected** than ever before. Connected enterprises are better equipped to answer questions such as:

- How do we harness data, advanced analytics and actionable insights with a real-time understanding of the customer and the business, to shape integrated business decisions?
- How do we develop compelling customer value propositions on price, products, and services to engage the most attractive customers and drive profitable growth?
- How do we design seamless, intentional experiences for customers, employees, and partners, supporting the customer value propositions and delivering business objectives?
- How do we interact and transact with customers and prospects across marketing, sales, and service and achieve measurable results?
- How do we operate the business with efficiency and agility to fulfil the customer promise in a consistent and profitable way?
- How do we build a customer-centric organisation and culture that inspires people to deliver on the customer promise and drive up business performance?
- How do we create intelligent and agile services, technologies and platforms, enabling the customer agenda with solutions that are secure, scalable, and cost-effective?
- How do we engage, integrate, and manage third parties to increase speed to market, reduce costs, mitigate risk, and close capability gaps to deliver the customer promise?

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