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JOHN DILLEY CONSULTING LIMITED
13TH MAY 2020

As landlords and tenants start to contemplate the allocation of pandemic risks in commercial property leases, it is timely to reflect on whether pandemics will be insurable in the future.

This article will focus on landlords and tenants interest in the insurance of rent, a specific application of Business Interruption Insurance (BI). But speculating on what the "new normal" might look like must start with reflection on where we are now.

It is no overstatement to say that right now the insurance industry is facing a public relations nightmare. There is extensive press coverage about the lack of support for businesses from insurance companies, the Hiscox Action Group has been formed, the Covid Claims Group has written a highly critical open letter to the ABI, and insurance companies are imposing Covid-19 and pandemic exclusions on all types of policies.

On the one hand, businesses have bought policies which make reference to denial of access and notifiable disease and, in the absence of an express exclusion of pandemic related losses, have an understandable expectation that their claims are valid. Cash flow vulnerable businesses, which includes most SMEs, expect a basic function of the insurance company in a crisis to be the dynamic response to insurance claims and urgent payment.

On the other, insurance companies are mostly consistent in the message that it wasn't their intention to insure a pandemic, that they have not assessed the pandemic risk probability nor funded for such losses, and so they are revisiting the policy wordings - incidentally, what other types of sophisticated contract are entered into without legal advice? - to examine what is covered.

This approach does not fulfil expectations of dynamism and urgency and in mid-April the FCA wrote to insurance companies directing them that SME's valid BI claims must be "assessed and settled quickly".

There is hope: one insurance company has publicly said that if the balance of interpretation concerning policy wording ambiguity lies with the customer the claim should be paid. But as the stand-off largely drags on, trade associations are shining light on the likelihood of extensive business failures directly resulting from delay in paying BI claims.

On 1st May the FCA announced that it is seeking clarity on BI policy wordings through a court declaration. Regrettably, this well-intentioned move may prove to be a case of "too little, too late" for too many SMEs.

How the insurance industry got into these difficulties - a reactive and fence-sitting culture, how SMEs should and should not buy insurance, the commoditization of insurance, why ambiguity in product structure arises, insurance broker culpability, and how the insurance market needs reform - and the impact of the hardening market would be the subject of another whole article. So we will move to this article's focus, the future allocation of pandemic risk in commercial property leases and how the insurance industry will respond.

The complex problem can perhaps be summarised as briefly as this: tenants don't want to pay for space they can't use, and landlords must fund their ongoing obligations to investors and lenders.

Let's assume that "pandemic insurance" (this unfortunate working title needs to be used to make sense of the problem) is available in the future. Isn't that the end of the matter? Don't existing arrangements, the existing wording of leases and insurance policies, work? The answer is "No".

If the lease form stays the same and the pandemic risk resides with the tenant, the tenant will buy the pandemic insurance to protect its position. This assumes that the insurance market has learned and the pandemic insurance product is fit-for-purpose.

But now the problem is tenants insurance buying behaviour. Today's bad publicity concerns the businesses which have bought BI cover with notifiable disease extensions. These are optional. Many businesses have not been advised about such cover, or have opted to not buy it. Many businesses do not buy BI at all.

Can a lease compel a tenant to buy pandemic insurance? If so, who will pay for the annual insurance policy audit? Many landlords already do not audit the buildings insurance of tenants who retain the insuring responsibility.

So the landlord might find itself with a tenant which is obliged to continue to pay rent in the event of a pandemic and Government lockdown, but which has no pandemic insurance or other resources to pay.

The alternative is that the landlord takes on the pandemic risk. This will require significant change to the rent suspension clause which typically only allows for damage. Clauses will need to respond to Government directives on social distancing and business closures.

Precision will be vital. Is Government advice sufficient or must there be a formal directive? What about the loss of turnover due to public fear of the pandemic before the Government takes action? Will voluntary closure to fulfil health and safety obligations be included?

If leases are carefully crafted then insurance companies have claims triggers to assess and a viable solution to support the real estate sector can be created. Whilst insurance is never an absolute panacea, it is likely that landlord control will appeal far more to lenders and investors than reliance on tenants.

Which leaves the question, will the insurance market be able to provide pandemic insurance in the future?

For the reasons reviewed at the outset, the short term outlook is bleak. There is far more insurance market dialogue about claims disputes and the imposition of policy exclusions than there is about solutions.

There have been attempts to estimate the Covid-19 cost to the insurance market but these are so qualified and changeable, and with the arguments about claims validity still raging, there is little point in referencing them here. Whatever the final cost, the suspicion is that the insurance industry balance sheet will prove to be inadequate to provide a solution. The base insurance principle that the losses of the few are paid for by the many becomes untenable when, as with a pandemic, the cause is so very pervasive that the majority have losses and the premium of the unimpacted minority is insufficient to afford them.

The way forward may be for the insurance industry to work in collaboration with the Government. A steering group of insurance industry leaders has already convened with the objective of formulating

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a response to the Government. Pool Re, the Government-supported reinsurance company, is participating to share its established terrorism insurance model as a possible template for what has been dubbed Pandemic Re.

Any solution should be considered a long way off. The insurance industry did not deliver a solution after previous pandemic scares. A commercial solution will be encouraged and preferred to reliance on taxpayers funds.

The insurance industry must learn from this crisis. There is clearly a huge opportunity for consumer-orientated reform. Where better to start than to deliver a pandemic insurance solution which delivers the real estate sector and UK PLC with the clarity and security needed to underpin recovery and growth.

John Dilley Consulting Limited is an independent consultant providing advice to real estate investors in insurance procurement strategy, adviser selection and performance monitoring.

Contact: John Dilley
Email: john@johndilley.consulting
Tel: 07879 007528
Web: johndilley.consulting