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Insights

DOES "LATE PAYMENT" OF COVID-19 BI CLAIMS CREATE ADDITIONAL EXPOSURE FOR INSURERS AND REINSURERS?

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As has been reported widely in the press, policyholders are seeking damages from insurers for "late payment" due to insurers rejection of their Covid-19 BI related claims. In particular, many small and medium sized businesses (SMEs) say they will go bust if their claims are not paid.

With the stakes so high, in this article we discuss the relevant issues under English law in relation to damages for late payment, which may arise for the insurance and reinsurance industry.

Insurers and reinsurers in England have been legally obliged to pay valid claims within a reasonable time since the coming into effect of this part of the Insurance Act in May 2017. The change in law led many commentators to speculate that it would result in a flood of claims for damages for late payment, or at the very least that they would become a standard add-on to any legal proceedings issued against insurers or even reinsurers .

That has become a reality recently in the Covid-19 BI claims, but the Court has yet to decide on this issue.

Considerations at the insurance level

The Insurance Act provides that it is an implied term of every contract of insurance and reinsurance that the insurer must pay sums due on the claim within a reasonable time.

A reasonable time includes a reasonable time to investigate and assess the claim and what is reasonable will depend on all the relevant circumstances such as the size and complexity of the claim and compliance with any relevant statutory or regulatory rules or guidance.

If the insurer shows that there were reasonable grounds for disputing the claim, the insurer does not breach the implied term and the conduct of the insurer in handling the claim may be a relevant factor. The Act provides that damages may be payable by the insurer/reinsurer for breach of the implied term, in addition to any interest due.

Damages for late payment are effectively unlimited and policy limits are to be ignored.

In the context of Covid-19 BI claims, certain categories of policyholders, such as SMEs and sole traders, say they are not able to finance their businesses whilst they debate coverage with their insurer, or during the period where a claim is investigated and adjusted. This process may take several months or longer by which time many businesses may collapse.

In such circumstances, policyholders are relying on the historical context of this part of the Act to seek damages from insurers for “late payment”, potentially far in excess of the limits of the policies that have been underwritten. It is said by policyholders that their consequential losses suffered as a result of insurers’ rejecting their valid claims were foreseeable.

It is strongly debatable whether such arguments will get sympathy from a Court, even if the FCA test case currently before the English court determines that there was BI coverage under a policy and the claim should have therefore been paid “within a reasonable time”.

After all, the Denial of Access/Public Authority type clauses were not intended for a nationwide imposed lockdown. Also, insurers have signed up to the test case very promptly, seeking a determination on a wide range of sometimes quite complex formulations of wordings. Therefore it is not unreasonable for insurers to seek judicial guidance, provided the process concludes without unreasonable delay.

Also, the FCA’s Covid-19 Claims Handling Guidance published in final form on 17 June 2020 provides a new framework for Covid-19 BI claims handling. If insurers comply, they will have a defence to any claim in respect of late payment by their “compliance with regulatory rules”, as the Act requires.

But that is not to say that there is no cover and one can see that some wordings are much broader than others. In addition, any “delay” by insurers prior to June 2020 may be deemed to be a factor by the Courts.

Insurers will, of course, also argue that the financial difficulties of the policyholder were not entirely due to the late payment, but rather due to other circumstances including, for example, the precarious financial position of the policyholder before the pandemic (if relevant).

Also it should be borne in mind that the FCA test case will not address the late payment issue. So it is more a matter of how insurers react to the outcome of the test case that the issue of late payment become relevant. That is, of course, only to the extent that the Court decides that there is cover.

Subscription Market

Where there is a subscription market, the question of late payment is particularly complex. What happens if the lead insurer delays payment, which causes the Court to award damages against the subscription market as a whole? To avoid that risk, slip leaders must act cautiously to avoid the risk

of paying 100% of the late payment damages as they have breached their duty of care to the following market.

Reinsurers

As the Act also applies to reinsurers, they may find themselves liable for their share of the damages awarded against the insurer, as the obligation arises out of the insurer's/their cedant's implied contractual duty to pay valid claims within a reasonable time. The reinsurer may therefore be liable for considerably more than the original reserved claim due to the award of damages against their cedant for late payment. But in this scenario, the reinsurer will only be liable up to its policy or treaty limits.

So if the English Court awards damages against an insurer, say for the financial collapse of the policyholder due to late payment of Covid-19 claims (i.e. it determines that the insurer delayed unreasonably in settling the claim), their reinsurer/s will be liable for those damages (up to the reinsurance cover limit) and reinsurers higher up the tower may find losses in layers not previously exposed. Those losses will most likely be deemed to have arisen out of the same 'event' or 'catastrophe', although one can see some arguing that the late payment element of the loss does not result from the original 'catastrophe' but some independent 'event' or 'cause', such as poor claims handling.

Reinsurers may therefore seek to engage with their cedants now on the non-payment of BI claims issues to avoid that potential additional exposure at some future stage.

In what circumstances could a reinsurer actually be held independently liable for damages for the late payment of a reinsured claim? Say, for example, the reinsured is simply fronting the business and it cannot afford to pay the claim until the reinsurer pays the reinsured. That could lead to the reinsured being wound up, or have its solvency rating materially reduced, therefore causing it other consequences in its business. In those circumstances, the reinsurer could be held liable for the actual damages suffered by the reinsured as a result of the reinsurer's delay in paying. Again, those damages are unlimited at the reinsurance layer and no upper limit will apply to the layer. An interesting question of itself.

Also where a reinsurer has claims control one can see that not only may a late paying insurer controlled by a reinsurer be liable for damages for late payment but that might create additional liability on the reinsurer for any other loss of say reputation or markets that may be attributable to the reinsurers own delay in this scenario.

Only time will tell the extent to which these issues will arise in the market, but insurers and reinsurers should be alive now to the impact the change in law in 2017 could have on Covid-19 related claims in 2020 and beyond.

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