

COVID-19 – Update on Insurance Implications

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COVID-19 Impact on Insurance

Crawford & Company offered an early outline of the impact of the novel coronavirus 2019, now known as COVID-19, based on our knowledge in late January 2020. Since that time, significant developments have occurred, and a clearer image of the insurance implications is emerging.

The comments in this update focus upon the impacts in Australia, Europe and the UK. This paper provides an overview of an issue that has provided much comment over the past few weeks.

Policy Response

We expected that few successful claims would arise under conventional Business Interruption policies as a direct consequence of infection. This has proved correct, with few claims notified, and even fewer giving rise to accepted claims, usually through the operation of exclusions for quarantinable diseases (or equivalent wordings).

Relatively few claims have been accepted so far, under specific covers relating to individual premises (primarily Entertainment Venues) and for individual Event Covers (again usually Entertainment risks).

More recently, as governments at all levels issued direct orders, closing or severely curtailing business operations, wider coverage has been triggered under Public Authority clauses attached to many policies. Policy response remains variable, dependent upon the wording and the directions of government. Analysis of each circumstance is critical in understanding if a policy may respond.



Virus Spread

It is no surprise that COVID-19 has spread beyond its epicentre in Wuhan, China. The speed and frequency of international travel disseminated it from Wuhan to Europe, the Americas, other parts of Asia and all parts of the globe except Antarctica.

The suggested incubation period is about 1-14 days, typically 3-5 days. Whilst all age groups are affected, severe outcomes are more common

amongst those over sixty. This has led younger people to assume that they are less susceptible, sometimes with catastrophic outcomes.

Efforts to halt the virus' spread have been variable, from public information campaigns to outright lockdowns. Public compliance has been similarly variable.

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Economic Impacts

Initially, the impact of COVID-19 was perceived as a health emergency, resulting in widespread infection and comparatively high frequency of death (compared to usual seasonal illnesses). However, the economic impact of widespread business closure as governments grapple with the crisis, was not initially understood.

The immediate impact of interruption to manufacturing in Wuhan and surrounding areas rippled through many industries dependent upon supplies from factories in the initially quarantined area. The Wuhan area is a key source of components and sub-assemblies used by diverse industries worldwide. Manufacturers in China and South Korea were the first severely hit, and this led to impacts on the motor and computer industries. Anyone unsuccessful in finding a computer or screen recently will have felt the consequences.

There has been widespread panic buying in anticipating of a lengthy period of home isolation leading to severe shortages of basic commodities, often apparently illogical; toilet paper, baking goods, pasta, vegetable seedlings. This has created huge logistical issues for retailers and their suppliers, supply chains suddenly cleared of goods. In turn, future demand for those goods will be depressed as the home overstocking flows back through the supply chain.

As governments have closed borders, the travel industry, especially airlines and hotels, has seen demand evaporate, prompting widespread grounding of airline fleets, standing down of employees and redundancies / layoffs. There is widespread speculation of failure of some airlines.

The impact on restaurants and other food outlets has been similarly severe, with patrons unable to access dine-in facilities and take-out options being limited. Business failure could be more common. Conversely, those restaurants with take-out or home delivery services have seen turnover through these distribution channels swell substantially.

Retailers are also seeing sharp drops in turnover, many ceasing trading, either temporarily or permanently. Employees have been laid off or made redundant.

For property owners, widespread abandonment of tenancies and rent default is a common problem. In turn, lenders, especially banks, are exposed to loan defaults.

Unemployment has increased substantially as businesses respond to the catastrophe facing them. For example, more than 280,000 (about 2% of the workforce) signed on for unemployment benefit in a single day in Australia, previously close to structural unemployment. Forecasts suggest a tripling of unemployment within weeks in Australia from 5.1% to more than 15%.

Commentators suggest an impact more severe than the Global Financial Crisis, if not approaching the Great Depression. Governments are reacting with packages to support businesses and retain employment.



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Insurance Implications

Some Insurers consider that their policies have a greater potential to respond to the actions of Public Authorities, if not to the first virus infection / contamination. Many are seeking legal advice as they grapple with the potential for an unimagined wide-scale response.

It is important, however, where policies respond to provide Business Interruption cover, to understand the impact on the business arising from a general downturn (or in some case upturn) in business from causal issues not directly related to that which triggered policy response. The “Other Circumstances” clause, applicable to the estimation of Standard Turnover and Gross Profit, is intended to adjust the results of the business for these separate discrete issues by applying a “but for” test when considering each issue independently.

A typical wording says:

“...to which such adjustments will be made as may be necessary to provide for the trend of your business and for variations in or other circumstances affecting your business either before or after the damage or which would have affected your business had the damage not occurred, so that the adjusted figures will represent as nearly as may be reasonably practicable the results which, but for the damage, would have been obtained during the relative period after the damage”

For each cause that may trigger policy response, ask yourself the question “but for” the event that

gave rise to policy response, what Turnover and Gross Profit would the business have earned had the event not occurred. It is that Turnover and Gross Profit that should be used in modelling the loss. Sometimes the answer is zero and many get confused that this means there is no policy cover at all. This is not the case; rather the policy provides an indemnity consistent with the application of the “Other Circumstances” clause.

The “Other Circumstances” clause has equal application to losses on-going at the time of the onset of COVID-19. It is not enough to look at historic trends or budgets. The impact of this new event must be taken into account when establishing the results that the business would have achieved. Any pre COVID-19 loss modelling in relation to Standard Turnover will need to be re-engineered to reflect the trading position businesses now face. Once businesses are operational again, there may be a period of recovery, often with a claw back of some lost Turnover, especially for those businesses usually enjoying stable Turnover, supplying staple commodities. Customer still need refrigerators, food and clothing, but they might be able to defer some purchases.

Conversely, where the reinstatement of normal business operations is delayed due to circumstances beyond the Insured’s control (perhaps a consequence of inability to replace stock or contents or complete repairs), Insurers may not wish to penalise an Insured where the reinstatement period is extended (subject to the limits of any Maximum Indemnity Period).

One area of uncertainty is the treatment of government grants. Many governments are offering significant incentives to businesses to stave off redundancies and keep businesses operational. Should these be treated as income, reducing the apparent Business Interruption loss? The case law surrounding such incentives varies by jurisdiction. One view is that this is not income and should not be brought to account; an alternate view is that failing to bring these grants to account would undermine the principle of indemnity, but it is vital that this is carefully considered.

A significant practical issue for all claims is the difficulties introduced by physical constraints on site visits. Loss adjusters are routinely instructed to visit a loss site in the immediate aftermath

of the incident to investigate, recommend on mitigation and gather the facts needed to report to carriers. The inability to control these first stages of the loss will materially affect the scale of the physical loss and increase the Business Interruption exposure. Whilst carriers and loss adjusters are making every effort to address this in different ways, the impact on future claims should not be underestimated. Even when access is possible, the current restrictions make it hard for restorers, builders and the like to undertake their work in a prompt fashion.

COVID-19 will have an impact on reserving for all Business Interruption claims. It introduces significant uncertainties and all in the Insurance Industry should recognise such uncertainties.

Practical steps for managing and quantifying loss

We repeat the key steps we outlined in our earlier paper. If a claim is presented, it will be complex in terms of loss measurement. Crawford Forensic Accounting Services offer some useful pointers based on their experience of prior losses:

1. Act promptly
2. Understand business drivers specific to the Insured's business model
3. Clarify cause and effect
4. Consider worldwide activities and all business segments
5. Document the cost/benefit of mitigation measures at time of decision
6. Call on the early advice of insurance professionals

Crawford Forensic Accounting Services has extensive experience in dealing with crisis situations, including infectious diseases. Our team of qualified forensic accountants / loss adjusters, based in key centres around the world, are available to aid and advise their Crawford colleagues, carriers, brokers and corporates in dealing with the impacts of COVID-19.



For more information:

For additional help, please call your local Crawford office or our regional Crawford Forensic Accounting Services experts. For more information about Crawford Forensic Accounting Services, please visit www.cfas.global.

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